PERMANENT LOAN TECHNICAL ASSISTANCE GUIDE

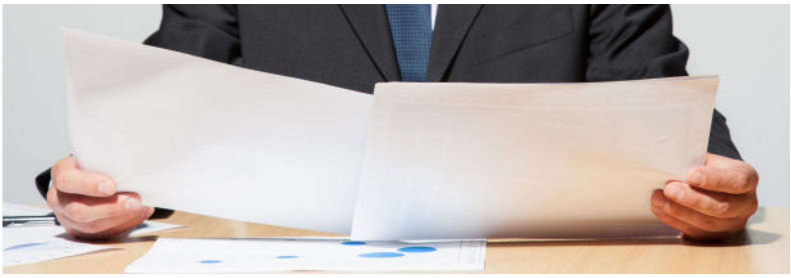
Even if your organization already owns residential or commercial buildings, real estate finance options can be confusing. Your focus is on your mission of providing affordable homes and apartments and supporting your community's residents. You may not have a lot of extra time and energy to also become an expert on permanent loans.

But financing to support your mission is exactly what we do at NeighborWorks Capital, which is why we created this guide. Most multifamily permanent lenders rely on cookie-cutter loans that can be quickly sold to investors. Those investors want to purchase loans with consistent characteristics and limited risk. Partners like NeighborWorks Capital offer more flexible options outside the rigid parameters prescribed by most national financial institutions.

Comparing the various offerings can be a daunting task. This guide will help you decode some of the important elements of permanent loans for residential and commercial properties. We've included guidance about things to consider when you need to refinance your building or are looking to buy a new one. Let's help you find the loan you need to advance your mission.

How to compare loan terms

Finding the permanent loan that best supports your mission involves more than comparing interest rates and closing fees. There are a handful of other important, but less obvious, factors that determine the value of your loan and how much it will cost over time. They include: debt coverage ratio, loan-to-value ratio, replacement reserves and repayment premiums.



Debt Coverage Ratio (DCR)

The most important factor in determining how much you can borrow is how much debt service (principal and interest payments) your property can afford to pay.

Lenders determine how much you can borrow by comparing your debt service for the year to the net operating income (NOI) of the property—how much it makes after all expenses are paid. The ratio of net operating income to debt service is the debt coverage ratio or DCR.

Most institutional lenders use a minimum debt service ratio of 1.25x, so your property has to generate at least 25% more NOI than the debt service payment. For example, if your debt service payments total $50,000 in a year, the property needs net income of at least $62,500 ($62,500 ÷ $50,000 = 1.25).

If you are refinancing a property that you've owned for a long time, your new loan amount may be small relative to the NOI, giving you a high DCR. This is what institutional lenders look for, because it means less risk to their investors. But your property and mission needs might require a lower DCR than an institutional lender will allow. For this kind of flexibility you should consider lenders that are familiar with mission-focused organizations and affordable housing.

Loan-to-Value Ratio (LTV)

The industry standard for maximum loan to value ratio (LTV) is 80%. That means the amount you borrow cannot be more than 80% of the property's appraised value. This is not an obstacle for most refinancing transactions. If you're refinancing out of an older,maturing loan, amortization and increasing property values might work in your favor.

However, if you're purchasing a property or revitalizing a distressed property, an 80% LTV can present a significant obstacle. You, as the buyer, may need to invest 20 percent or more of the purchase price to close

the transaction. An older or distressed property might also need capital investment right away to address critical repairs or make improvements to improve occupancy.

A twenty-percent down payment reduces the lender's risk, but a nonprofit organization may not have that much capital to contribute. Plus, investing cash in a property reduces the resources available for pursuing other opportunities related to your mission. Fortunately, it's a barrier some lenders are willing to address. For example, NeighborWorks Capital allows LTVs as high as 95% in some cases. This means you need less cash for a new purchase or recapitalization, and have more to invest in other mission activities.

In short, when comparing permanent loan options, don't just look at interest rate. Consider the LTV so you can evaluate where to invest your money to do the most good.

Replacement Reserves

Every apartment property needs repairs, major and minor, over the course of its life. Fortunately, these repairs are (usually) predictable. Even if a property is currently in good condition, the costs of some major items–new roof, boiler, siding, concrete, HVAC system–are more than the property can generate from operations in a year.

Because permanent loans are a long-term partnership, your lender should work with you to plan for capital investments during the life of the loan. Setting aside replacement reserves every year ensures that you have the cash on hand when you need it for an expensive capital expense. The amount you'll need to set aside is determined by how much work the property needs, and when, during the term of the loan.

A building engineer will prepare a Property Condition Report after a thorough inspection and investigation of the property–the HVAC system, roof and siding, windows and doors, fire safety and egress, concrete and paving, appliances, and even carpeting. The PCR will estimate the capital investment needed over the life of the loan. By including an inflation factor (a new roof in 8 years will cost more than a new roof today), the Property Condition Report will forecast how much essential repairs will cost.

Some lenders calculate replacement reserves using a simple formula based on age and project size. Other lenders don't require any at all. This might seem like a good deal, but it leaves your property at risk and will require you to cover these costs from operations or out of pocket.

On the other hand, a supportive lending partner wants to make sure the property stays in good repair so you can continue to support your communities and fulfill your mission. A well-funded replacement reserve also gives you peace of mind that you can cover major costs when they inevitably arrive. It prioritizes mission sustainability over quick profit.

Prepayment Penalties/Premiums

Many homeowners refinance their mortgages when interest rates go down. That's not an option for most multifamily permanent loans, because they are sold to investors, and investors want a predictable return for a predictable period of time. Most permanent loans include lock-out periods, when no early payment can be made, and prepayment premiums–fees for early repayment. These premiums increase the cost of refinancing and tie your hands when a refinance is needed.

Flexible lending partners may still have prepayment premiums, but they tend to be more forgiving than those prescribed by institutional lenders. For example, while most institutional lenders keep a prepayment penalty in place for the full term of their loan, prepayment premiums on a NeighborWorks Capital loan are only in effect for the first five years of your loan term. This flexibility allows you to pivot to meet new challenges or pursue new mission opportunities.

Choosing the right lender

The four factors described above will help you compare different loan terms, but how do you decide which lender is the right choice for your property? Consider these five factors to select a lender who will be the right fit.

1. **Compare interest rates and payments.** While interest rates don't capture the full cost of your loan, they are a big part of it. Make sure to ask if the rate will adjust at some point during the loan, and what index will be used to determine the new rate. Payments are also determined by the amortization period. Most loans are amortized over 30 years. A 15-year amortization, which will pay down that principal faster, will have 48% higher payments. Your property may also need an interest-only period, so you can make lower payments while you complete repairs or focus on increasing occupancy. Not all lenders can or will offer interest-only payments.

2. **Establish timelines.** Closing on time can mean the difference between success and disappointment. Early in the application process, be sure to set timelines with your potential lender. Work with them only if you're confident they will close when you need them to and on the loan terms you are expecting.

3. **Investigate closing fees and costs.** Talk to lenders about the expected costs to underwrite and close the loan—origination fees, the costs of third-party reports, title and escrow charges, legal fees, etc. Most lenders won't promise an exact figure, but they should be able to provide a good estimate.

4. **Ask about recourse and guarantees.** One of the advantages of many institutional loans is that they are non-recourse. That means they won't pursue your organization's assets if there is a default and foreclosure. To get a nonrecourse loan you'll need a low Loan-to-Value ratio, high DCR, and a host of escrows, reserves, and fees you'll pay at closing and during the loan. If a loan is particularly risky, a lender may require the sponsor (or the owner) to provide a repayment guarantee. That's exactly what it sounds like: if the property cannot make the payments, the guarantor must make them. Guarantees and recourse often "burn off" over the early part of the loan term as long as the property performs as expected and the loan balance is paid down on schedule.

5. **Find a lender who will support you.** Even if you've done this before, the process of application and underwriting can be confusing. It helps if you have a lending partner who is willing to answer your questions and walk you through the process to closing, as well as the ongoing reporting for the loan. Make sure the lender you choose is one you feel comfortable partnering with for the life of your loan.

How to prepare for your loan application

One of the best ways to ensure that your loan request is processed quickly is to assemble as many of the documents and as much property information you can at the beginning of the process. These include:

- Financial statements for the property - at least the last two full years and the current year to date
- Your organization's financial statements - the last three annual audited financials, plus your most recent quarter-end balance sheet and income statement
- The purchase contract, or purchase offer, if you're acquiring the property

- Information on any existing loans or use restrictions on the property, usually from a state or local government agency (like a housing finance agency)
- Estimates for the costs of planned rehabilitation or new construction
- Market analysis if the development will be new constructionAppraisals, environmental reports, or surveys you may have for the property

Your lender should give you a list of all required documents, statements, reports, and property information. Not sure what you need? Just ask.

What your lender will consider

All permanent lenders underwrite loans by evaluating the strength of the sponsor (that's you) and the performance history and financial performance of the property. These elements will include:

- Your organization's experience as a multifamily property ownerYour property management with the market and with the resident population
- Your organization's financial strength and capacity to deal with disruptions in occupancy, control operating costs, manage maintenance and repairs, and cover occasional operating deficits
- Your history with your lender and other lenders
- What kind of resident services and programs you provide that support positive operations
- The operating history, market position, and potential for maintaining and increasing rentsVariabilty of operating expenses and how they compare to other properties in your portfolio and the local market
- The property's condition, how much capital investment is needed, both immediately and over the term of the loan, and the property's capacity to pay for it

Don't worry, your lender will ask for any other information or documentation they need. Keep the lines of communication open and try to respond to any information requests as quickly as possible. This will help keep your loan application moving through the underwriting and approval process.

Partnering with NeighborWorks Capital

If you're considering NeighborWorks Capital for your permanent loan, the best first step is to call or email one of our Loan Officers. You'll find all of our contact information at the end of this Guide.

Because NC is not an institutional lender, we have a streamlined underwriting and approval process. We can almost always close loans within 90 days of the first discussion, and much faster than that if needed.

Our loan officers offer guidance and support throughout the loan application, underwriting, and closing process. If you have questions, reach out. **We're here to help.**

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