Mortgage Refinancing

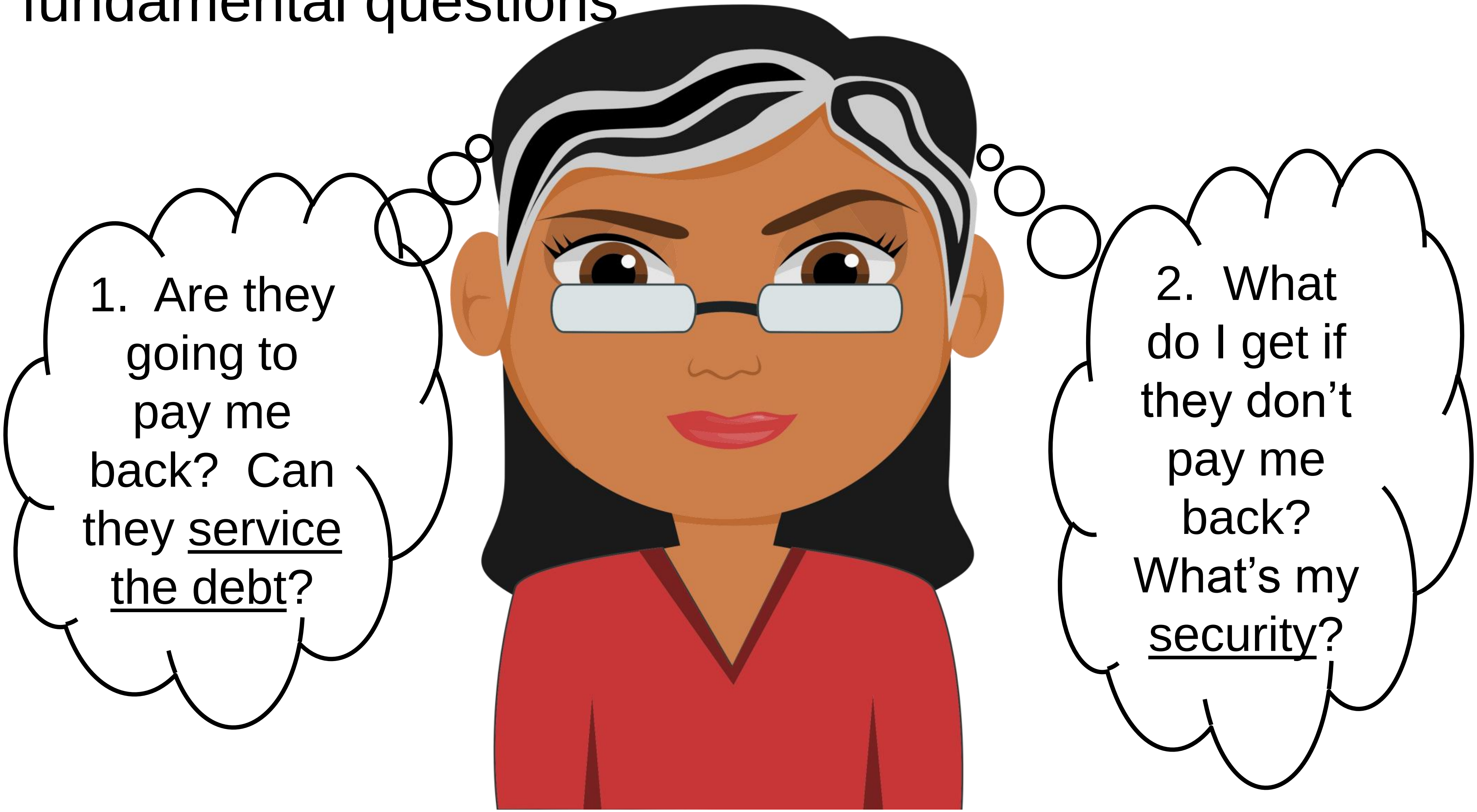
What non-profit housing providers need to know

Alterna

Sandra Baumann-Chadwick
ONPHA Conference – November 2017

How Lending to Non-profit Housing Works

Your lender is looking for good answers to two fundamental questions



November 2017
Alterna refers to Alterna Savings and Credit Union Limited ("Alterna Savings") and its wholly owned Subsidiary CS Alterna Bank ("Alterna Bank"). Together, Alterna Savings and Alterna Bank form the Alterna Financial Group

Lender's Valuation vs.Realtor's Valuation

Lender will base their valuation on the income that the property generates today (because if they have to foreclose, that is what they inherit)

$$\frac{\text{Net Operating Income}}{\text{Capitalization Rate}} = \text{Value}$$

- **Lender's valuation is based on current use of the property and current income generated**
- **Realtor's valuation is based on market value of the best use of the property and assumes true market rents**

November 2017

What can the Borrower Afford?

- You lender will want to make sure that you can afford your debt for the full amortization of the loan. To understand this they will look at your Debt Service Coverage Ratio (DSC).

DSC is really saying for every dollar in debt payments the borrower has an extra _____ cents to cover contributions to reserves or other unexpected expenses.

$$\frac{\text{Net Operating Income}}{\text{Debt Service}} = \text{DSC}$$

How is Underwriting NOI Determined?

- Starts with your Income Statement
- NOI = Income – Expenses
  (excludes non-cash items & property related debt)

NB

When calculating NOI we don't include one-time capital expenditures

Treatment of reserves can vary when calculating NOI, typically only mandatory reserve payments are included

	2016
Rental Income	$ 428,259
(rental arrears)	-$ 2,900
Subsidies & Grants	$ 270,607
Parking	$ 19,590
Laundry	$ 11,532
Other Income	$ 1,990
Total Income	$ 729,078
Salaries	$ 62,105
General Maintenance	$ 67,116
Utilities	$ 113,505
Taxes	$ -
Reserves*	$ 62,400
Total Expenses	$ 305,126
Net Operating Income	$ 423,952

* Reserve requirements will depend on age and condition of building as well as what is mandated by any operating agreements in place

How is Debt Service Determined?

- Debt Service = All principal and interest payments for all debt secured by the property
  - If refinancing an existing mortgage, old mortgage payments will be replaced by new mortgage payments
  - If seeking a second mortgage, existing first mortgage payments will remain and second mortgage payments will be added
  - Debt Service is the sum of all property secured principal and interest payments, including all prior ranking debt

Example

Existing mortgage replaced by new $5 million first mortgage.
Annual principal plus interest payments of $309,575.
Thus total Debt Service is $309,575.

Debt Service Coverage Ratio - Example

$$\frac{\textbf{NOI}}{\textbf{Debt Service}} = \textbf{DSC}$$

$$\frac{\$423{,}952}{\$309{,}575} = 1.37$$

After every dollar spent on operating and debt servicing this organization has $0.37 to cover the unexpected.

Debt Service Coverage Ratio - Example

$$\frac{\textbf{NOI}}{\textbf{Debt Service}} = \textbf{DSC}$$

$$\frac{\$423{,}952}{\$309{,}575} = 1.37$$

After every dollar spent on operating and debt servicing this organization has $0.37 to cover the unexpected.

At Alterna we typically look for a DSC of 1.20 for a first mortgage when working with multi residential properties

$$\frac{\$423{,}952}{\$378{,}528} = 1.12$$

In our example the non-profit housing provider also had a second mortgage. This added an additional debt service requirement

We would typically look to ensure that 2nd mortgage debt has at least a 1.10 DSC.

Valuation - A Simplified Example

Two identical buildings are located right next door to each other. One building charges market rents, and the other is a non-profit housing provider generating significantly less income. The buildings may look the same, but from the lenders' perspective they have very different valuations.

	Market Rent Apartment	Non-profit Housing Provider
$\frac{\text{NOI}}{\text{CAP Rate}} = \text{Value}$	$\frac{\$10,000}{0.04\%} = \$250,000$	$\frac{\$7,500}{0.04\%} = \$187,500$

November 2017
Alterna refers to Alterna Savings and Credit Union Limited ("Alterna Savings") and its wholly owned Subsidiary CS Alterna Bank ("Alterna Bank"). Together, Alterna Savings and Alterna Bank form the Alterna Financial Group

Underwriting Valuation – Example

	2016
Rental Income	$ 428,259
(rental arrears)	-$ 2,900
Subsidies & Grants	$ 270,607
Parking	$ 19,590
Laundry	$ 11,532
Other Income	$ 1,990
Total Income	$ 729,078
Salaries	$ 62,105
General Maintenance	$ 67,116
Utilities	$ 113,505
Taxes	$ -
Reserves*	$ 62,400
Total Expenses	$ 305,126
Net Operating Income	$ 423,952

* Reserve requirements will depend on age and condition of building as well as what is mandated by any operating agreements in place

$$\frac{\textbf{NOI}}{\textbf{CAP Rate}} = \textbf{Value}$$

$$\frac{\$423{,}952}{0.06\%} = \$7{,}065{,}900$$

$$\frac{\textbf{Mortgage}}{\textbf{Value}} = \textbf{Loan to Value Ratio (LTV)}$$

$$\frac{\$5{,}000{,}000}{\$7{,}065{,}900} = 70.76\%$$

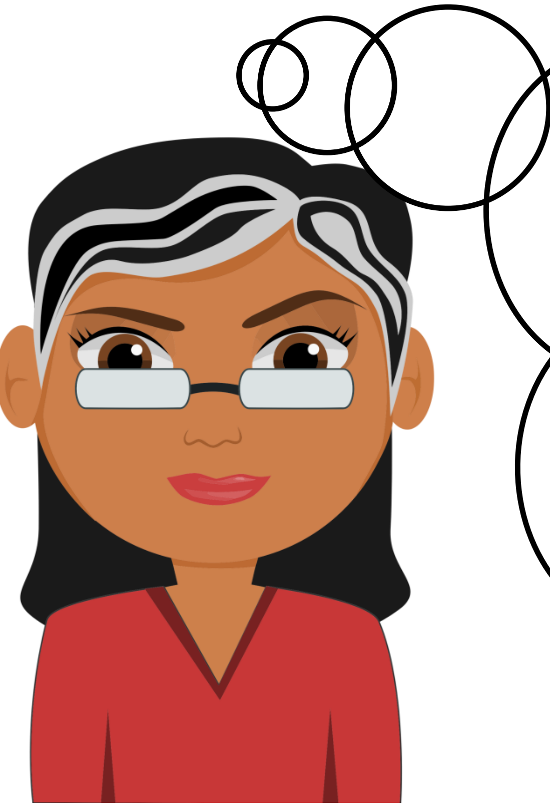
Max LTV is 75% of underwriting value

November 2017

Alterna refers to Alterna Savings and Credit Union Limited (“Alterna Savings”) and its wholly owned Subsidiary CS Alterna Bank (“Alterna Bank”). Together, Alterna Savings and Alterna Bank form the Alterna Financial Group

Alterna

Lending Principles for Non-Profit Housing



1. Can this organization afford this debt
2. Do they have the funds to continue to maintain this property over the full amortization period
3. Do they have the funds they need to cover their operating expenses

November 2017

Alterna

Summary - What is your Lender Thinking

- They have a solid reserve fund
- Their DSC on our debt is 1.37
- Total DSC on all debt is 1.12
- **"I'm confident that they can service the debt"**
- The building is in good shape and they have the reserve funds and ongoing contributions to maintain it
- Mortgage of $5million is for 70.76% of the $7million value of the building
- **"I'm comfortable with how this loan is secured"**

November 2017
Alterna refers to Alterna Savings and Credit Union Limited ("Alterna Savings") and its wholly owned Subsidiary CS Alterna Bank ("Alterna Bank"). Together, Alterna Savings and Alterna Bank form the Alterna Financial Group

How Subsidies are Treated by a Lender

- Subsidies will only be considered as income if they are there for the full amortization period of the loan
- Housing providers can mitigate against the risk of subsidy loss by ensuring that their lease agreements specify the full market rent
  - This needs to be reconciled in financial statements as follows:
    - Rental revenue (as per lease agreement)
    - (less) rental supplement
    - Plus rental subsidy

Alterna

Hidden Costs

Additional costs that you will need to budget include:

	Appraisal Report (new)
+	Environmental Report (3 years max)
+	Building Condition Assessment (new)
+	Legal Fees
+	Title Insurance
	Up to $20,000

Additionally your lender will charge a loan fee of approximately 50bps on the total loan size

November 2017

Where does it go sideways?

- **Management -** If your property manager/board is not skilled/comfortable in the area of commercial lending and construction you may want to seek out additional supports
- **Financial History -** We look at historic data to do the analysis. If you have historically been on shakier financial ground than your are today, you will have to demonstrate what is in place to ensure that continues.
- **Land Lease -** If you have property on leased land, the lease will need to extend past the full amortization period of the loan
- **Unapproved Consultants -** You must use consultants and engineers that are approved by your lender (all lenders will have their own lists). Using an unapproved consultant or engineer can result in a need to redo work/additional costs.

Questions?

Sandra Baumann-Chadwick

Senior Account Manager

Alterna Savings

(416) 213-7900 x 7707

Sandra.Baumann-Chadwick@alterna.ca

November 2017

NEW COMMONS DEVELOPMENT

Rethinking Financing and Development

Peter Zimmerman

November 3, 2017

Vision + Capital + Expertise

Vision

Part of a national charity dedicated to building capacity in the non-profit sector and improving the lives of Canadians.

Capital

A pool of low-interest investment capital available for new affordable housing. Money to fund the higher risk front end of community-based housing projects.

Expertise

A dedicated team with expertise in non-profit and market development, government programs, planning approvals, project financing and construction management.

Backed by a Strong Family of Community-Based Sponsors

Vancity Community Foundation

HAMILTON COMMUNITY FOUNDATION

CATHERINE DONNELLY FOUNDATION

real estate foundation BRITISH COLUMBIA

ATKINSON
For social and economic justice

NEW MARKET FUNDS

Project Focus

- Affordable housing
- Other community assets

- Projects that are $10 million or more

- Community impact
- National mandate
- Initial projects in Greater Toronto Area and Vancouver

NEW COMMONS DEVELOPMENT

Outline

1. The Objectives

2. Working Backwards from pro forma

3. Metrics of Lending analysis

4. Making the Equation Work

Objectives

1. A Non-Profit provider interested in expanding an existing project or building new housing on a site within their portfolio or on a site they would acquire for the project.

2. Some of the metrics of analysis are the same as a refinancing deal, some are different. The focus is on the unique financing problems on a new construction project.

Refinancing vs. New Construction

Refinancing	New Construction
Project: Real	**Project:** Hypothetical
Source of Data: Audited Financial Statements	**Source of Data:** Appraisals, Construction Cost Reports, Market Studies, Revenue and Operating Cost Projections
Lending Risk: Low	**Lending Risk:** High
Commitment: First Mortgage	**Commitment:** Construction Financing and Take Out Mortgage

NEW COMMONS DEVELOPMENT

The Pro Forma "Punchline" Sources and Uses

Sources

Debt	37,500,000	75.0%
Program Funding	-	0.0%
Sponsor Equity	12,500,000	25.0%
Total	50,000,000	100.0%

Uses

Land	5,000,000	10.0%
Hard Costs	38,000,000	76.0%
Soft Costs	7,000,000	14.0%
Total	50,000,000	100.0%

Maximize

Minimize

Program Funding

Sources

Debt	37,500,000	75.0%
Program Funding	4,000,000	8.0%
Sponsor Equity	8,500,000	17.0%
Total	50,000,000	100.0%

Uses

Land	5,000,000	10.0%
Hard Costs	38,000,000	76.0%
Soft Costs	7,000,000	14.0%
Total	50,000,000	100.0%

Free Land

Sources

Debt	37,500,000	75.0%
Program Funding	4,000,000	8.0%
Land Value	5,000,000	10.0%
Sponsor Equity	3,500,000	7.0%
Total	50,000,000	100.0%

Uses

Land	5,000,000	10.0%
Hard Costs	38,000,000	76.0%
Soft Costs	7,000,000	14.0%
Total	50,000,000	100.0%

Free Land

Sources

Debt	37,500,000	75.0%
Program Funding	4,000,000	8.0%
Land Value	5,000,000	10.0%
Sponsor Equity	3,500,000	7.0%
Total	50,000,000	100.0%

Uses

Land	5,000,000	10.0%
Hard Costs	38,000,000	76.0%
Soft Costs	7,000,000	14.0%
Total	50,000,000	100.0%

Appraisal Required

Soft Costs

Sources

Debt	37,500,000	75.0%
Program Funding	4,000,000	8.0%
Land Value	5,000,000	10.0%
Sponsor Equity	3,500,000	7.0%
Total	50,000,000	100.0%

Uses

Land	5,000,000	10.0%
Hard Costs	38,000,000	76.0%
Soft Costs	7,000,000	14.0%
Total	50,000,000	100.0%

Estimates to
Service Proposals

Hard Costs

Sources

Debt	37,500,000	75.0%
Program Funding	4,000,000	8.0%
Land Value	5,000,000	10.0%
Sponsor Equity	3,500,000	7.0%
Total	50,000,000	100.0%

Uses

Land	5,000,000	10.0%
Hard Costs	38,000,000	76.0%
Soft Costs	7,000,000	14.0%
Total	50,000,000	100.0%

Cost Analysis

Class 'B' (Substantive) Estimate

NEW COMMONS DEVELOPMENT

Construction Finance

Sources

Debt	37,500,000	75.0%
Program Funding	4,000,000	8.0%
Land Value	5,000,000	10.0%
Sponsor Equity	3,500,000	7.0%
Total	50,000,000	100.0%

Uses

Land	5,000,000	10.0%
Hard Costs	38,000,000	76.0%
Soft Costs	7,000,000	14.0%
Total	50,000,000	100.0%

Construction Financing Metrics

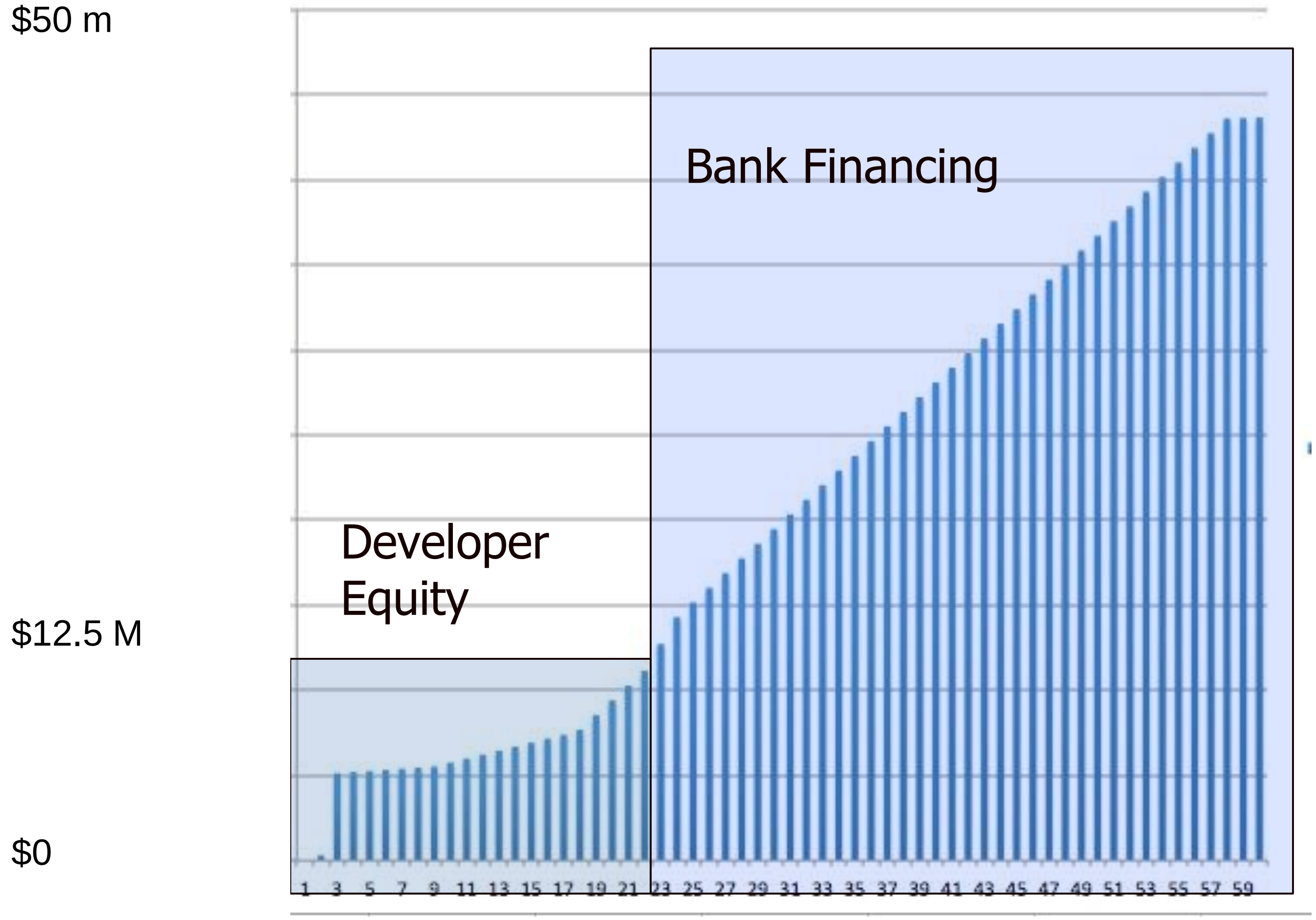
- **Loan to Cost Ratio**

1. Usually no more than 75% of the Cost of the Project

2. Advances: after owner equity

NEW COMMONS DEVELOPMENT

Loan Advances



NEW COMMONS DEVELOPMENT

Construction Financing Metrics

- **Debt Coverage Ratio**
- Usually > 1.2 times coverage in projected project operations

Example

1. Operations pro forma shows NOI of $2,000,000 / year
2. Maximum Mortgage Payments = 2,000,000/1.2 = $1,667,000 year
3. Based on 4% interest rate and 25 year Amortization

$1,667,000 in payments = $35,000,000 mortgage

Making the Equation Work

Sources

Debt	37,500,000	75.0%
Program Funding	4,000,000	8.0%
Land Value	5,000,000	10.0%
Sponsor Equity	3,500,000	7.0%
Total	50,000,000	100.0%

Uses

Land	5,000,000	10.0%
Hard Costs	38,000,000	76.0%
Soft Costs	7,000,000	14.0%
Total	50,000,000	100.0%

1. Interest Rates
2. Amortization Period
3. Debt Coverage Ratios
4. NOI

NEW COMMONS DEVELOPMENT

Approaches to Increasing NOI

Energy Efficiency in Design

- Building performance investments
- Tenant paid utilities

Property tax reduction/waiver

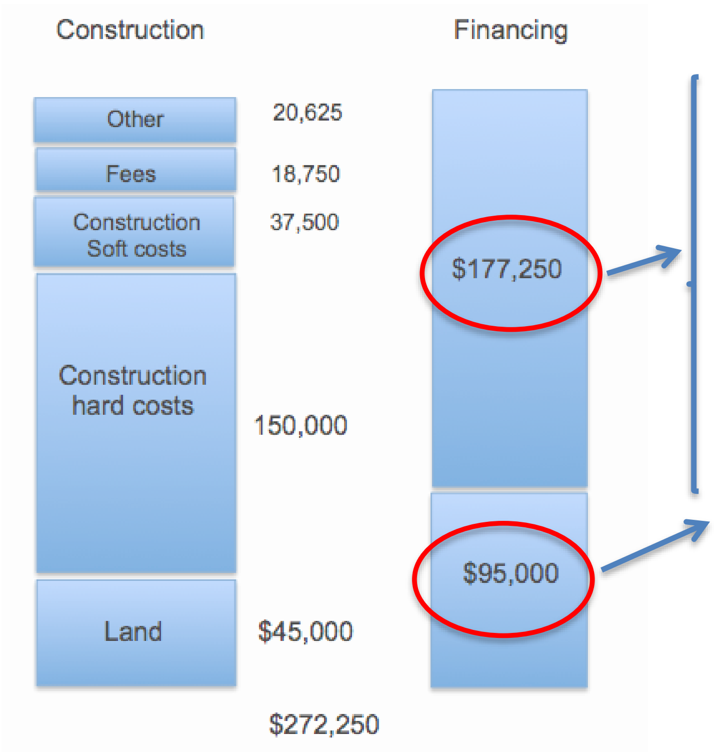
- Time limited
- Perpetual contingent on affordability

Time limited operating grants

- Reduce level of initial rents
- Allow for increased debt service

NEW COMMONS DEVELOPMENT

Approaches to Increasing Debt Capacity



Financing

- Borrow at government rates
- Long-term debt
- Increased amortization periods
- Interest only period of financing
- Higher debt ratios
- Alternative financing sources (reduce equity contribution needs

NEW COMMONS DEVELOPMENT

Case Study: Community Service Agency, Toronto

The Opportunity

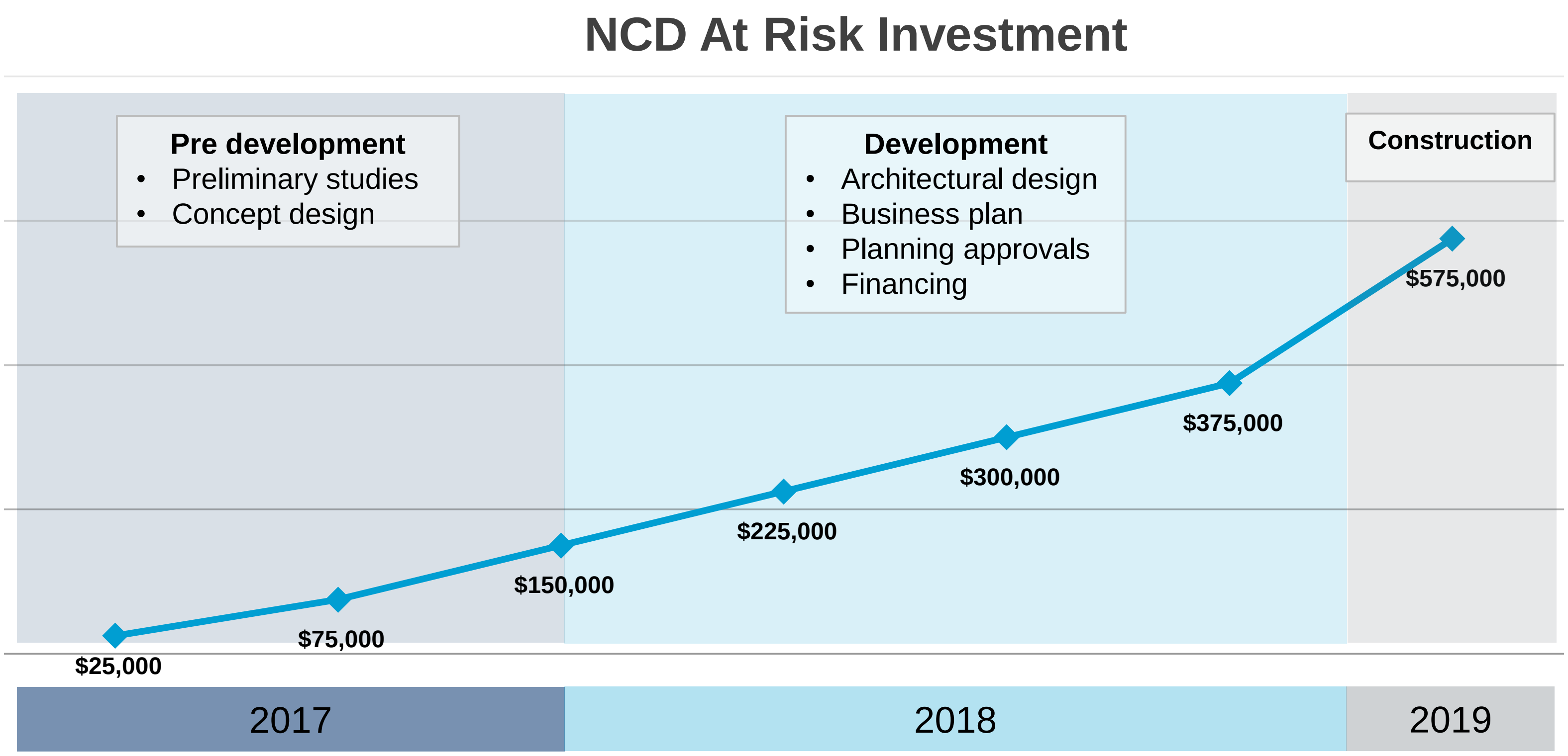
- Strong community agency with ownership of depleted asset
- Interest in redevelopment and desire to expand its affordable housing capacity

The Partnership

NCD provides planning, development and construction **leadership**; secures **government program support**; and **lends**, below market rate, required project equity up to construction financing

Agency develops project operations plan and **identifies target community** for estimated 100 new residential units

Case Study: Toronto



Towards an Optimum Financing Model

Sources

Debt	40,095,000	81.0%
Program Funding	4,000,000	8.1%
Land Value	5,000,000	10.1%
Sponsor Equity	405,000	0.8%
Total	49,500,000	100.0%

Uses

Land	5,000,000	10.0%
Hard Costs	38,000,000	76.0%
Soft Costs	6,500,000	13.0%
Total	49,500,000	99.0%

NEW COMMONS DEVELOPMENT

Conclusion

- There are no magic bullets

- Projects will require:
  - Grants
  - Land
  - Below-market interest rates & extended amortization
  - Relaxation of lending requirements
  - Operating subsidies – rent supplements / property tax waivers
  - At risk up front capital to construction financing

NEW COMMONS DEVELOPMENT