Financing Constraints and Opportunities

Statewide Housing Summit: Building Capacity Across Oregon Communities to Address Current Housing Market Challenges

Hood River, OR
May 27, 2016
Agenda

• Summary of constraints on access to financing
• Review of potential opportunities

• Discussion and knowledge sharing around additional challenges, opportunities, unknowns/data needs, desired tools
Constraints

• Banks, institutional lenders, servicing companies, focused on private finance

• Key takeaway: There is liquidity at least through end of this year and probably most of next. However, accessing it in smaller communities and rural areas is complicated and expensive.
Constraints

• Knowledge of/interest in markets outside of Portland Metro
  – Even lenders with presence in OR, may not have full team here
  – Perceived “risk” associated with smaller markets is higher
  – Very little competition between lenders
  – Appraisals, Physical Assessments, ESA are all more complicated
Constraints

• Underwriting based on quality of building and expected cash flow, but also on sponsorship strength, expertise, and history.

• Requirements include net worth at least equal to loan amount and liquid assets to cover 9 months of loan payments
Constraints

• Particularly difficult for those new to development or new to a market; partners can help (e.g., hiring professional management)

• Most comfortable with sponsors with background in construction (e.g., homebuilders) or finance (e.g., brokers)
Constraints

• Underwriting based on LTV/DSCR, amount is lesser of two measures
  – LTV is lower and DSCR higher in smaller tier markets
  – Projected NOI insufficient to justify large loan, particularly for affordable projects

• In markets where knowledge is low, underwriters will tend to be more conservative
Constraints

• On acquisition and rehab, seismic risk is now major factor in review

• Stabilized property usually 90% for 90 days, but higher risk may require 6 months; <10 units 90% for 12 months

• Pool of private lenders is smaller for mixed-finance projects; timeframes and restrictions (e.g., covenants) need to be clear

• Strong preference for larger deals
Opportunities – Private Finance

• Government backed multifamily loan programs:
  – Fannie Mae Small Multifamily Loan
  – Freddie Mac Small Balance Loan
  – FHA Section 223(f) – acquisition and refinancing
  – FHA Section 221(d)(4) – construction or substantial rehabilitation

• Major push for “workforce” housing; up to 80% of AMI

• All but last provide permanent financing, not construction

• Foundations, these programs often targeted toward very low income
Opportunities – Public Programs

• Revolving, low-interest loan programs for land acquisition, pre-development, and/or construction
• Land banking, esp. brownfields
• Risk reduction strategies, “pre-approved”, fast-track designs, e.g., for affordable units, ADUs
• Technical assistance and training, e.g., multifamily, affordable housing programs, market analyses
• Bonuses and incentives, e.g., density bonuses
• Fees and taxes, e.g., linkage fees, excise taxes, transfer taxes
• Bonds
• Inclusionary zoning?
Discussion

• Additional constraints encountered?

• Other opportunities found?

• Other information that is needed?

• New tools, programs, or strategies that could be authorized?
Construction Loan Application

Narrative

• Narrative describing proposal including
  – Site
  – Project concept
  – Market information
  – Credibility of development entity
  – Applicant financial statement
  – Proforma
  – Supporting data for proforma #
  – Description of collateral
  – Guarantees
Construction Loan Application Other Required Documents

- “For construction” drawings
- Specifications (interior and exterior)
- Guaranteed Maximum Price General Construction Contract
- Pertinent leases
- Owner/Construction manager agreement
- Major trade subcontracts
- Detailed breakdown of hard costs/schedule of values
- Detailed project budget (includes hard and soft costs)
- Development and construction schedule
- Soils report
- Site survey
- Appraisal
- Title commitment or policy
- Consultant agreements
- Phase I Environmental Site Assessment (and Phase II and remediation reports if applicable)
- All permits necessary for construction
- Bonds/letters of credit
Commercial Real Estate Financing

• Construction loan/project financing - where the land and structure(s) are developed to the point of sale or leasing and the loan is paid off or converted to a permanent mortgage. Typically recourse/guarantees provided.

• Acquisition/refinancing – where the source of the repayment of the loan is the income generated by the real estate leases, fees, etc. Typically non-recourse loans.

• Permanent financing – borrower’s primary exit strategy is to refinance the property and hold it for long-term cash flow. Typically non-recourse loans.
Commercial Real Estate Finance

• Borrower and guarantor financial analysis
  – Financial statements assessing both cash flow and balance sheet
  – Contingent liabilities assessing potential effects of liabilities on overall cash flow
  – Unencumbered liquidity looking for available cash to cover shortfalls (9 months)
FHA Loans

**Section 221(d)(4)**
- Combined construction and permanent
- 40-year amortizing
- Non-recourse
- Assumable and pre-payable
- 36 month, interest-only construction
- Require compliance with Davis-Bacon, local cost factor
- Unrestricted rents
  - Market, 85% LTV, 1.18 DSCR
  - Affordable, 87% LTV, 1.15 DSCR
  - Subsidized, 90% LTV, 1.11 DSCR

**Section 223(f)**
- Acquisition, rehabilitation
- 35-year amortizing
- Non-recourse
- Assumable and pre-payable
- One time supplemental
- Requires compliance with local cost factor (for rehab)
- Unrestricted rents
  - Market, 85% LTV, 1.18 DSCR
  - Affordable, 87% LTV, 1.15 DSCR
  - Subsidized, 90% LTV, 1.11 DSCR
Fannie Mae and Freddie Mac

Fannie Mae SML
- Under $5M
- 5, 7, 10, 15, 20, 25, 30 year terms
- 25 or 30 year amortization
- Non-recourse
- Interest rates based on risk “tiers”, smaller cities higher risk
- 80% max LTV
- 1.25x DCR

Freddie Mac SBL
- Under $5M
- 5, 7, and 10 year terms
- 30 year amortization
- Non-recourse
- Interest rates based on risk “tiers”, smaller cities higher risk
- 80% max LTV
- 1.25x DCR
Develop or Not?

• Lower rents (lower NOI) or higher costs can make risk of undertaking development greater

• Equation can be changed through increasing NOI through:
  – More total units (higher densities – although this increases costs)
  – Mixing or changing the mix of units (more market rate)
  – Subsidizing rents