



Successful Solutions in a Tumultuous Market: Project Review for Residential Lenders

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Construction Lending

VOLUME!!!

- Warren Buffett said it best “It’s only when the tide goes out that you learn who’s been swimming naked.”

Agenda Project Review

- Budget
- Plans and Specification
- Construction Schedule
- Construction Contract
- Prepays
- Site Conditions
- Permits
- Environment Reports
- Soil Testing
- CCSI - Examples
- Wrap up

Construction Budget

A thorough budget is critical to a successful construction project.

- Does the budget follow a methodical process to build a home?
- Does it reflect all of the budget drivers?
- How is the budget presented?
- Is risk mitigation considered when reviewing the budget?

Key line items of the Project

Appliances	Framing
Bath Tile	Grading
Cabinets	HVAC
Counter Tops	Contractor Supervision and Overhead
Doors	Painting
Drywall	Plumb Fixtures
Electric Fixtures	Plumb Rough
Electric Rough	Roofing
Ext Finish	Windows
Flooring	
Foundation	

Budget Drivers

- Borrower
- Builder/Contractor
- Owner Builder
- Appraiser
- Loan to Value (LTV)

Budget Submission

- It seems like most every builder uses their own method to build a budget.
 - Back of a napkin
 - Excessive detail
 - Uses only individual knowledge
 - Allocating funds correctly
 - Budgets out of book
- Translation of the budget to the banks form.
 - Who handles that translation

Budget Risk Management

- Where does your organization manage budget risk?
 - Typical examples
 - Trust the budget provided by the builder
 - Appraiser cost analysis
 - Rely on a builder-appraiser comparison
 - Underwriter looks at the budget
 - Use a more advanced approach
 - Compare the budget line items against a data base of comparable projects

Budget Risk Management (con't)

- Additional budget risk areas:
 - Budget shortfall
 - Interest and Contingency Reserve
 - Loan underwritten to meet the banks policies
 - Permanent loan impacted (one time or two time close)
 - Borrowers unable to match equity

Plans & Specifications

- Plans and Specs are the instruction manual for the owners dream.
- Do the plans match the budget and borrowers expectation?
- Need a minimum of 3 copies with the application.
 - Lender, appraiser and underwriter
- Lenders collateral
 - REO implication
 - Complete a half built home

Construction Schedule

- Is it realistic?
 - Who is driving the term?
 - Borrower
 - Builder
 - Agency (Government)
 - \$3MM home built in 12 months
 - \$400K home built in 18 months
- Construction progress
 - Consistent
 - Inspection timing

Construction Contract

The contract between the Builder and Borrower needs to be completely reviewed.

- Key sections to review:
 - Fixed budget / Open budget
 - Borrower paid items
 - Builder compensation
 - Does it support the completion of the home
 - Timeline of the project
 - Front loaded
 - Penalty to borrowers for delays
 - Cost over runs

Prepays

- Composition of Prepays
 - Borrowers equity
 - How has the borrower presented Prepays
 - Receipts
 - Equity in property
 - Analyze for a balanced budget
 - Hot Spots

Site Condition

- Review the site before funding.
 - What is on the site?
 - Vacant, trees, mobile home or house
- Mitigate risk by completing a pre-funding inspection.
- Hot spots

Permits

- Critical to the project:
 - Have they been requested?
 - Have they been reviewed?
 - Have all city, county and state specific laws been followed?
 - Understand the average time to obtain a permit?
 - Hot spots

Environment Report

- Does the project make sense for the area?
 - Neighborhood
 - Access roads
 - Farm land
 - Mixed use
 - Train tracks
 - Protected animals and lands

Soils Report

- Do the Project, Plans and Budget support the type of soil?
 - Septic
 - Wells
 - Hill side
 - Radon gas
 - Previous structure
 - Geology shows underground obstacles
 - Neighboring properties

CCSI

- “CCSI” Custom Construction Scene Investigation
- Instructions
 - Original basic loan information
 - Current loan status
 - Would you:
 - Be glad you made the loan
 - Sell “As Is”
 - Complete construction
- Disclaimer:
 - Any similarities to loans you have made or are working on is just a coincidence.

Loan 1 - Loan Details

This loan was originated with the follow highlights:

•Loan Amount:	\$1,481,249
•Appraised Value:	\$2,001,000
•CLTV:	74%
•FICO:	755
•Borrower Information:	Full Document

Would you or your company have made this loan?

Loan 1 - Current Loan Status

•Loan Commitment:	\$1,481,249
•Amount Disbursed:	\$982,074
•Current UPB to Value:	262%
•Current BPO:	\$375,000
•Percent Complete:	16%
•Percent Disbursed:	66%

Loan 1 - Loan Details

•Builder Budget:	\$104/sq ft
•Appraiser Budget:	\$140/sq ft
•Comparative cost budget:	\$200/sq ft
•Difference:	(\$96)/sq ft

Loan 1 – Option Details

•Option One:	“As Is”
a.Gross Sales Price:	\$375,000
b.Less \$ Disbursed to date:	(\$982,074)
c.Less \$ required to complete:	<u>(\$ NA)</u>
d.Net Gain/Loss	(\$607,074)
•Option Two:	”Construction Completed”
a.Gross Sales Price:	\$900,000
b.Less \$ Disbursed to date:	(\$982,074)
c.Less \$ required to complete:	<u>(\$900,000)</u>
d.Net Gain/Loss	(\$982,074)

Loan 2 - Loan Details

This loan was originated with the follow highlights:

•Loan Amount:	\$3,420,000
•Appraised Value:	\$4,621,000
•LTV:	74%
•FICO:	752
•Borrower Information:	Full Document

Would you or your company have made this loan?

Loan 2 - Current Loan Status

•Loan Commitment:	\$3,420,000
•Amount Disbursed:	\$2,052,525
•Current UPB to Value:	114%
•Current BPO:	\$1,800,000
•Percent Complete:	0%
•Percent Disbursed:	60%

Loan 2 – Budget Analysis

•Builder Budget :	\$229/sq ft
•Appraiser Budget :	\$288/sq ft
•Comparative cost budget:	\$300/sq ft
•Difference:	(\$71)/sq ft

Loan 2 – Option Details

•Option One:	“As Is”
a.Gross Sales Price:	\$1,800,000 Lot
b.Less \$ Disbursed to date:	(\$2,052,525)
c.Less \$ required to complete:	<u>(\$ NA)</u>
d.Net Gain/Loss	(\$ 252,525)
•Option Two:	”Construction Completed”
a.Gross Sales Price:	\$3,700,000
b.Less \$ Disbursed to date:	(\$2,052,525)
c.Less \$ required to complete:	<u>(\$1,581,000)</u>
d.Net Gain/Loss	(\$ 66,475)

Loan 3 - Loan Details

This loan was originated with the follow highlights:

•Loan Amount:	\$2,100,000
•Appraised Value:	\$2,800,000
•CLTV:	75%
•FICO:	709
•Borrower information:	Full Document

Would you or your company have made this loan?

Loan 3 - Current Loan Status

•Loan Commitment:	\$2,100,000
•Amount Disbursed:	\$1,504,250
•Current UPB to Value:	125%
•Current Sales Price BPO:	\$1,200,000
•Percent Complete:	18%
•Percent Disbursed:	72%

Loan 3 – Budget Analysis

•Builders budget:	\$162 /sq ft
•Appraisal cost budget:	\$275 /sq ft
•Comparative cost budget:	\$275 /sq ft
•Difference	(\$113)/sq ft

Loan 3 – Option Details

•Option One:	"As Is"
a.Gross Sales Price:	\$1,200,000
b.Less \$ Disbursed to date:	(\$1,504,250)
c.Less \$ required to complete:	<u>(\$ NA)</u>
d.Net Gain/Loss	(\$ 304,250)
•Option Two:	"Construction Completed"
a.Gross Sales Price:	\$2,600,000
b.Less \$ Disbursed to date:	(\$1,504,250)
c.Less \$ required to complete:	<u>(\$1,187,000)</u>
d.Net Gain/Loss	(\$ 91,250)

National Association of Residential Construction Lenders (NARCL)
Top Five (5) Operational Issues

What have been the Top Five Operational Issues you have experienced, which has impacted your construction program?

- 1 Reduction in Staff (FTE's) – Doing More w/ Less**
- 2 Tools & Ability to Manage Completion Risk**
- 3 Concerns w/ Contractor Changes (Budgets, Timing, Lien Releases, etc.)**
- 4 Need for Technology to assist w/ Pipeline Management**
- 5 Ability to Efficiently Manage Default (Borrower, Project Status, etc.)**

National Association of Residential Construction Lenders (NARCL)
Top (5) Reasons for Loan Default, due to the Builder

What are the Top Five issues you have experienced with the Builder, that has led to problems with completion of the collateral and or a construction loan default?

- 1 Lack of Working Capital (Liquidity)**
- 2 Mis-appropriation (due to lack of control) in the Funding Process**
- 3 Projects - Front-Loaded or Poorly Analyzed**
- 4 Line of Credit Frozen or Cut Back**
- 5 Starts w/ Out Customer (Spec) & High Cancellation Rate**

Wrap Up

To review the key topics we reviewed:

- Importance to analyze all aspects of the project.
- Risk management starts with the budget.
- Use all tools available to mitigate risk.

Resources

- Information available from:
 - NARCL
 - Budget Forms
 - Surveys
 - Data resources
 - Various Risk Management Companies
 - Construction Lending Consultants

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- Construction Lending Background:
 - Division Executive Managing WaMu's Custom Construction Product
 - \$3.0+ Billion in sales
 - \$3.5 Billion in disbursement
 - Developed and Managed outsourced functions
 - Evaluated outsourcing components and entire process
 - Acquired construction portfolios from bankrupt mortgage companies
 - Warehouse lending group had sublimits to facilitate construction products
 - Currently consulting with a number of companies on asset risk management to portfolio acquisition
 - The good, the bad and the ugly