Refinancing

What is your lender thinking?

Alterna

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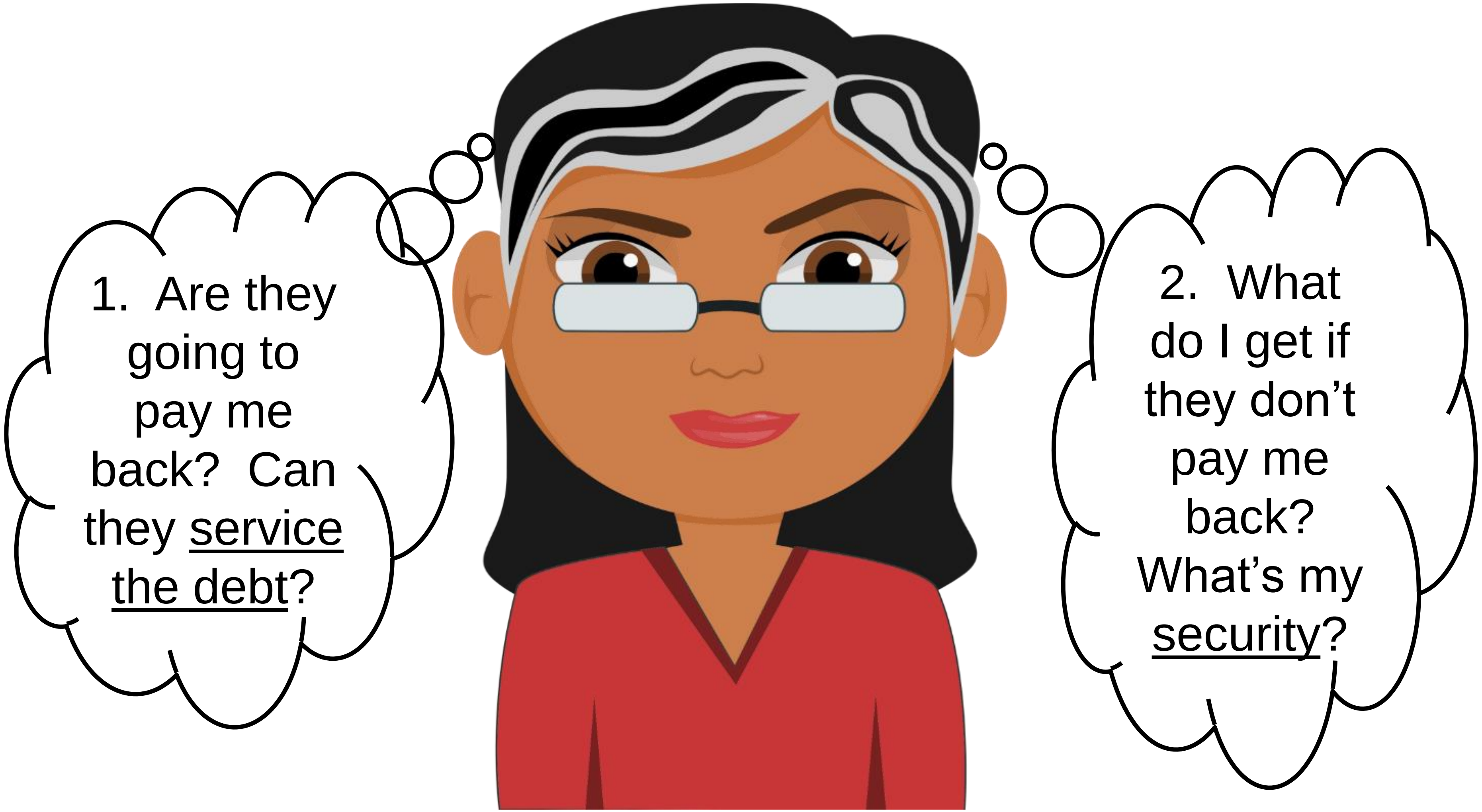
April, 2018

How Lending to Housing Co-ops Works

Your lender is looking for good answers to two fundamental questions



Lender’s Valuation vs.Realtor’s Valuation

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

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

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

What can the Borrower Afford?

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

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

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

How is Underwriting NOI Determined?

- Starts with your Income Statement
- NOI = Income – Expenses

(excludes non-cash items & property related debt)

NB

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

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

	2017
Rental Income	$ 1,126,052
(rental arrears)	$ -
Subsidies & Grants	$ 90,644
Laundry, Cable etc.	$ 62,119
Other Income	$ -
Total Income	$ 1,278,815
Management	$ 150,664
General Maintenance	$ 101,532
Utilities	$ 111,404
Taxes	$ 139,531
Insurance	$ 50,234
Sector Membership dues and Conferences	$ 17,616
Bad Debts	$ 2,340
Reserves*	$ 198,531
Total Expenses	$ 771,852
Net Operating Income	$ 506,963

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

How is Debt Service Determined?

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

Example

Existing mortgage replaced by new $4.75 million first mortgage.
Annual principal plus interest payments of $306,669.
Thus total Debt Service is $306,669.

Debt Service Coverage Ratio - Example

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

$$\frac{\$506{,}963}{\$306{,}669} = 1.65$$

After every dollar spent on operating and debt servicing this housing coop has $0.65 to cover the unexpected.

Debt Service Coverage Ratio - Example

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

$$\frac{\$506{,}963}{\$306{,}669} = 1.65$$

After every dollar spent on operating and debt servicing this coop has $0.65to cover the unexpected.

At Alterna we typically look for a DSC of 1.35 for a first mortgage when working with housing cooperatives.

$$\frac{\$506{,}963}{\$374{,}930} = 1.35$$

In our example the housing coop also had a second mortgage. This added an additional debt service requirement

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

Valuation - A Simplified Example

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

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

Underwriting Valuation – Example

	2017
Rental Income	$ 1,126,052
(rental arrears)	$ -
Subsidies & Grants	$ 90,644
Laundry, Cable etc.	$ 62,119
Other Income	$ -
Total Income	$ 1,278,815
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* Reserve requirements will depend on age and condition of building as well as what is mandated by any operating agreements in place

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

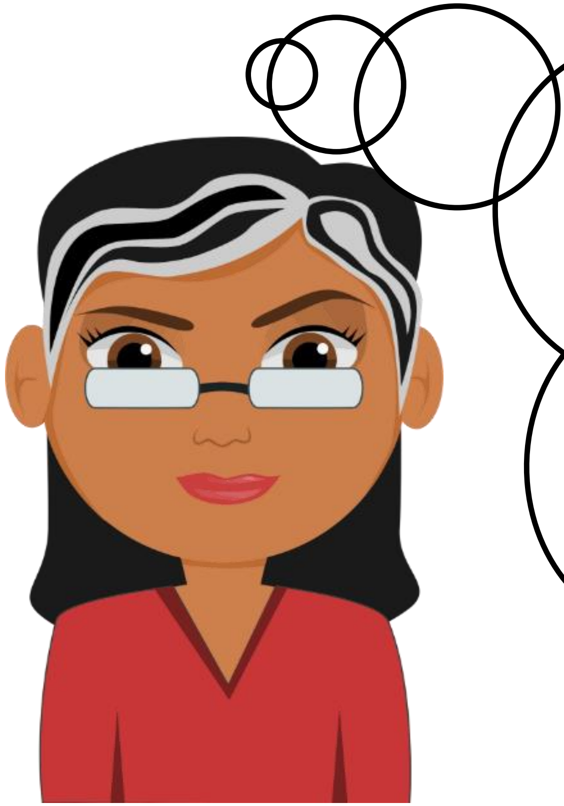
$$\frac{\$506{,}963}{0.06\%} = \$8{,}449{,}383$$

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

$$\frac{\$4{,}750{,}000}{\$8{,}449{,}383} = 56.21\%$$

Max LTV is 75% of underwriting value

Lending Principles for Housing Cooperatives

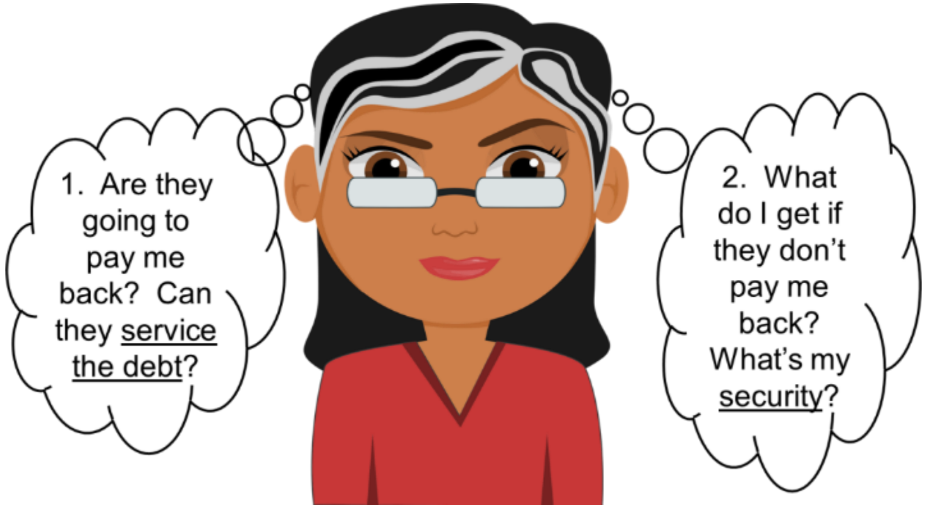


1. Can this housing cooperative afford this debt?
2. Do they have the funds they need to cover their operating expenses?
3. Do they have the funds to continue to maintain this property over the full amortization period?

Summary - What is your Lender Thinking

- They have a solid reserve fund
- Their DSC on our debt is 1.65
- Total DSC on all debt is 1.35
- **"I'm confident that they can service the debt"**

- The building is in good shape and they have the reserve funds and ongoing contributions to maintain it
- Mortgage of $4.75million is for 56.21% of the $8.5million value of the building
- **"I'm comfortable with how this loan is secured"**



How Subsidies are Treated by a Lender

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

Hidden Costs

Additional costs that you will need to budget include:

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

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

Where does it go sideways?

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

Contact Information

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