MULTI-HOUSING NEWS MHN ONLINE

Money for Makeovers

Lenders and sponsors find innovative solutions to financing upgrades at newly acquired properties.

- by Jeffrey Steele | Mar 05, 2018
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Renovation and acquisition often go hand in hand. Many, if not most, of the multifamily properties that come under new ownership this year will get spruced up. Even for properties that pose distinct financing challenges, creative solutions are available, and some innovative options are gaining traction.

“Financing is available to include improvements in the total acquisition,” said Barry Saywitz, president of The Saywitz Co. and managing partner of Saywitz Properties. “Typically, however, the financing will include some type of holdback … in the event those improvements will take place after the acquisition date.” Lenders generally consider in-place rents and current asset value, as well as future or pro forma rents expected from completion of the improvements and the property’s repositioning, he added.

The government-sponsored enterprises are a leading source of makeover money, and a new agency product with a growing following is Fannie Mae’s Mod Rehab Supplemental Mortgage Loan. Introduced in 2017, the vehicle enables owners who have a current Mod Rehab loan to tap into the asset’s equity. To be eligible, the investment for renovation must be valued at $10,000 or more per unit and be completed within 36 months of the first-lien mortgage closing.

“The supplemental loan is sized and priced comparable to a first lien mortgage loan,” explained Meghan Varga, managing director at Berkadia. “This makes interest rates and loan terms extremely attractive by enabling owners to lock in long-term permanent debt prior to renovation and access trapped equity in the future at very favorable loan terms.” The Fannie Mae Mod Rehab Supplemental saves borrowers as much as 45 basis points compared to traditional supplemental financing, she said.

Options from Freddie Mac include the Value-Add Loan, an attractively low-cost, flexible product. The short-term, variable-rate financing covers renovations of $10,000 to $25,000 per unit. Highlights of terms include interest-only terms, no interest rate cap or lockout, and waiver of the 1 percent exit fee if Freddie Mac itself refinances the loan. The Freddie Mac Value-Add offers variable interest rate spreads in the high 200 basis-point range over LIBOR.

Advenir recently obtained an $80 million Value Add loan for its acquisition and renovation of an aging South Florida asset: Advenir at PGA, a 44-year-old community in Palm Beach Gardens. Acquired from Landmark at Garden Square LLC in a $97.3 million deal, the 542-unit property was most recently renovated in 2009. Berkadia arranged a three-year, floating-rate loan with five years of interest-only payments and an 82 percent loan to value.

Locked in

Saywitz rehab property in La Quinta

Sponsors undertaking larger renovations of $25,000 to $60,000 per unit can qualify for Freddie Mac's Moderate Rehab Loan. Owners can access low-cost debt during renovation while eliminating interest-rate risk on permanent financing, and variable-rate spreads are in the low 300 basis-point range over LIBOR. Construction financing is floating-rate and interest-only loan and can be structured to advance proceeds monthly. "Therefore, the owner is not accruing interest on unused funds," Varga said. Permanent financing is structured during interim-phase financing and can be fixed-rate or floating-rate.

Moderate- and high-leverage debt funds offer opportunities for "heavy lift" acquisition and repositioning deals, reported Shahin Yazdi, principal & managing director with George Smith Partners. In a recent example, the firm placed non-recourse senior debt for two communities—one vacant and one near-vacant. Keeping the properties competitive in the face of local demographic shifts made the upgrades essential. "The assets, while in good condition, were significantly dated and lacked modern appliances and amenities," Yazdi explained.

The sponsors' business plans called for investing $15,000 per unit in extensive cosmetic and amenitized capital upgrades. "Banks and agency bridge traditionally decline this level of rehabilitation and/or require cash flow in place at funding," Yazdi noted. "The majority of commercial banks required a repayment guarantee for asset sub-1.0 coverage at closing."

The LIBOR-based loans were in the 6 percent range, and were fed through an interest reserve. A tight local market with microscopic sub-2 percent vacancy laid the groundwork for attractive terms: non-recourse funding to 80 percent of total capitalization, Yazdi said. Draws were structured to fund construction and avoid out-of-pocket sponsor payments to contractors. On "Lite Lifts" or managerial transitions, pricing can be sub-four percent, and recourse would be determined by loan to value/loan or to cost, Yazdi said.

Below break-even debt-service coverage will put the cost of capital higher, and may or may not require a repayment guarantee. For more comprehensive repositionings, coupons hover around 6 percent, driven by the run-up of LIBOR. Eighty percent of total capitalization is achievable without bringing in preferred equity or mezzanine debt.

Affordable solutions

Just-A-Start 50 York Street, Cambridge

Owners are finding creative solutions to financing upgrades in the challenging affordable housing sector. Community development financial institutions like the Community Development Trust, Low Income Investment Fund and National Housing Trust and Reinvestment Fund typically offer higher LTVs and lower debt service coverage ratios than conventional lenders, contends Peter Schaeffing, president of High Impact Financial Analysis, of Albany, N.Y., which underwrites renovation financing for affordable housing lenders, among others. CDFIs will often lend as much as 90 percent LTV, and in extreme cases 105 percent LTV. The CDFIs will also lend to 1.10 DSCRs, at rates ranging from 4.50 to 6.75 percent.

The challenge of capitalizing renovations for affordable communities often requires public-private partnerships. A 10-minute drive east of downtown Atlanta in the city’s Edgewood neighborhood, Jonathan Rose Cos. and Columbia Residential are eyeing an $18 million makeover for their newly acquired, 204-unit garden-style community. Dubbed Edgewood Court Apartments, the 68-year-old property last underwent a major renovation in 1981.

State and city agencies are supplying much of the capital for the $18 million project. The primary financing sources are 4 percent low-income housing tax credits issued by the Georgia Department of Community Affairs and tax-exempt bonds issued by Invest Atlanta, the city’s economic development agency. When completed in early 2019, the upgrades will include a new community and leasing center equipped with a fitness center and computer lab, a community garden, energy conservation measures, new roofs and gutters, and extensive improvements to units. After the renovation, Edgewood Court will maintain its affordable classification under the federal Section 8 program and will be designated for residents with incomes no more than 60 percent of area median income.

A project underway in Cambridge, Mass., demanded an even more intricate financing package. Just-A-Start, a 50-year-old non-profit affordable housing developer, is undertaking a $48 million effort to renovate 19 communities and rebuild a 20th that was destroyed by fire in 2016. Highlights range from envelope systems, HVAC systems and sprinklers to kitchens, baths and site improvements.

MassHousing, a quasi-public agency tasked with financing affordable housing, secured the single largest piece of capital: $22.6 million in construction financing provided by JP Morgan Chase, including a $10.1 million permanent loan and a $12.5 million bridge loan. Other pieces include $14.2 million in equity generated through an allocation of Low-Income Housing Tax Credits by the Massachusetts Department of Housing and Community Development; a $3.8 million Just-A-Start seller note; a $5.2 million sponsor loan; $10.1 million in assumed subordinate debt; a $540,000 loan from the Cambridge Redevelopment Authority; and a $435,000 deferred developer fee.