When the Bank Says No. How to Creatively Finance a Multifamily Deal

Unfortunately, they're often tough to make work, especially when there's a big price gap between seller and buyer.

By **Erik Sherman** | February 29, 2024 at 06:59 AM

Faced with higher rates, stricter bank underwriting and terms, and often pressure from maturing existing loans with low interest and high leverage, many in the multifamily space are finding traditional bank financing to be difficult to obtain.

GlobeSt.com spoke with some experts and found that, indeed, there are some alternative strategies beyond the GSEs, insurance companies, and the like that can work. However, as one noted, there are stubborn barriers that can make alternative financing inconsequential.

There are different ways of defining alternative financing. “I think we're all trying to figure out how to do deals again,” Kevin Crook, director of acquisitions and dispositions of Investors Management Group, tells GlobeSt.com. “Are you trying to see what the future brings? You could do agency [or government sponsored enterprise like Fannie Mae and Freddie Mac, you could do mezzanine. There are plenty of things out there — fixed, floating [interest rates].”

From one view, those seem standard. However, alternative can mean anything investors or owners don't typically rely on, even if others do regularly.

“In a lot of urban cores where there are existing office buildings being converted or vacant buildings, we've been able to use historic tax credits,” Dan DiCarro, director of real estate advisors at middle-market investment bank Brown Gibbons Lang & Company, tells GlobeSt.com. Depending on the location, there may be both federal and state programs. “We've worked on four separate competitive applications for another [Ohio] tax credit, called the transformational mixed use development credit.”

“For new construction deals, you can subsidize maybe 25% to 30% of the construction costs with PACE financing,” DiCarro adds. Brown Gibbons Lang has also seen master leases “utilizing a corporation's balance sheet and financial strength where lease-up risk was still a risk in a transaction.” That can be the difference between getting, say, a construction loan or not. The major name mitigates lease-up risk.

“We've also been utilizing private banking sectors of banks,” says DiCarro. “They could bring over their financial portfolios and utilize those as security to bring loans to the table.”

The biggest factor that Brandon Smith, managing director, capital markets at JLL, says, “There’s only so many ways to do the math. If you could buy a deal where the going in yield is close to your interest rate, that’s a green light for most investors.” Some are using preferred equity. CMBS has become bigger in multifamily. He also points to available rate buy-down features. “Pay an extra 2% up front and we’ll drop your rate by 30 basis points.” That might make the numbers work.

Overall, there are two secrets to alternative financing. One is to recognize that as long as there’s money coming in at sustainable rates for a project, the exact source doesn’t matter.

“It’s not so much trouble getting financing, it’s getting decent financing to make the deal work,” says Barry Saywitz, owner of management and brokerage firm The Saywitz Company as well as The Saywitz Properties, which owns and manages more than 100 multifamily properties.

A buyer might try for financing from the seller, but they have to be willing to give terms and an interest rate that makes a deal more compelling. When the seller — or an investor — can get around 5% at a bank or through shorter-term Treasurys, why bother with the property?

Saywitz has sometimes used an installment plan, with the money the seller needs now in cash and then a ten-year installment plan. “I’ve said we’re going to close in 120 days, not 30 days. We will do the work and fix all the deferred maintenance and all the issues the bank and insurance companies will want,” he explains.

Unfortunately, it’s getting to the common ground of reasonable price that is the biggest deal stopper. “The biggest discrepancy is that you have a seller with yesterday’s numbers and a buyer who wants a deal,” Saywitz says. “People come to me are you interested in a property. I say, ‘Yes but not at your number.” He offers his number and most frequently the seller is no longer interested.

Until the bid-ask gap narrows to a compromise, alternative financing won’t matter.