START SMALL

A guide to financing small multifamily building projects

Community Preservation Corporation

ABOUT CPC

Established in 1974, The Community Preservation Corporation (CPC) is a nonprofit, affordable housing and community revitalization finance company that believes housing is central to transforming underserved neighborhoods into thriving and vibrant communities. We provide innovative capital solutions, fresh thinking, and a collaborative approach to the often complex challenges that owners and developers of multifamily housing face.

More than 70 percent of CPC's investments since inception have been in small building projects — buildings with 5 to 49 units. That's more than 3,000 loans to all types of borrowers. These include first-time owners who have been able to acquire or unexpectedly inherited a rental property; experienced general contractors or property managers who want to branch out; and local business owners who want to own their storefronts and convert additional space into rental housing units for extra income.

Although every project and borrower is unique, small building projects tend to have one thing in common—they serve as an entry point for multifamily real estate professionals. Because of their size, small building projects are a practical first step for new owners interested in building their real estate knowledge and experience.

Putting all the pieces together to finance a project, especially for the first time, can be daunting. Unfortunately, while there are plenty of get-rich-quick-property-flip schemes out there, there are few reliable resources for new small building owners interested in realizing steady profits through responsible long-term ownership.

That's why we developed this guide. Small buildings are the cornerstones of communities large and small, and, as a mission-based lender, CPC is committed to supporting their owners and to helping keep these properties, and the neighborhoods they are located in, healthy and strong.

UNCOMMON EXPERTISE. UNMATCHED IMPACT.

For more information, visit **communityp.com**.

Owning a Multifamily Building

Owning and developing real estate is entrepreneurial in nature and some level of risk comes with the territory. With knowledge, partnerships, and patience, developing or owning rental property can be both financially and personally rewarding. **Our advice: Start small.**

GUIDE OVERVIEW

This guide is a straightforward tool that gives you the basic knowledge you need to navigate financing a small multifamily project, whether that entails acquisition, refinance, rehabilitation, new construction or all four. We've also included best practices for managing your property when fully leased.

The guide is designed to help you obtain, whatever your experience level or building type, the information you need, quickly and concisely. It will not, however, take the place of conversations with your lender. We recommend starting those conversations early, as every financial institution (including CPC) will have slightly different requirements, documents, and processes.

Small buildings are generally defined as those with 5 to 49 units, though this definition can vary.

WHY SMALL BUILDINGS?

CPC went through an extensive outreach process in creating this guide, holding many internal and external interactive workshops across New York State. We spoke with developers, lenders, municipal representatives, and other stakeholders about their experience with small buildings to ensure that this guide provides the information you need to be successful.

Over and over, we heard the same thing — while developing, owning, and managing small buildings is not always simple, small building developers and owners are some of the most important providers of rental housing in the United States. Small buildings make up the majority of the multifamily rental housing stock in this country, and it is because of the energy, entrepreneurship, and talents of its owners and developers — and now, you — that so many people have places to call home.

Welcome to the industry.

SOME NOTES ON THE GUIDE

Callout icons highlight important takeaways.

- Did you know?
- Ask about
- The CPC way
- Circle back
- Upstate NY
- Downstate NY
- Energy efficiency

Glossary

For any definitions not provided in the text, there is a glossary of key terms and concepts at the end of the guide. In the digital version of the guide, key terms are hyperlinked to the glossary.

"Owner" or "Developer"?

Generally, an owner is someone who maintains legal title to a property. A developer is someone who orchestrates the planning and construction components of a project. Throughout the guide, "owner" will be used to describe either or both.

SMALL MULTIFAMILY BUILDING PROJECT FINANCING PROCESS MAP

The table of contents below can be used as a process map for financing small buildings. Each section builds on information from preceding ones, so we recommend you read the guide in order.

CLOSING

This phase of the process is focused on documentation. Examine the paperwork needed to close, and what to expect on closing day.

- Commitment Letters
- Common Documents
- Legal Considerations

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PHASE 2

CONSTRUCTION & REHABILITATION

This phase discusses standard requirements of a construction loan, including the requisition process, and offers guidance on making the property ready for residents.

- Requisitions
- Change Orders
- Converting to a Permanent Mortgage

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PHASE 3

PROPERTY MANAGEMENT

Ensuring a small multifamily building is occupied and in good health requires ongoing work. This phase contains tips to ensure the long-term profitability of your business.

- Marketing and Renting Units
- Hiring a Property Manager
- Maintaining Your Building

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PHASE 4

The Financials of Rental Properties — A Primer

Developing and owning small buildings is a business. Understanding profitability and the financial risks of owning a property is key to making your small buildings business work.

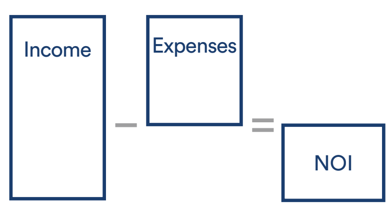
This primer is just an overview — for more detail, refer to “Ballparking Costs – Developing Pro Formas,” starting on page 21.

Income
Any multifamily rental property, regardless of size or type, generates its revenue (income), from residential rents and, in some cases, other activities within the building, including retail or office rents (if mixed use), parking fees, laundry, cell towers, or air rights. Mixed use properties require additional information gathering for your analysis because commercial rents are calculated on a square-foot basis and can vary according to a property’s access to foot traffic, transportation, or available parking.

Expenses
Every building also has costs (expenses) associated with keeping it stable and well-maintained (healthy). These include items like repairs, utilities, taxes, or snowplowing or shoveling. If your property has a commercial or retail unit, preparing that unit for a tenant (building out) may add costs for you, the owner.

Net Operating Income (NOI)
What is left over from your income after any vacancy loss and expenses is called your net operating income (NOI).

Income must be greater than expenses for a project to work financially. That is, NOI must be positive. Even the best project idea in the world is not feasible if NOI is negative.



A portion of NOI will become your profit. NOI will also be the source of funds to make distributions to anyone who invested in your project and to repay your permanent mortgage (this payment is known as your debt service). Because of this, all lenders go through a vetting process (underwriting) to figure out how much they’re willing to lend to you. This is based on how much NOI is projected and the likelihood your building will generate this same amount every month.

In the case of existing buildings that are occupied and fully operating, also known as performing or stabilized, figuring out NOI can simply be a matter of looking at the building’s actual historical income and expenses. With newly constructed or rehabilitated projects, however, potential owners need to look at comparable properties’ rents (comps) to estimate how much income their building, once completed, can be expected to generate.

OVERVIEW OF CAPITAL TYPES

Equity

Capital provided by you, your business partners, or an investor that is required by lenders as part of the total funding sources. Equity investors are generally rewarded fees for use of their capital, a portion of the NOI (after your monthly debt payment is paid), tax benefits, and a portion of the property's value at the time of sale or some other predetermined time.

Debt

Capital that is lent with the expectation that the borrower will repay the principal, plus interest, on a regular basis, usually monthly. The loan principal is the initial loan amount. The interest — a percentage of the loan principal — is the amount charged to a borrower.

Subsidy

Capital, generally from a public source, in return for which the recipient must provide a public good. With rental housing, this often takes the form of setting aside units for people that meet certain income criteria (i.e., for affordable housing) and charging them lower rents. See page 32 for more information.

TIPS FOR NAVIGATING THE FINANCING PROCESS

Who Should You Talk With?

As the owner of your property, you are ultimately responsible for every aspect of your project. Throughout this process, you should be talking with as many people in the industry as you can, including general contractors (GCs), other small building owners, and appraisers, to expand your knowledge and network.

Working With a Lender

All lenders operate differently, but be prepared to work with a number of different employees of your lender along the way. You should, however, have one primary contact who helps you through the process; this person is usually called a "mortgage officer" or "loan officer."

Documents

Some of the information a lender will request will need to come in the form of documents, some informal and some formal, for legal or institutional purposes. Because your project will evolve over time (especially if it involves a construction loan), or because some information can become outdated, or stale, you may be asked to submit updated documents throughout the process. Some documents may have to be provided by certain deadlines, which, if you miss them, could cause delays in the overall project. For a list of common documents needed to close a loan, see page 44.


SENECA
BLOCK
OPEN

PROJECT FEASIBILITY & PREDEVELOPMENT

To determine if a project is viable, you need to assess your and your team's skills, the market and the municipality where your project is to be located, and whether the financing is adequate to cover all costs.

PROJECT FEASIBILITY

Most people who want to own a small building already have a project idea. Whether they have their eye on a specific building or vacant lot, think there's a need for rental housing in their downtown, or already own a building that they're trying to stabilize, the first step is the same: determining project feasibility.

cpc *Because new construction is more complex, CPC recommends an acquisition only or minor rehabilitation for an owner's first project.*

Timelines

The feasibility phase is for information gathering and almost always requires you to revisit your initial assumptions. Moving from an idea to reality is, necessarily, an evolutionary process, so you should expect that elements of your project may change, and that, depending on what you discover along the way, your timeline could be longer than you originally anticipated.

What If Your Project Isn't Feasible?

Developing and owning buildings require patience, creativity, and perseverance. Not all projects are feasible; most of the developers we spoke with told us they look at many buildings before they find one they would even consider moving ahead with. Be ready to go back to the drawing board many times.

GATHERING INFORMATION

To help you and your lender determine if a project is feasible, you will need to gather various types of information. This information generally falls into three main categories:

You and Your Team

What are the skills and expertise you need for your project to succeed? Do you need to bring in expertise to round out your own?

The Project and Site

Where is the property or site? Is it in a strong or weak market? What is its condition, and what are the costs associated with your project idea?

Financials

What are the income and expenses for the property, including development costs if construction is needed? Do the numbers make economic sense? Do you have the required equity?

You and Your Team

Successfully owning a small building requires certain skills. In this section, we'll discuss the range of skills different project types require, common team members you may need to add, and using partner capital to meet lender equity requirements.

OVERVIEW

To own multifamily housing, you and your team need to have certain skills, to have established good character, and to be financially strong enough to complete any construction or rehabilitation (if relevant) according to a lender's standards. You'll also need to be able to keep the property well maintained over the long term.

CPC highly recommends you start talking with a lender prior to contracting with anyone or expending any funds. Remember that at this point, you are still determining feasibility.

CONSIDER THIS

- As the owner and project lead, you are ultimately responsible for keeping the team on track. We encourage you to speak to as many experts as possible; this helps build your knowledge base and increases your network of potential team members.

- You will need to work with your lender to determine if your team members' experience levels meet your lender's requirements. You may have construction or property management skills, or have a personal contact in mind to handle certain aspects of the project, such as electrical work. However, your lender may have particular requirements around the certification, training, or experience required for your team. You should clarify these requirements prior to adding team members.

- If you are interested in using subsidies, it is helpful to have someone on your team who is familiar with subsidy program requirements.

Successful small building projects require a range of skills; see page 12 for a full list.

BUILDING YOUR TEAM

The characteristics of your project will dictate the expertise, as well as the documentation, you will need. As you begin your conversations with experts, use the following list to track what skills are required for your project; this will give you a sense of how to supplement your own skills with those of additional team members.

Most Projects:

- ☐ Market Analysis
- ☐ Property Condition Assessment
- ☐ Income and Expense Estimates
- ☐ Property Value Estimates
- ☐ Subsidy Coordination
- ☐ Financial Statements
- ☐ Reporting to Financial Partners
- ☐ Partner Contractual Agreements
- ☐ Bookkeeping and Accounting
- ☐ Title Search
- ☐ Property Management

Rehabilitation or Construction Projects May Also Need:

- ☐ Zoning Analysis
- ☐ Site Plan
- ☐ Construction Cost Estimates
- ☐ Permits
- ☐ AIA Contracts (see detail below)
- ☐ Property Tax Forecasting
- ☐ Building Code Compliance
- ☐ Tax Abatement Qualification
- ☐ Final Certification

Additional Skills:

?

Part of your early conversations with your lender should include getting an understanding of what the document and process requirements are in the phases following project feasibility assessment and predevelopment. For example, most construction lenders will require you to use standard forms created by the American Institute of Architects (AIA) for various stages of the construction and rehabilitation processes. These forms include one for your GC's contract.

COMMON TEAM MEMBERS

Depending on your project type, you may need to bring some or all of the following professionals on board:

Architect – draws the plans for your construction project, creates bid specifications, and must be both licensed and familiar with the building codes and local zoning requirements for the community in which your project is located. Your architect will be responsible for holding your general contractor accountable for the project plans and requirements, so it's important to have a good working relationship with whomever you choose.

General Contractor (GC) – manages the daily logistics and oversight of your construction project. A GC is key to ensuring your project is done on time and on budget, and they should have sufficient experience to address any problems that come up at the site or with vendors or subcontractors. A GC can also provide valuable insight on building design and engineering.

Lawyer – confirms your best interests are considered. Your lawyer will review all loan documents, attend your loan closing, and can assist in any tenant-related legal issues that arise once your building is ready for occupancy. CPC recommends that you begin working with an attorney early in the process.

Property Manager – covers all activities associated with keeping your building operating efficiently and at full occupancy. Good property management is key to keeping your property financially stable over the long term.

Licensed Subcontractors – perform trade-specific tasks, such as plumbing, electrical work, and painting. Subcontractors may be either individuals or companies hired by the GC during a project.

Expediter – submits, files, requests, or otherwise seeks issuance of permits on your behalf. Expediters are licensed professionals and are commonly used in NYC.

VETTING YOUR TEAM

When choosing experts to add to your team, you will want to check their experience to ensure they are capable of performing to your standards and in compliance with any laws.

Character

Prior to your loan closing, a lender will go through a due diligence, or vetting, process of you and the members on your team. Lenders will want to have some understanding of whether you have a history of acting with good faith in your personal and business activities — in essence, they are assessing your ability to pay back your loan. They generally ascertain this by reviewing your personal financial statements, calling your references, and reviewing your credit reports. Legally, they must have permission from you to do the last of these, so anticipate signing an authorization form as part of your application process.

CPC can help you think through the right questions to ask potential partners.

CONSIDER THIS

When Talking to General Contractors

Many of the general contractors initially hired by the small building borrowers we spoke with lacked the experience or financial strength needed to successfully complete the borrowers' projects. While CPC cannot recommend specific contractors, our construction experts can talk with you about what to look for, what questions to ask, and what your GC contract should look like. The following are some questions to keep in mind:

- ☐ Ask to see past projects or work.
  - Is their experience in line with the work your project requires?
  - Have they worked in the city where your project is to be located?
- ☐ Ask for references.
  - Was their last customer satisfied with the completed project?
- ☐ Ask for financial statements.
  - Do they have cash on hand? (read more about this in "Digging Deeper" on the next page).

If you will be using subsidies to finance your project, there may be specific building-related requirements you'll need to meet. These could include specific upgrades to the building to fix life safety violations, or income verification paperwork for your residents.

When Thinking About Property Management

You may benefit from bringing in a property manager, whether it's because you have more buildings than you can manage alone or because of property distance, time, or experience constraints. If you have limited experience or live far from the property, your lender may require you to add a property management company to your team prior to agreeing to lend to you. To learn about property management, see "Property Management," beginning on page 52.

BUILDING A FINANCIALLY STRONG TEAM

All lenders will want to check your financial health and that of any member of your team with an ownership stake in the property. Requirements for what "healthy" looks like vary by lender, but are generally comprised of one or more of the following:

All Projects:

Equity – Most lenders require that you invest some of your own equity in your project. Your project cannot use all of your liquidity (see below for definition) up front — a lender will want to know that you have access to other capital if needed during development.

Some lenders will refer to equity colloquially as "skin in the game."

Rehabilitation and Construction Projects:

Liquidity – Liquidity is cash that you have on hand or can get fairly quickly. A lender will want to see liquid assets that are sufficient to meet your equity requirements, plus a cushion.

If you lack cash to meet equity or liquidity requirements, talk with your lender about how to leverage other properties you own or whether you can bolster your financial strength by working with a partner.

Net Worth – Your net worth is your total assets minus your total liabilities, or what you owe subtracted from what you own. Depending on how many properties you are developing or planning to own, it may be useful to retain an accountant to help you determine if you meet your lender's net worth requirements.

Additional potential collateral requirements – A lender may require that you provide a personal guarantee of payment, a payment and performance bond, a letter of credit, or cash in lieu of a letter of credit; often you can get your GC to put up this collateral. You should discuss any additional collateral requirements with your lender.

DIGGING DEEPER: THE CONSTRUCTION AND REHABILITATION BIDDING PROCESS

Most owners will engage in a bid process to choose certain members of their team, such as the GC. Your architect will be responsible for creating bid documents and specifications so that all bids you receive quote the same project, down to the list of materials to be used.

You will generally want to receive bids from three different GCs. Because small building projects are generally less costly, not all contractors may be willing to bid on your project. Some of them may insist on partial payment in advance of doing work. This should be a red flag for you — it will certainly be for your lender. Because construction loans are advanced based on completed work (see "Requisitions," starting on page 49), GCs will need to be able to cover costs for a period of time. If they are unable to do that, they may lack the financial strength to manage delays or other issues as they arise.

The Site and the Project

In this section you'll learn about the physical needs of a site or building, the market and municipal considerations that can affect project feasibility (including rental demand, zoning, and community plans), and ballparking project costs.

FINDING A PROPERTY

If you do not already own a property, you may want to work with a real estate professional who is solely in the business of buying and selling properties. While many people initially think of a broker or realtor, there are many additional options that may end up saving you time and money. For example, there are entities that work with local municipalities to develop targeted areas by revitalizing vacant, abandoned, or foreclosed properties. The key here is to work with someone you feel will help identify and assess potential buildings or lots to acquire, or what development initiatives or plans might be underway in the neighborhood, town, or city you're considering.

Because of their neighborhood and community ties, CDCs and land banks are often great sources of information about the local market, available properties, and government funding sources that you might be able to take advantage of to help with your project.

Look into alternative ways to find a property:

- Land banks
- Community Development (CD) offices
- Community Development Corporations (CDCs)
- Local neighborhood community-based nonprofits
- Municipal Industrial Development Agencies (IDAs)

CONSIDER THIS

When assessing properties and planning construction, keep in mind that your lender will perform their own inspection of your site and project prior to closing your loan. They will send (at your expense) an engineer to determine whether your project complies with codes and is being built with quality products that are durable and will help achieve projected rents. Soliciting feedback from a contractor during the site selection and predevelopment phase can help ensure you meet lender expectations when this inspection occurs.

MARKET CONSIDERATIONS

Everyone's heard "location, location, location" with respect to real estate. Most people understand that your building's location has an impact on your operating costs and income. A professional market analysis will give you an understanding of some key elements, but you should do a little investigating on your own.

Ask yourself the following:

What do you know about the location and neighborhood?

- Is it considered stable, up-and-coming, or disinvested?
- What do online searches of community and neighborhood satisfaction reveal?
- Have you been to the property and neighborhood in person, and at different times of the day and night?
- What is the crime rate?

Look at comparable properties

You can use comparable properties (comps) to ensure you are purchasing the property at a fair price, and to determine what you are likely to be able to charge for rent. When looking at comps, you should be looking for properties that are similar to your finished project, including the quality of amenities, age, and the square footage of units.

Research these aspects:

A professional market analysis will provide in-depth information, but you may be able to find the same information online for free. Whether you do the research yourself or hire someone to do it for you, you'll need to know about:

- Access to transportation
- Local economic characteristics
- Zoning (for more on zoning, see page 19)
- Demographics
- Comps
  - Rents
  - Expenses
  - Taxes
  - Size
  - Amenities
- Crime

MUNICIPAL CONSIDERATIONS

Every city has rules about how buildings should be constructed and maintained (building codes) and where they can be built (zoning), as well as, possibly, preferences for certain kinds of development in certain key areas. Because these vary so greatly, your best source of information is someone who works for a particular municipality itself. These rules and requirements can have huge impact on the scope of your project, so you or a team member will need to keep the following questions in mind:

Zoning

- Is your intended use allowed and clearly defined as an approved use?
- Is the property in a flood plain? If so, does this have an impact on the project design, location, and insurance requirements?
- How big can your building be?
- What are the parking requirements?

Building Codes

- Are there codes that prohibit what you're planning to do?
- What permits are required?
- Does your project need to be Americans with Disabilities Act (ADA) compliant?
- Have you considered life safety requirements, such as fire sprinkler systems?
- Is your building up to code?
- Are there existing violations?
- Does the building layout match municipal records?
- Are there any title issues?

Community Plans and Development Preferences

- Is there an existing municipal or regional development plan in place or in process?
- If there is a plan in place or about to be implemented, there may be special abatements or other incentives available that could affect your financing. To find out, talk to the municipal representatives from the IDA or CD Office in the community you are considering for your project.

NYC

In some cities, it may be a good idea to hire a land-use consultant or expediter who has experience with your municipality's requirements.

CONSTRUCTION SCOPE

When looking at properties, you'll want to consider the amount, if any, of construction needed for the building to be ready for occupancy (habitable). Keep in mind that the building or lot may require work before you can get started on the project as you envision it. The amount of work required can have a substantial impact on the cost of your project, and therefore the feasibility of the project itself. You should bring select members of your team with you to see the property so that you can gauge the physical needs of the site, and estimate associated costs as you go.

The work required may be beyond your initial project idea, which can have an impact on feasibility. For this reason, CPC always recommends refraining from spending too much money on drawings or acquisition up front.

Consider integrating energy-efficiency upgrades into your construction project. They can decrease your utility bills, and improve financial stability and tenant satisfaction.

Quick Checklist for Scoping Your Construction Needs:

For new construction or rehabilitation projects, ask the following questions:

- Are there any environmental issues (e.g., underground storage tanks, asbestos or lead paint in existing buildings, or is it a known brownfield site)? ☐ Yes ☐ No
- Does the site require any grading (i.e., leveling of the lot) in order to build? ☐ Yes ☐ No
- Does the site have rock that needs to be removed? ☐ Yes ☐ No
- If there is an existing building, are there any health and safety issues that have to be addressed as required by the lender or the building or code department of the community? ☐ Yes ☐ No

For occupied buildings, ask the following questions:

- Are there any building code violations that need to be addressed? ☐ Yes ☐ No
- If a tenant moves out, will you need to update kitchens or bathrooms before a new tenant moves in? ☐ Yes ☐ No
- How old are the mechanical systems? Do they meet current standards? ☐ Yes ☐ No
- Are there signs of structural integrity problems (e.g., sloping floors)? ☐ Yes ☐ No

Given your responses, what are your next steps?

____

____

BALLPARKING COSTS — DEVELOPING PRO FORMAS

A pro forma is simply an evolving set of calculations that help determine whether the project meets the feasibility criteria of you and your lender. Pro forma calculations are generally done on two separate spreadsheets referred to as "Income and Expense Statements" (I&E) and "Construction or Rehabilitation Budgets." The projections determined in your initial calculations may evolve throughout the project as conditions change or new considerations emerge.

To understand this at a higher level, refer back to the Primer. Pro formas are based on the income and expense concepts introduced there.

The following sections are designed to introduce you to the line items, or entries in your I&E and budget, that you'll need to be thinking about as an owner. Because the amount for each line item will vary from project to project (depending on the municipality you're considering, property type, etc.), you'll need to consult with relevant professionals (GCs, local tax assessors, utility providers, appraisers, other owners, etc.) to gather the information needed to populate your pro formas. CPC recommends comparing cost estimates from multiple sources.

INCOME AND EXPENSES STATEMENT (I&E)

An I&E is a tool used to list the project income, expenses and NOI of a building. Each input is a line item; within the industry, there is some variation in how line items are grouped, e.g., painting could be grouped under maintenance, or listed separately.

Income

The following are typical line items:

Residential Rent

Potential residential rents can be determined based on the actual historical performance of the property (trailing 12-months, or T-12) or on comps (post-rehabilitation or construction, if relevant).

Other Sources of Income

Rental income can also be generated by commercial space, which is generally priced by the square foot. Buildings can also generate additional income from onsite laundry, cell towers, parking, etc. Generally, you will want to list these, along with commercial rents from office, retail, or community space, separately from residential rents.

Vacancy Loss

Tenant turnover is inevitable, so you should assume some regular income loss. The standard assumption is 5 percent for residential rents and 10 percent for other income, but you may want to make this higher depending on the vacancy rate in your community or given your building type. Some lenders will refer to this item as Vacancy and Collection Loss to also account for those times when rent payments are delayed or difficult to collect.

EXPENSES

The following are typical line items:

Taxes

Making your property more valuable through construction or rehabilitation means that its real estate taxes will most likely increase. It is crucial that you forecast this early on. Consult with your assessor as part of due diligence prior to closing your loan or starting construction work.

Utilities

Utilities include water, electricity, and gas. Including energy-efficiency measures can decrease your utility costs and increase resident satisfaction. Discuss these opportunities with your architect and your mortgage officer.

Insurance

Insurance could include builders risk, liability, building replacement and other kinds of insurance. Your lender may have insurance requirements beyond what you originally expected, so anticipate some changes in this line item as you move through the process.

Repair and Maintenance

This generally includes all ongoing maintenance. It can cover everything from landscaping and snowplowing to painting or upgrading a unit when it is vacated. There is an additional, separate line item, repair reserve, that covers the expenses associated with major repairs, capital improvements, or future systems replacements.

Property Management

This covers all activities associated with keeping your building operating efficiently and at full occupancy. Although costs will vary by provider and property location, management companies will generally charge between 3 and 8 percent of the monthly rental income of your property. For a thorough discussion of this topic, see "Property Management," starting on page 53.

Legal and Accounting

As a business owner, you may wish to retain a licensed professional accountant, a lawyer, or both. An accountant will most likely help you understand how your building is performing financially. Many lenders require legal opinions as part of their loan closing documents, in which case retaining an attorney for at least that purpose is unavoidable.

Repair Reserves

Major building systems and components, such as boilers, hot water heaters, and roofs, have standard life cycles. It is important to understand where each of these components is in its life cycle, and to put aside money for its inevitable replacement or repair. A lender will usually collect a repair reserve as a monthly sum with your mortgage payment.

Net Operating Income (NOI)

NOI, as explained in the Primer, is the source of both your profit and what you will use to pay any debt or equity costs. As an owner, you'll need to decide if the project you have in mind meets your profitability requirements.

CPC uses room count rather than unit count for some of its calculations when underwriting property expenses: Studio – 3 rooms; 1 BR – 4 rooms; 2 BR – 5 rooms; 3 BR – 6 rooms; etc. Other lenders may use square feet or units only.

Income and Expense Statement Sample Format

The following is an example of how to set up your I&E; you can use this (or a version in Excel) as you contact relevant professionals for information on your project's projected income and expenses. To see a completed sample of an I&E, look at the case study beginning on page 36.

Income	Calculations	Annual Income
Residential Rent	Projected monthly rent per unit x number of units x 12 months	
Other Income		
Commercial or Other Rent	*Projected monthly commercial rent x 12 months*	
Laundry	*Projected monthly laundry income x 12 months*	
Parking	*Projected monthly parking income x 12 months*	
Storage	*Projected monthly storage income x 12 months*	
Cell Tower	*Projected monthly cell tower income x 12 months*	
Total Other Income	Sum all other income	
Gross Income	Total annual residential rent + total annual other income	
Vacancy & Credit Loss – Rent (5%)	Total annual residential rent x 5%	
Vacancy & Credit Loss – Other (10%)	Total annual other income x 10%	
Effective Income (EI)	Gross income minus (rent vacancy & credit loss + other income vacancy & credit loss)	

Expenses	Calculations	Annual Expenses
Taxes	Consult with local tax assessor	
Water & Sewer	Consult with local utility providers	
Heat	Consult with local utility providers	
Gas & Electric	Consult with local utility providers	
Insurance	Consult with insurance providers	
Repair & Maintenance	Consult with local plumbers, electricians, painters, etc.	
Property Management	Consult with property management companies	
Legal	Consult with local lawyers	
Accounting	Consult with local accountants	
Landscaping & Snow Removal	Consult with local landscapers & snow removal service providers	
Cleaning Supplies & Exterminating	Consult with local cleaning service providers & exterminators	
Staff Salaries	Consult with property management providers or your lender	
Total Annual Expenses	Sum all expenses	
Repair Reserves	Consult with your lender	

Effective Income	$
(Total Annual Expenses + Repair Reserves)	- $
Net Operating Income	**$**

CONSTRUCTION OR REHABILITATION BUDGET

A construction or rehabilitation budget is generally broken into three types of costs: acquisition and/or refinance, hard costs, and soft costs. Generally, acquisition and refinance costs are separated into their own line items. Even if your project does not include rehabilitation or construction, you can use the budget template to track costs associated with your acquisition or refinancing.

Acquisition

The acquisition cost is the contracted cost to purchase the property. Even if you've owned your site or building for a substantial period of time, you may be able to count a portion of any increase in value since you acquired it (called its imputed value) toward your project's equity requirements.

Refinance Existing Debt

If you own the property, any existing debt will be refinanced by the new loan.

Hard Costs

These are costs associated with building construction and site work, including labor and materials.

Construction

This involves costs associated with the building's structure and site, including labor and materials. Any construction or rehabilitation project will go through a plan and cost review with a lender. See page 46 for more details.

Construction Contingency

This is a cushion for unexpected costs that may arise during construction. It is generally calculated at a minimum of 10 percent of the cost of construction.

Soft Costs

Soft costs are professional fees and other carrying costs (including construction interest) incurred for the project. This includes fees your lender will charge you to borrow money. Some soft costs, like appraisals, are predetermined and some, like architects' and developers' fees, are calculated as a percentage of the total project cost.

Fees

Fees are a normal part of the borrowing process. You should ask your lender to explain each of them so you clearly understand them. Consult your attorney as well.

CONSIDER THIS

Over the long term, all rental buildings will have rehabilitation needs; this is inevitable because of cumulative wear and tear, and the natural lifespan of major components, like boilers or roofs. You may also want to make upgrades at some point to increase your property's value or to compete with newer units on the market. Even if your current project is solely an acquisition, we recommend you familiarize yourself with rehabilitation- and construction-specific information here and throughout the guide.

Construction or Rehabilitation Budget Sample Format

The following is an example of how to set up your construction or rehabilitation budget; you can use this (or a version in Excel) as you contact relevant professionals for information on your project's projected costs. Note that while some of the line items in a construction budget are based on percentages of other line items, most are simply built in as the actual cost of that item. To see a completed sample of a construction or rehabilitation budget, look at the case study beginning on page 36.

Acquisition and Refinance	**Costs***
Acquisition	
Refinance	
Total Acquisition + Refinance	

Hard Costs	**Costs***
Construction	
Construction Contingency (10%)	
Total Hard Costs	

Soft Costs	**Costs***
Professional Fees	
Borrower's Architect & Engineer	
Borrower's Legal	
Lender's Engineer	
Environmental	
Lender's Commitment	
Appraisal	
Lender's Legal	
Title	
Mortgage Recording Tax (NYS-specific)	
Survey	
Carrying Costs	
Construction Interest	
Real Estate Tax	
Water & Sewer	
Insurance	
Gas & Electric	
Marketing	
Total Soft Costs	
Soft Cost Contingency (5%)	
Total Soft Costs (Including Contingency)	

Total Acquisition + Refinance	$
Total Hard Costs	$
Total Soft Costs	+ $
Total Development Costs	**$**

*Discuss these with a GC, your lender, other owners, etc.

Financials — Getting to Actuals

In order to secure a loan, it's necessary to determine accurate figures for income, expenses, and construction or rehabilitation budgets. Based on these numbers, a lender will determine the amount of debt your project can support.

DOCUMENTATION

You will need to provide your lender with the I&E and construction or rehabilitation budget you've created, along with any documentation you have that helps explain your numbers. For an occupied, performing building, for example, you would want to give the lender a rent roll, a list of residents and the rent they've paid for the past one to three years, to support your belief that the building can earn a certain income on a monthly basis. For an unoccupied building, you can use estimated comps, as discussed in previous chapters.

From these numbers, a lender will begin a process known as underwriting.

UNDERWRITING: THE PROCESS OF ASSESSING RISK

Once lenders have a relatively accurate picture of your team, your financials, your project and site, your I&E, and your construction or rehabilitation budget, they can start to assess the risk you and your project represent. To some extent, they will have been doing this all along, but at this point, they will quantify your risk and decide if your project is feasible and what terms they are comfortable offering.

What Lenders Assess

Lenders, by virtue of their familiarity with the markets they operate in, have a good sense of how much income a property is likely to generate and average construction costs. They will also have standards they use to assess the financial feasibility of your project.

Every year, CPC publishes maintenance and operations standards, a list of average borrower building expenses, broken down by building type and location. Ask your CPC mortgage officer for the most recent standards.

Construction Underwriting

Lenders will also have standards by which they weigh construction and rehabilitation costs. Based on your proposed scope of work, your mortgage officer will have a good idea, on a square-foot basis, of what it will cost you to construct or rehabilitate your building. Your lender will have an expert, either in-house or a third party, who will review your proposed construction or rehabilitation costs prior to closing your loan to ensure they are not out of line with the project type or location. As you move ahead, this review of construction costs will most likely include the bids of general and subcontractors, as well as signed construction contracts.

LOAN TERMS

Through underwriting, a lender will determine the type of loan that best fits your project's needs and your goals, and will set the specific terms of the loan.

Interest Rates

Your interest rate, which is expressed as a percent, is what lenders will charge you to borrow their money. In other words, this is the cost of debt for you.

Loans can have different interest rates, and can have either a fixed or adjustable rate:

- Fixed rate – interest rate remains the same during the term of the loan.
- Adjustable rate – the interest rate fluctuates during the term of the loan, most likely based on a market index such as LIBOR.

Construction loans are almost always adjustable rate loans.

Loan Products: Repayment Terms

Repayment terms for the principal balance plus interest are based on the type of loan product.

Construction loans – these are generally interest only. Regular payments are made to cover the interest costs on the amount drawn down during construction. At the end of the term, which is generally up to 24 months, the full loan amount is due as a balloon payment. This can be repaid through a permanent mortgage.

Permanent loans – these are generally fixed rate and amortizing. This means that the interest and principal are paid on a constant basis throughout the term of your loan.

- If the loan term and amortization match (i.e., 30 years/30 years), the full loan amount will be paid off once you reach the end of your term. This is commonly referred to as a fully amortizing loan.
- If the loan term and amortization do not match (i.e., 15 years/30 years), at the end of the 15th year you will be required to make a balloon payment. A balloon payment means that you will need to repay the principal balance at the end of the term — this is normally done by refinancing the property (i.e., getting a new permanent loan).

If you use a permanent loan to pay this balloon amount, you are "taking out" your construction loan or "converting" to a permanent mortgage.

CPC offers a forward rate lock permanent loan product, wherein we will simultaneously commit to both a construction loan and its permanent takeout. The product mitigates your interest rate risk during the construction phase.

YOUR LOAN AMOUNT — SIZING A LOAN

Regardless of whether you are seeking a construction loan, a permanent loan, or both, your lender will start in the same place, with "sizing." This means figuring out the permanent loan amount your project can support, based on its actual or projected NOI.

Often times, the terms "loan" and "mortgage" will be used interchangeably.

Generally, there are two different approaches a lender can take to determine the loan amount your project can support. These are based on standard ratios and calculations and are known as the debt coverage ratio approach (DCR) and the loan to value (LTV) approach. For a fuller explanation of these calculations, see the following pages.

Once lenders have calculated both supportable loan amounts, they select the amount that is the lesser of the two. This, however, may not be the final loan amount. There are other factors, such as internal loan amount limits to borrowers and the strength of the market in which your project is located, that may lead to additional adjustments to the supportable loan amount.

FUNDING THE LOAN — SOURCES AND USES

Once lenders have determined what they are comfortable using as your loan amount, they will compare that to your construction or rehabilitation budget. They will then create what is called a "Sources and Uses Statement." This statement shows in a single table the capital sources of funds and how those funds will be used.

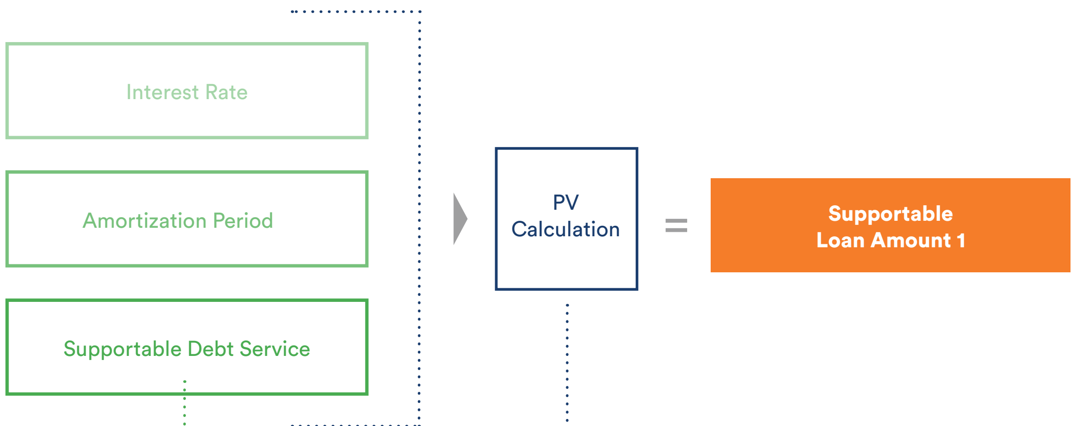
SIZING A LOAN — UNDERSTANDING THE APPROACHES

Generally, lenders use two standard methods, called the debt coverage ratio (DCR) approach and the loan to value (LTV) approach, to calculate a project's supportable loan amount.

Because a loan amount is dependent on NOI, it is very important that you and your lender agree on your building's potential or actual NOI.

First Approach: Debt Coverage Ratio (DCR)

The debt coverage ratio approach uses two calculations, one to determine the amount of debt service your project can support (DCR) and one (present value, or PV) to determine what size your loan principal can be, given that your debt service must pay, over a period of time, for both the loan principal and interest. For our purposes, the PV calculation has three inputs: the debt service your project can support, the proposed loan amortization and the proposed interest rate.*



Supportable Debt Service

The debt coverage ratio (DCR) is what your lender uses to make sure your entire NOI doesn't go to monthly debt service, in case you have unanticipated vacancies or building repairs, and to ensure you're able to actually profit from your property.

$$DCR = \frac{NOI}{\text{Total Supportable Debt Service (principal + interest payments)}}$$

Your lender will determine your supportable debt service by dividing your NOI by their DCR:

$$DS = \frac{NOI}{DCR}$$

PV Calculation

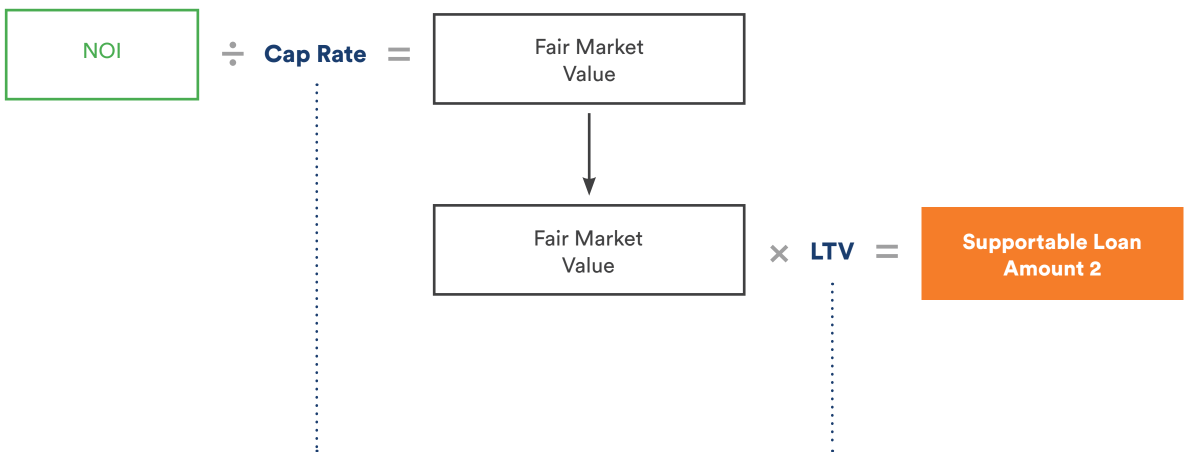
Most people use an automated calculator to perform the PV calculation (either Excel, a financial calculator, or an online tool).

*Note that the PV calculation does have other uses and there are additional inputs for those uses, but they are beyond the scope of this guide.

CPC's standard is a 1.25 DCR.

Second Approach: Loan to Value Ratio (LTV)

The loan to value ratio is a second method used to calculate a loan amount. Lenders use this ratio to determine how much risk they are willing to assume. Think about a worst-case scenario — foreclosure. Lenders want to make sure, should they have to foreclose on your property, that the property is worth more than the amount of your loan. At a minimum, they are hoping to cover legal and any maintenance costs they may incur as well as any loss of value resulting from a distressed sale.



Capitalization Rate (Cap Rate)

The cap rate defines the rate of return on an investment based on the income of the property and the estimated return to the owner. Cap rates, which are reflective of current market activity, are generally derived by appraisers and other providers of market data, and will be used by your lender to confirm the fair market value of your property.

Loan to Value (LTV)

A way of assessing risk.

$$LTV = \frac{Loan}{Fair\ Market\ Value}$$

Lower LTV indicates lower risk and higher LTV indicates higher risk.

▼ LTV = ▼ Risk ▲ LTV = ▲ Risk

CPC's standard LTV maximum is 80%.

GAPS IN FINANCING

A gap in financing occurs if there is a difference between the total cost to develop and the total amount of funding (debt plus equity). A project is generally not feasible if the equity required is excessive relative to the expected market rate of return.

Common options to fill gaps include the following:

- Commit more of your own or an investor's equity to the project.
- Incorporate energy-efficiency measures, which will lower operational costs, in turn increasing NOI.
- Use grants or subsidies.
- Look into tax benefit programs.

Subsidies

A subsidy is funding provided by some level of government (municipal, county, or state) and made available to a project because that project has been deemed by the issuing agency to provide a public good. A public subsidy will generally come with restrictions on some aspects of your project for a period of time. These could include income of the tenants, or how the property can be used. Keep in mind that there may be yearly reporting requirements to confirm that these conditions are being met.

Common subsidy providers in New York include the following:

- New York City Housing Preservation & Development (HPD)
- New York State Homes and Community Renewal (HCR)
- Community Development (CD) offices - HOME Funds

Grants

Grants usually come from foundations, private family offices, or city, state, or federal agencies, and help support their providers' missions. Some examples include energy-efficiency grants and down payment assistance. These may also have reporting or other compliance requirements.

Most housing regulatory agreements use a concept called area median income (AMI), to calculate the income caps and rent reductions.

CPC has significant experience working with subsidies, grants, and tax benefit programs, so consult with your mortgage officer if you're interested in exploring subsidy options in your area.

There are many subsidies and grants available for energy-efficiency upgrades. Check with your lender to see which options may work for you.

Tax Benefit Programs

Tax Abatements

Tax abatements reduce an owner's local real estate taxes. Generally, abatements are given to support development in a disinvested area or one in which the government is interested in promoting certain kinds of development.

Tax Credits

These are IRS programs administered by state and federal agencies. The programs incentivize specific outcomes by giving owners tax credits that they can sell to investors who use them to offset a portion of their federal taxes. Owners are thereby able to obtain additional equity. Some examples are Historic Tax Credits and the Low Income Housing Tax Credit Program (LIHTC). The rules and regulations of each of these programs are unique.

PILOTs

PILOT is an acronym for "payment in lieu of taxes." It is an arrangement under which a payment is made to compensate a local government for some or all of the property tax revenue that it loses because of the tax-exempt nature of the ownership of a property or of a property itself.

Tax Exemptions

Tax exemptions reduce the value of a property for tax purposes so that an owner's tax bill will be lower, generally for a finite period of time.

A CLOSER LOOK

Using alternative sources of funding to fill gaps can positively affect the feasibility of your project. Keep in mind they can add an extra layer of complication, so you'll want to work with a team and a lender who have expertise in this area.

How historic tax credits work:

Your building will need to be certified by the National Park Service (NPS) as a historic structure. Once the building is declared historically significant, known as Part 1, it qualifies for Historic Tax Credits. The next step is approval of your rehabilitation plans by the State Historic Preservation Office (SHPO), and subsequently NPS. As part of their review, they will confirm that your rehabilitation scope of work meets their standards. Approval from both groups is known as Part 2. The credits can then be sold to an investor through a syndication process to raise equity for the project. The equity from the sale will pay in after several benchmarks are met. You can also use the credits against your federal and state income tax liability.

Historic tax credits are a key subsidy in upstate New York, because of the prevalence of historic properties, particularly in downtown cores. New York also has a State Historic Tax program; consult with your mortgage officer if you'd like to learn more.

THE LENDER'S INTERNAL PROCESS

While lenders are working with you, they will simultaneously be creating what's called a "mortgage offering" or "mortgage package" for review by the decision makers in their organizations. This is often a mortgage or credit committee, a formal group of the lender's officers who meet on a regular basis to discuss and vote to approve or deny loans.

Some lenders have rules that tie a loan amount to the number of committee members needed to approve a loan, with fewer members being needed for smaller loans.

Other lenders may refer to a mortgage offering as a "credit memo," "underwriting review," or "asset summary report."

Mortgage Offerings

The format of mortgage offerings varies from lender to lender, but they will include all of the information the lenders' credit teams require to make investment decisions for their companies:

- A narrative describing you, your team, and the project
- Historical (if applicable) or projected income and expenses
- An analysis of the market
- A description of any pertinent tax credit or abatement programs
- An analysis of the appraisal and third-party reports
- Sources and uses
- The proposed interest rate and payback schedule

After loan officers confer with their institution's decision makers, they may come back to owners with changes to the interest rate, loan amount, or equity requirement. They may even have additional requirements that will have to be met before they'll agree to lend.

If your loan is approved, you'll need to assess whether the loan terms the lender is offering work for you and whether there is room for negotiation. To ensure the terms are compatible with you and your project, you will want to confer with your lawyer, accountant, and other members of your team.

CONSIDER THIS

Different lenders will offer different loan products. If you are seeking loans for multiple purposes (e.g., acquisition, construction or rehabilitation, and permanent takeout), you can choose to seek financing for each part separately, perhaps even from different lenders. Be aware that this can change a lender's rate and fee calculus. This is to say that they may be willing to give you a fee discount if you borrow from them for both your construction and permanent loans, but not for a permanent loan only.

THE COMMITMENT LETTER

If your project is feasible and deemed financeable by a lender, and if you choose to accept a lender's offer, the lender will issue what is called a "commitment letter" for you to review and sign. This letter contains all the details about your pending loan, including your and the lender's responsibilities. It will contain standard conditions that must be met before your loan can close, and may also contain what CPC calls "special conditions," which are unique to your project. Review the commitment letter carefully with your lender and get clarification on anything that's confusing.

You will have a certain amount of time to review and sign your commitment letter, after which the offer the lender is making expires.

Reviewing your commitment letter

A commitment letter is usually a legally binding document, so you should review it with a lawyer before signing it. Commitment letters generally have three types of provisions: basic loan terms such as amount, interest rate, and duration; conditions that must be met in order for the loan to close; and some (but not all) of the legal terms of the loan documents themselves.

Here are some items to look out for:

General: You must understand the requirements laid out in the commitment letter. This includes understanding any effect those requirements might have on you and your team.

Timelines: These will specify when certain items need to be provided or actions taken, as well as when any associated documentation has to be furnished. These could include deadlines for the completion of construction, leasing, and loan extensions and conversions.

Prepayment, Yield Maintenance, and Lockout: These are terms that can affect your ability to pay off the loan before it has reached maturity (end of the term). For example, a lender could be entitled to a fee or to some amount of interest, even if a loan is paid off early, or the lender could prohibit a borrower from paying off a loan before a specified period passes.

Personal Financial Covenants: You will most likely be required to maintain a specified level of liquidity and net worth during the term of a construction loan. This can vary greatly from institution to institution.

Reporting: A lender may require specific reporting, such as ongoing maintenance and operations costs. If you are using subsidies as a funding source, there will also be reporting requirements related to those.

Guarantee Requirements: These requirements vary greatly between lenders and projects. Generally speaking, these ensure a lender's ability to recover in the event of a loan default, and are related to the recourse and nonrecourse concept outlined below.

Recourse vs. Nonrecourse: These are two types of loans that differ as to who may be sued if a borrower fails to repay a loan. In both types, a lender can sue the borrower to take possession of any collateral used to secure the loan. The key distinction is whether a lender can also go after other assets of the borrower or those of the other principals in a project; in nonrecourse loans, lenders cannot (except in the event of fraud or waste), in recourse loans, they can.

Small Buildings in Practice: A Case Study

The following case study provides a concrete example of the feasibility and predevelopment phases of a small building acquisition and rehabilitation project, as outlined in the guide. It is based on actual small buildings CPC has financed and borrowers we've worked with to illustrate how a project might (or might not) prove feasible.

YOU AND YOUR TEAM

Experience and Character

You are fairly new to development, with no previous multifamily experience. However, you are a homeowner, and recently worked closely with a contractor to rehabilitate a single-family house that is now on the market. You're interested in taking the next step and, based on your recent project, are confident you can choose trustworthy partners and vendors, deal with construction timelines and budgets, and balance project costs to ensure you can make a profit.

Your brother-in-law is a plumber and your sister is an architect, and both worked for you on the single-family house project. You also had a good experience with your previous contractor and lawyer, and would like to add them to your team if you find a viable property.

You feel good about the character of your proposed team, but you need to find out more about the experience and capacity of its individual members to confirm that they can handle a multifamily project.

- Is your sister familiar with the code and other requirements of the communities you're considering purchasing in?
- Your brother-in-law works for a plumbing company and did your project as a side job; would he be able to take on a bigger project?
- Has your former contractor had past success with multifamily projects? Would the contractor work with your brother-in-law or does it have its own plumbing subcontractor already?
- Does your lawyer also have expertise in multifamily real estate transactions?

Property Management

Given your own level of experience, you've decided against new construction and have begun looking for small multifamily rehabilitation project opportunities in your hometown. Your sister and brother-and-law (both of whom have done some work on county land bank projects) tell you the land bank has a targeted redevelopment plan in an older neighborhood in a nearby city. The city is within a 20-mile radius, but since you were originally thinking you'd do the property management yourself, you need to think through the repercussions of the additional distance.

- In emergency situations when you might have to respond in person, what are the personal and economic costs of 40-mile round-trip drives?
- What are the estimated costs of having the property managed by a third party?
- Do you know of any reputable property management companies, or do you need to go through a search process?

Financial Strength

You used part of an inheritance and some savings to cover the costs of your recent single-family rehabilitation project; this has left you short on cash until the property sells. You know you'll need some equity and liquidity for your next project, so you need to assess whether you have the financial strength to manage the project on your own, or if you need additional partners.

- Are you confident that your single-family property will sell in the near future, or is there equity or liquidity you can leverage from your primary residence?
- Are there family members or friends you would consider bringing onto your team in order to bolster your financial strength?

THE PROJECT AND SITE

You meet with representatives from the land bank, who are working with owners and the city to figure out how to improve the neighborhood's rental housing stock. You are impressed with the land bank employees, who seem genuinely committed to revitalizing the neighborhood, and are excited by one of the properties on their targeted-for-rehabiliation list, a partially occupied, 16-unit building with historic importance in the community. The current owner has struggled with upkeep and is interested in a quick sale.

The land bank offers to take you on a walking tour, and you're pleased with the block on which the property is located. Although the building stock is definitely aging, most of the neighboring properties (a mix of single- and multifamily buildings) look well kept. There is a small park at one end of the street and a bus stop connecting the area to the city's downtown at the other.

In order to determine if the property makes financial sense, you collect relevant market and municipal information, such as comps and tax requirements. You also ask the land bank for help in collecting building performance information from the current owner, who provides you with unit rent history and some old heat and electricity bills.

PUTTING IT ALL TOGETHER — DEVELOPING PRO FORMAS

Using the comps, market, and building performance information you've collected, you begin to build out your draft income and expense statement.

Project Details

16 units, 48 rooms, $1250 rent per month (average per unit, after planned rehabilitation)

Income	Calculation	Annual Income
Residential Rent	$1250 rent income per unit x 16 units x 12 months	$ 240,000
Other Income		
Commercial or Other Rent	No commercial or other rent income	$ 0
Laundry	Assumed $10 per unit x 16 units x 12 months	$ 1,920
Parking	No parking income	$ 0
Storage	No storage income	$ 0
Cell Tower	No cell tower income	$ 0
Total Other Income	Sum all other income	$ 1,920
Gross Income	Total annual residential rent + total annual other income	**$ 241,920**
Vacancy & Credit Loss – Rent (5%)	Total annual rent x 5%	$ 12,000
Vacancy & Credit Loss – Other (10%)	Total annual other income x 10%	$ 192
Effective Income (EI)	Gross income minus (rent vacancy & credit loss + other income vacancy & credit loss)	**$ 229,728**

Expenses	Calculation*	Annual Expenses
Taxes	Average of actual taxes from CPC small building projects	$ 34,677
Water & Sewer	$150 × 48 rooms	$ 7,200
Heat	$270 × 48 rooms	$ 12,960
Gas & Electric	$130 × 48 rooms	$ 6,240
Insurance	$620 × 16 units	$ 9,920
Repair & Maintenance	$800 × 16 units	$ 12,800
Property Management	Effective income x 6%	$ 13,784
Legal	$140 × 16 units	$ 2,240
Accounting	$1300	$ 1,300
Landscaping & Snow Removal	$85 × 16 units	$ 1,360
Cleaning Supplies & Exterminating	$95 × 48 rooms	$ 4,560
Staff Salaries	$780 × 16 units	$ 12,480
Total Annual Expenses	Sum of all expenses	**$ 119,521**
Repair Reserves	$250 × 16 units	$ 4,000

Effective Income	$ 229, 728
(Total Annual Expenses + Repair Reserves)	- $ 123,521
Net Operating Income	**$ 106,207**

* Expenses used are based on actual CPC project expenses or averages from CPC's maintenance and operations standards (ask your CPC mortgage officer if you'd like a copy of the most recent version of the standards).

You still need to put together a construction budget, so you call your contractor to see if they'd be willing to meet you for a walk through the building. During the tour, the contractor talks with you about some concerns — the possible presence of asbestos and lead paint, older wiring and outdated fixtures and appliances. But, the contractor is generally enthusiastic about the building's condition and its historic charm. The contractor gives you some good information about projected rehabilitation costs and offers to arrange times for you to confer with subcontractors, if you would find that helpful.

Construction Budget

Acquisition and Refinance	Costs*
Acquisition	$ 465,000
Refinance	$ 0
Total Acquisition + Refinance	**$ 465,000**

Hard Costs	Costs*
Construction	$ 800,000
Construction Contingency (10%)	$ 80,000
Total Hard Costs	**$ 880,000**

Soft Costs	Costs*
Professional Fees	
Borrower's Architect & Engineer	$ 40,000
Borrower's Legal	$ 5,000
Bank's Engineer	$ 15,000
Environmental	$ 2,000
Lender's Commitment	$ 19,233
Appraisal	$ 3,500
Lender's Legal	$ 14,000
Title	$ 4,162
Mortgage Recording Tax (NYS-specific)	$ 12,822
Survey	$ 3,000
Carrying Costs	
Construction Interest	$ 133,771
Real Estate	$ 13,100
Water & Sewer	$ 5,600
Insurance	$ 24,300
Gas & Electric	$ 6,600
Marketing	$ 2,500
Total Soft Costs	**$ 304,588**
Soft Cost Contingency (5%)	$ 15,229
Total Soft Costs (Including Contingency)	**$ 319,818**

Total Acquisition + Refinance	$ 465,000
Total Hard Costs	$ 880,000
Total Soft Costs	+ $ 319,818
Total Development Costs	**$ 1,664,818**

*Costs used are based on costs from actual CPC projects.

You next work with a lender to determine if your project is financeable. Based on conversations with you and review of the project details, your lender proposes the following as the best fit for your project's needs and your goals.

Lender's DCR: 1.25
Amount Available for Annual Payments: $84,966
Amount Available for Monthly Payments: $7,080
Interest Rate: 5.25%

Term: 30 years
Loan Size: $1,282,220
Your Equity Contribution: $382,597 (this amount is just under 23% of total development costs (TDC); most projects require a 20% – 25% equity contribution).

Your lender creates the following sources and uses statement, which assigns which line items the debt will pay for and which your equity contribution will need to cover.

	Uses	Sources	
	Costs	**Equity**	**Debt**
Acquisition	$ 465,000	$ 196,550	$ 268,450
Refinance	$ 0	$ 0	$ 0
Hard Costs			
Construction	$ 800,000	$ 0	$ 800,000
Construction Contingency (10%)	$ 80,000	$ 0	$ 80,000
Total Hard Costs	**$ 880,000**	$ 0	**$ 880,000**
Soft Costs			
Professional Fees			
Borrower's Architect & Engineer	$ 40,000	$ 40,000	$ 0
Borrower's Legal	$ 5,000	$ 5,000	$ 0
Lender's Engineer	$ 15,000	$ 15,000	$ 0
Environmental	$ 2,000	$ 2,000	$ 0
Lender Commitment	$ 19,233	$ 19,233	$ 0
Appraisal	$ 3,500	$ 3,500	$ 0
Lender Legal	$ 14,000	$ 14,000	$ 0
Title	$ 4,162	$ 4,162	$ 0
Mortgage Recording Tax (NYS-specific)	$ 12,822	$ 12,822	$ 0
Survey	$ 3,000	$ 3,000	$ 0
Carrying Costs			
Construction Interest	$ 133,771	$ 0	$ 133,770
Real Estate Tax	$ 13,100	$ 13,100	$ 0
Water & Sewer	$ 5,600	$ 5,600	$ 0
Insurance	$ 24,300	$ 24,300	$ 0
Gas & Electric	$ 6,600	$ 6,600	$ 0
Marketing	$ 2,500	$ 2,500	$ 0
Total Soft Costs	**$ 304,908**	**$ 170,818**	$ 0
Soft Cost Contingency (5%)	$ 15,229	$ 15,229	$ 0
Total Soft Costs (Including Contingency)	**$ 319,818**	**$ 186,047**	**$ 133,770**
Total Development Cost	**$ 1,664,818**	**$ 382,597**	**$ 1,282,220**

Note: For the purposes of the case study, we assume that your pro formas need no adjustments, and that the loan the project's NOI can support covers the cost of construction.

FINANCING GAPS

The case study assumes that the NOI of your project can support the debt you need to rehabilitate your building. But what if your projected numbers don't add up? You now have what is known as a financing gap, which you'll need to fill in order for your project to be viable.

The scenarios below are examples of ways that a gap in financing could occur in a project. The first assumes a change in NOI and, consequently, a decrease in your supportable loan amount. The second assumes an increase in the cost of acquisition that is not supported by the previously determined loan amount.

Scenario One:
You overestimated the amount of rent your building can generate; instead of an average of $1,250 per unit, the reality is closer to an average of $1,000 per unit. This means the amount your project has available for annual payments is only $70,220, and your new supportable loan amount is around $848,000. Because the new loan amount is smaller, fees that are dependent on either the loan size or the TDC decrease as well, giving you a new, lower TDC of about $1.6 million. Given your construction costs, you now have a little more than a $400,000 gap.

New TDC	$ 1,638,518
New Loan Amount	$ 847,767
Equity	– $ 382,597
Gap	**$ 408,154**

Scenario Two:
You have underestimated the cost to acquire your building; you will need to spend a bit more than $535,000. This time, fees dependent on the TDC further push up costs, and bring your TDC up to $1.7 million. Your supportable loan amount isn't big enough to cover the difference, and you now have a gap of just over $70,000.

New TDC	$ 1,735,002
Original Loan Amount	$ 1,282,220
Equity	-$ 382,597
Gap	**$ 70,185**

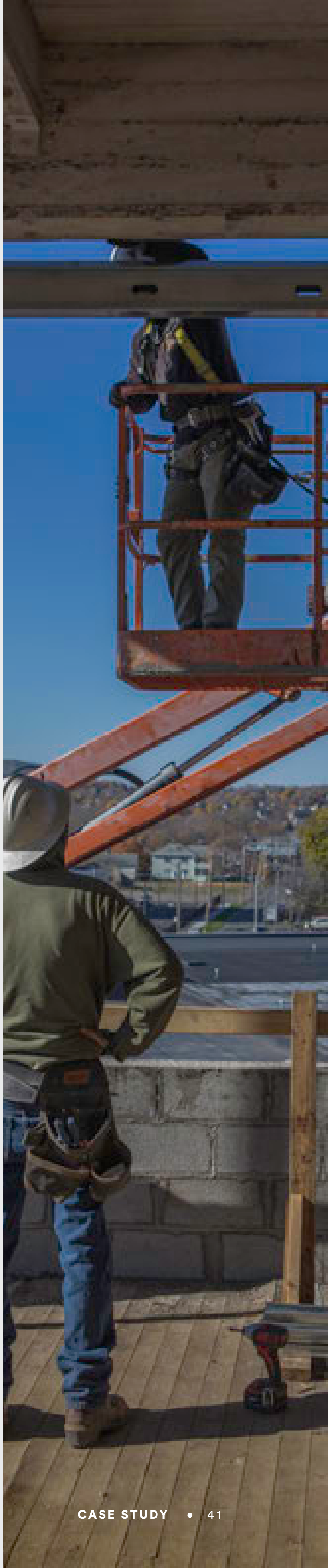
Filling the Gap

For these scenarios, a number of options exist for you to fill your gap and make your project feasible:

- Reducing your construction scope.
- Leveraging your existing properties to increase your equity contribution.
- Bringing in another equity investor.
- Talking to your lender about funding programs or subsidies for which your project may qualify.

For more detail on the range of options when faced with a gap, see page 32.

CPC is often able to increase supportable loan amounts based on projected utility savings for projects that integrate energy-efficiency measures. Talk with a CPC mortgage officer about energy-efficiency opportunities.



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CLOSING

In advance of your loan closing, you will be asked to submit finalized versions of the paperwork you have been collecting through predevelopment. For this phase, we cover how to prepare for your closing and who from your team will be involved.

TIMING IS EVERYTHING

Commitment letters are time bound. This means that once you receive and sign your commitment letter, you have a set amount of time to close your loan. Generally, this is 60 to 90 days. Your lender will most likely provide you with the full list of documents you will need to submit within this period.

While there can be some flexibility in scheduling your closing date, you will generally be charged additional fees to extend your commitment period. Push beyond that, and you may have to restart the entire loan sizing process. In addition, if too much time has passed since you ordered third-party reports, your lender may deem them out-of-date or stale. This means that delays can have monetary consequences: redoing these reports is an added cost to the project that you will want to avoid if possible. You may also face monetary consequences with your legal counsel.

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Stay in touch with your mortgage officer. At CPC, we set up regular conference calls with owners and their teams to ensure there is no confusion over what documents or information are needed. It is important to keep this type of dialogue going and to submit paper-work in a timely fashion. Otherwise, your project could face delays.

60 – 90 Day Period

Maintain Liquidity
You will most likely need to resubmit financial statements and refrain from any actions that will alter your liquidity from what was previously communicated.

Title Report
Your lender will need to review a title report in order to close. There is often a lag time from when a title report is ordered to when it is received. Start working on this early.

Prepare to Start Construction
Use this time to ensure you are ready to start construction as soon as your loan closes. Finalize the scope of your project and confirm you have received all required permits.

COMMON DOCUMENTS

A list of some common documents lenders require in order to close a loan follows. You'll notice that what is needed for a construction or rehabilitation loan is more extensive than what is needed for the acquisition of a building only. Work with your lender to determine exactly what documentation is required for your project.

Acquisition Only

- ☐ Lender application
- ☐ Credit check authorization
- ☐ Financial statements and organizational documents (if a partnership or LLC is involved)
- ☐ Proof of insurance (title and building)
- ☐ Real estate tax confirmation
- ☐ Title report
- ☐ Copy of purchase and sales agreement
- ☐ Certified rent rolls
- ☐ Executed leases
- ☐ Management agreement
- ☐ Permanent certificate of occupancy and certificate of completion
- ☐ Appraisals (these must have taken place in the past year)
- ☐ Engineering and environmental reports

For construction and rehabilitation loans, there is also a construction monitoring process with its own set of documents. Monitoring occurs throughout the term of these types of loans. See the Construction and Rehabilitation phase for greater detail.

In addition to the list above, a rehabilitation or new construction project will require:

- ☐ Architect plans and specifications
- ☐ Architect drawings
- ☐ Architect professional liability insurance
- ☐ General contractor financial statement
- ☐ Building permits or department-approved plans, or both
- ☐ Evidence of municipal site plan approval

Use the space below to note any additional items outlined in your commitment letter:

GETTING FROM COMMITMENT TO CLOSING

During the predevelopment and project feasibility phase, you submitted information and documents to your loan or mortgage officer. The main purpose of this was to determine how much debt you needed, and how much you could support. At this stage, the goals change. Now, a lender will be collecting documents that will become legally binding.

It is normal for this phase to feel duplicative. You are entering into a legal agreement, so there will be added review and scrutiny for quality control.

The Lender's Staff

Lenders will most likely bring on additional staff to review the paperwork you have already submitted. Their goal will be to verify that everything meets legal standards and is accurate. They will then need to collect additional documentation for anything that did not meet their criteria. You may be asked to resubmit documents you've already provided because they are out of date or are missing information. Remember that a lender is trying to ensure that the information it has remains current and is correct.

You and Your Team

You may be dependent on other members of your team to deliver the necessary information or documents. Your general contractor, lawyer, and architect will play a big role in this phase. Your role is to keep your team accountable so that there are no delays. Be sure to ask questions to clarify exactly how each document should be structured and what it needs to contain.

NYC

Hiring an expediter to deal with municipal agencies is common in NYC. These consultants can help clear liens and resolve permitting issues.

Outstanding Documents

Use the space below to keep track of your documents and their deadlines:

Document Name	Due Date	Complete
	/ /	☐
	/ /	☐
	/ /	☐
	/ /	☐
	/ /	☐
	/ /	☐
	/ /	☐

A BIT MORE ON DOCUMENTS

Insurance

Your lender will require you to have specific types of insurance that meet specific coverage amount thresholds. You will need to provide proof that you have purchased the correct insurance policies, with the correct amount of coverage, for the full period of your loan. You can request proof of insurance from your insurance provider. Be aware that, occasionally, wording or clause edits will be necessary. When needed, your lender should help you discuss requirements with your insurance agent.

At CPC, we require proof of insurance via specific accord forms and policy documents.

Architect and GC Due Diligence

For construction or rehabilitation loans

In the same way that lenders vet your ability to pay your debt service, they will formally review your architect and GC's experience, capacity, and financial strength prior to closing. Your lender will require you to provide specific documentation to demonstrate that your architect and GC are able to satisfactorily complete the project. Your lender should give you guidance about these requirements in the predevelopment and feasibility stage, when you are assembling your team. This is why we recommend starting a conversation with your lender early on.

Plan and Cost Review

For construction or rehabilitation loans, all lenders will require a formal review of your architectural drawings, specifications, and construction budget. This is generally conducted by an in-house expert and will be confirmed by an outside third party. This review is to ensure that your general contractor's costs are in line with industry standards, and that the architect's plans meet building code, zoning, and other requirements. We recommend conferring with your lender's staff person who is responsible for the plan and cost review as early as possible so that you, your architect, and GC are working together to get you to closing. The more complete the plans and budget are by the time the final review takes place, the greater the likelihood that you will be able to close on time.

LEGAL CONSIDERATIONS

Title Search and Report

Generally prepared by a title company, an abstractor, or an attorney, this is a written analysis of a property's ownership and lien history (see below for more on liens). It will include a legal property description, the names of recent titleholders, and any liens (including mortgages), easements, and overdue taxes on the property. You will be required to submit the title report to your lender prior to your loan closing, and pay for title insurance for both you and your lender based on the report. If you are receiving a construction loan, a title continuation (an update, basically) will also be required as a condition of funding each requisition. See the Construction and Rehabilitation phase for more information.

Liens

In real estate, a lien is a notice attached to your property stating that a creditor claims you owe it money or have failed to fulfill some other obligation. In a more general sense, a lien is a claim against an asset for the owner's unpaid bills. When a lien is placed on a property, it means that the owner cannot legally sell, refinance, or otherwise transfer clear title to the property without first paying off the outstanding lien. Your lender will review whether there are liens as part of the title search, but you can also perform a record index search to see if any of your partners have liens on their businesses.

Promissory Note

You can think of a promissory note as a legally enforceable IOU that includes the steps and timeline for repayment, as well as the consequences of failing to repay. This is a financial instrument that accompanies your mortgage. You will be required to sign this at your closing. This can also be referred to as a note payable.

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Be sure to clarify where and to whom you should be directing your loan payments, as well as the right contact person for any questions, as late payments can result in fees or other penalties.

THE DAY OF CLOSING

On closing day, you'll need to bring the required fees, any outstanding paperwork, your legal representative, and a certain amount of patience. Closing documents, including the promissory note and mortgage, can take many hours to review and, for legal purposes, require your repeated signature. Also, there may be last-minute changes that have to be made to your loan paperwork during the closing. If this happens, make sure you are comfortable with the edits and ask your legal representative to explain anything you don't understand.

CONSTRUCTION & REHABILITATION

The term of your construction or rehabilitation loan begins the day you close. For this phase, we review who from your team is involved during construction, and the process for submitting funding requests to your lender.

REQUISITIONS

Construction should be completed within the term of your loan. As noted, the term for your loan is specified in your commitment letter. Throughout the term of your loan, you can make requisitions on a regular basis, usually monthly.

A requisition is simply a detailed request for payment for the labor, materials, and other construction costs associated with your project. Your lender will have specific forms you are required to use and deadlines by which you must submit them in order for you to be paid in a timely manner.

The requisition process continues throughout the life of your construction loan. This means that once you receive payment for the previous month's expenditures, you should have already moved on to your next request. Because of this, creating a construction timeline with your GC is key to ensuring there are no delays in payment, or any ripple-effect delays in your project's completion.

In addition to carrying out all site work, you will need to host third-party and lender site visits, conducted to ensure your project is proceeding on time, on budget, and in compliance with code.

Generally, the monthly requisition process is as follows:

1. The GC completes a requisition form approved by the American Institute of Architects (AIA).
2. The borrower requests that the lender's third-party engineer visit the site to confirm that the work is completed and accurately reflected on the requisition form.
3. The third-party engineer completes a required report and submits it to the lender.
4. The lender reviews the report internally and performs standard due diligence. See the next page for a look at what specifically is reviewed.
5. Assuming no issues or questions arise, the lender remits payment to the borrower less any retention or standard holdbacks.

SITE VISITS

A lender will engage a third-party engineer to review requisitions and perform site visits. Although this engineer will work on your lender's behalf, this person is not the lender's employee. This means that your lender will most likely also have a staff person visit your site with some regularity throughout construction. Generally, this will be on a quarterly basis, but can be more or less frequent, depending on how your project is progressing. The staff person will be monitoring the progress of your project to ensure it will be completed in accordance with your loan terms. The staff person will also review the engineer's reports to confirm your GC has completed the work for which the contractor has submitted requisitions.

CHANGE ORDERS

Construction is subject to unexpected delays, particularly in the early stages of a project. For this reason, your construction or rehabilitation budget will have a line item called "construction contingency." This is generally 10–20 percent of the total cost of construction. By submitting a "change order," which is an AIA form, you will be able to use these contingency funds to pay for a certain amount of changes to the scope of work. A lender will try to ensure there is sufficient money in this contingency set aside throughout the project so that any unforeseen expenses that arise can be covered by the construction loan. Any expenses exceeding the contingency allotment are your direct responsibility to be paid for out of pocket.

An inside look at requisition review

We commonly hear from borrowers that the first requisition is the hardest simply because it is the first time going through the process. Here is a list of things to keep in mind when you're going through the requisition process:

- Your requisition documents will need to be signed by your architect, GC, and the lender's third-part engineer, and then notarized. This means that they all must agree on what percent of the project is complete before you can submit paperwork.
- A loan administrator will go through all submitted paperwork line by line. If there is any inconsistency in numbers, your requisition paperwork will be returned to you, and you will need to resubmit it. For this reason, you'll want to make sure that all parties are in agreement on all the numbers before you submit the paperwork.
- Your lender will run a title check on the property each time a requisition is submitted. A lender will not be able to pay on requisitions if the title search shows any new liens or other encumbrances.
- Your GC and subcontractors will be required to sign lien waivers and have them notarized.

CONVERTING YOUR CONSTRUCTION LOAN TO A PERMANENT MORTGAGE

At the construction loan term's end, you will need to pay off the full amount of the loan. This is generally done by obtaining a permanent loan to "take out" your construction loan. If you haven't already arranged a permanent take-out loan prior to beginning construction, you should be shopping for one while the construction phase is underway.

Prior to converting your construction loan to a permanent mortgage, you will need to meet certain thresholds. Some of these are similar to what we described earlier in the guide, and others have to do with proving that construction has been completed, residents are in place, and the project is cash flowing.

At CPC, converting to a permanent mortgage requires a separate closing; different lenders will approach the conversion process differently. Be sure to discuss this with your lender.

Sample Conversion Requirements

Here is a list of requirements that generally must be met prior to conversion:

- ☐ Satisfaction of any conditions laid out in your commitment or closing letters.
- ☐ Certification by the lender's construction expert (may be a third party or in-house) that the project has been completed.
- ☐ Attainment of the LTV and DCR required by the permanent lender
- ☐ Achievement of minimum rentals – a minimum level of stable income; i.e., a certain number of units have been leased or preleased at a minimally-acceptable rent level. This generally requires that you provide a certified rent roll.
- ☐ Issuance of a certificate of occupancy (or C of O) by the municipality in which your building is located.
- ☐ Your maintenance of an acceptable credit score and financial status over the term of the construction loan.

Add your own lender's additional requirements below:

PROPERTY MANAGEMENT

PROPERTY MANAGEMENT

Property management includes the whole range of activities you or your property manager will perform to ensure your small building stays occupied, in good health, and profitable over the long term.

Property management includes resident screening and selection, rent collection, repairs and maintenance, and payment of your debt service.

RESIDENT SCREENING AND SELECTION

For those undertaking construction or rehabilitation of a building, screening for residents may actually begin prior to the completion of your scope of work. You'll need to advertise that your units are available; local newspapers and retail establishments with public bulletin boards can be good options, as well as online sites. If you are managing the property yourself, you can also outsource this process to a local realtor, who will generally charge a fee to the people they place in your units.

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If you used subsidies for your project, there may be requirements about where and how you advertise to ensure that the people the subsidy is meant to serve are aware that your units are available and have the chance to apply to rent them.

It is illegal to use such factors as the race of applicants or whether they have children as reasons not to rent to them. Irrespective of whether you are aware of what your responsibilities are with respect to selecting tenants in advance, you are still liable for any infractions. There are legal requirements both for you as a landlord and for your building, and these can be different for your specific community, the state, and the country overall. For this reason, you may want to consult with your lawyer.

Marketing Your Apartments

By looking at advertisements for other apartments in your area, you can get a sense of what potential residents will want to know before contacting you to view your units. Such advertisements usually include information about bedroom sizes, access to public transportation, quality of schools, parking options, amenities, such as dishwashers, washers and dryers, and whether utilities are included in the rent. You will save time in apartment showings if you provide clear and honest details about your units, so resist any urge to embellish your description.

Rental Applications

Prior to showing your units, you should also have an application and lease ready. Basic application and lease templates can be found online. As we mentioned, laws can vary from place to place, so if you are using an online search, be sure to review relevant local laws. In addition to a resident application and lease, your state may require documentation, such as lead paint disclosure forms and window guard notices. By having these documents ready, you may be able to move faster when applicants show interest in moving in quickly. Again, you may want to have your lawyer review these documents prior to using them for the first time.

Check in with your lender about landlord training opportunities that may be available in the community in which your property is located.

RENT COLLECTION

You should decide in advance how, where, and when you wish to receive rent. Communicate these decisions both in person at the lease signing, and in the lease itself.

You may wish to give a small monthly discount to residents who are willing to commit to automatic debit payments, as these are very helpful in ensuring timely receipt of rent.

As noted previously, you should outline in the lease any late fees, charges, or steps you will take if rent is late or not paid. Lenders may ask to see a copy of your standard lease, as they have a vested interest in ensuring your property is generating cash. If residents do not pay you, you cannot pay back your loan.

ONGOING MAINTENANCE

Property operation and maintenance plays a large role in the long-term stability of your property. By visiting your property on a regular basis, you can ensure that any issues are proactively handled. You can conduct a walk-through of a boiler room and exterior of a building, and check in with your tenants to ensure everything is operating properly. As mentioned earlier, you will also want to be mindful of the operating life of any major systems to ensure these are replaced on schedule.

Small Building Financing Milestones

Keep this milestone list close by and use it as a quick reference to keep your project on track and on time.

PRIMER

- ☐ Calculate your small building's projected NOI.

PROJECT FEASIBILITY & PREDEVELOPMENT

- ☐ Engage with potential lenders.
- ☐ Determine your own skills and financial strength and who you might need to add to your team.
- ☐ Identify sources of information regarding what small properties in the municipality you're interested in are available to acquire.
- ☐ Research market characteristics, including demand, demographics, and comps.
- ☐ Research the zoning, building code, and community development requirements or plans in the municipality that interests you.
- ☐ If your project requires construction or rehabilitation, create a scope of work.
- ☐ Create pro forma I&E and construction or rehabilitation budget (as needed).
- ☐ Calculate your small building's supportable loan amount to determine project feasibility. (Use a lender's LTV and DCR requirements if relevant and accessible).
- ☐ If your project has a financing gap, speak to your lender about subsidy or other options.

CLOSING

- ☐ Review your commitment letter with your lawyer. Make sure you fully understand this legally binding document.
- ☐ Create a checklist of the documentation you must provide and of the requirements you must meet before you can close your loan.
- ☐ Confirm with your lender what you will need to bring with you to your scheduled closing.

CONSTRUCTION & REHABILITATION

- ☐ If your project involves construction, create a requisition schedule with your general contractor and architect.
- ☐ Familiarize yourself with AIA change order forms, in case you need to submit one as your project progresses.
- ☐ Create a checklist of the documentation you must provide and of the requirements you must meet before you can convert your loan.

PROPERTY MANAGEMENT

- ☐ Prepare a marketing plan for your units and create a standard lease.
- ☐ Identify and hire, if needed, a property manager or management company.
- ☐ If you are managing your property yourself, determine regular property maintenance requirements, including landscaping, plowing, and basic repairs, and identify any vendors you will need to support your building.

Glossary

AMORTIZING LOAN: a loan for which interest and principal are paid steadily throughout the loan's term.

APPRAISER: someone who determines the fair market value of a property.

AREA MEDIAN INCOME (AMI): the median income, generally defined by the U.S. Department of Housing and Urban Development, for a household in a given area.

ASSET: something you own that represents an economic benefit (e.g., cash, accounts receivable, or buildings).

BALLOON LOAN: when the loan term and amortization period do not match (e.g., 15 years versus 30 years), and, at the end of he loan term, the borrower is required to pay off the loan, the borrower must make a lump sum or "balloon" payment.

BUILDING CODES: the rules or standards set by a municipality that dictate how a building must be constructed.

BUILDING OUT: the customized interior changes a landlord may make to prepare a commercial space for a tenant.

CAPITAL: another word for money; see "debt" and "equity."

CASH FLOWING: when the cash inflows of a project are higher than cash outflows, during a given period.

COMMUNITY DEVELOPMENT OFFICE: a department in a municipality that is responsible for managing the housing and economic and community development needs of its residents.

COMPARABLES ("COMPS"): rental properties with similar characteristics as the property to which they are being compared. These characteristics generally include building size, age, class, amenities and location.

DEBT: capital that is lent with the expectation that the borrower will repay the full amount plus interest, on a regular basis, usually monthly.

DEBT SERVICE: the amount of money needed to pay the principal and interest of a loan.

EFFECTIVE INCOME (EI): projected income from a rental property, minus its anticipated vacancy and collection losses.

EQUITY: capital provided by you, your business partners, or an investor that is required by lenders as part of the total funding sources. Equity investors are generally rewarded by fees for use of their capital, a portion of the NOI (after your monthly debt payment is paid), tax benefits, and a portion of the property's value at the time of sale or some other predetermined time.

EXPENSES: the costs associated with keeping a rental property stable and well maintained.

FIXED RATE: an interest rate that remains the same during the term of the loan.

FULLY AMORTIZING LOAN: when the loan term and amortization period match (e.g., 30 years/30 years), such that the full loan amount will be paid off once the borrower reaches the end of the loan term.

GENERAL CONTRACTOR (GC): an individual or company who manages the daily logistics and oversight of a construction project.

HABITABLE: when a building is healthy (see definition of "healthy" below) enough for it to be occupied. One measure of a building's habitability is whether it meets a municipality's building codes.

HARD COSTS: direct construction costs.

HEALTHY: a stable and well-maintained property.

IMPUTED VALUE: assumed value given to an item when the actual value is not known or available.

INCOME: for a rental property, the money a tenant gives an owner in exchange for use of a space (residential or commercial units) or for use of an amenity (e.g., on-site parking or laundry).

INCOME VERIFICATION: in instances where subsidies are used, the process by which owners confirm that their tenants qualify given the income ceiling parameters for the subsidies.

INTEREST: amount charged to a borrower by a lender (as a percent of the loan principal) for a loan.

LAND BANKS: organizations which (generally in partnership with a government entity) acquire distressed buildings or land for the purposes of redevelopment (for the public good).

LAWYER: a person who practices law and is qualified to provide legal advice and services.

LEASE-UP THRESHOLD: a requirement (prior to converting a construction loan) that a certain percentage of a property's units have signed leases (even if the renters are not yet able to move in).

LIABILITIES: something that is a future obligation (money that has to be paid).

LINE ITEMS: entries in an income and expense statement or construction or rehabilitation budget.

MIXED USE: properties with a combination of residential and commercial uses.

MORTGAGE OFFICER OR LOAN OFFICER: an employee of a lender who helps borrowers through the process of borrowing money.

NET OPERATING INCOME (NOI): the difference between a rental property's income and its expenses, other than debt service.

PERFORMING: a performing property is one with low vacancy rates that is generating income in keeping with projections, with no large, unforeseen expenses, and that is paying its debt service.

PLAN AND COST REVIEW: a review of the architectural drawings and the construction costs of a particular project to ensure they are in line with industry standards.

PRINCIPAL: initial amount of a loan (not including interest payments).

PRO FORMA: an evolving set of calculations that help determine whether the project meets the feasibility criteria of you and your lender.

PROPERTY MANAGER: a person or company who is responsible for performing all activities associated with keeping a rental building operating efficiently and at full occupancy.

REALTOR: a real estate agent who supports the buying and selling of properties, usually for a fee.

RENT ROLL: a list of all of the tenants of a building, as well as the rents due and the rents paid.

SCOPE OF WORK: work to be performed according to a contract, broken down by cost per item.

SMALL BUILDINGS: generally understood to be any multifamily rental property (or combination of properties) with a total of between 5 and 49 units.

SOFT COSTS: any construction project cost that is not a direct construction cost.

SUBCONTRACTORS: individuals or companies hired during a project to perform trade-specific tasks, such as plumbing, electric, drywall, and painting.

STABILIZE: work performed on a property to ensure it is healthy.

SUBSIDY: funding provided by some level of government (e.g., municipal, county, or state) and made available to a project because that project has been deemed by the issuing entity to provide a public good.

TERM: the period during which a borrower will make payments on a loan. The loan may or may not be fully paid off at the end of the loan term (see amortizing loan).

THIRD PARTY: an individual or entity that is involved in the loan process but is not the borrower or the lender.

TITLE REPORT: a written analysis of a property's ownership and lien history.

TRAILING TWELVE MONTHS ("T-12"): documentation of a building's income and expenses from the prior 12 months.

UNDERWRITING: the due diligence lenders perform to ensure their borrowers (based on the likely performance of their rental properties), as well as their character, credit, liquidity, etc.) can repay their loans in a timely manner.

VARIABLE RATE: an interest rate that fluctuates during the term of a loan.

ZONING: the division of a municipality's land into zones, each designated for specific purposes and subject to associated regulations.

CPC would like to thank our many small building finance partners over the years, particularly those who contributed their time and expertise to the development of this resource, including:

Albany County Land Bank
A-Zone Properties, Inc.
Avante Contracting Corporation
Better Neighborhoods, Inc.
Bottom Line Construction & Development LLC
Buffalove Development
Capitalize Albany Corporation
Capital Bank
Center City Place LLC
Center for NYC Neighborhoods
City of Rochester
Community League of the Heights
Corinthian Group LLC
Energy Reduction Concepts, LLC
Enterprise Community Partners
Falcon Project Quality Management, NYC
Fulcrum Properties LLC
Harlem Congregations for Community Improvement, Inc.
High Impact Financial Analysis, LLC
Home Leasing
Mohawk Realty Partners
North East Area Development, Inc.
Northwest Bronx Community & Clergy Coalition
NYC Department of Housing Preservation & Development
NYS Homes and Community Renewal
NYU Furman Center for Real Estate and Urban Policy
PathStone Corporation
Patrick Dutton Company
Project Urbanista
Providence Housing Development Corporation
RiseBoro Community Partnership
Rosewalk Properties LLC
Settlement Housing Fund, Inc.
TLW Group Inc.
Town of Bethlehem
University Neighborhood Housing Program

This document was designed in collaboration with **TYTHEdesign.**

At CPC, we tailor our financing products to meet the needs of the communities we serve. For our full list of products, visit us online or contact your local CPC mortgage officer.

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