SQUARE FEET

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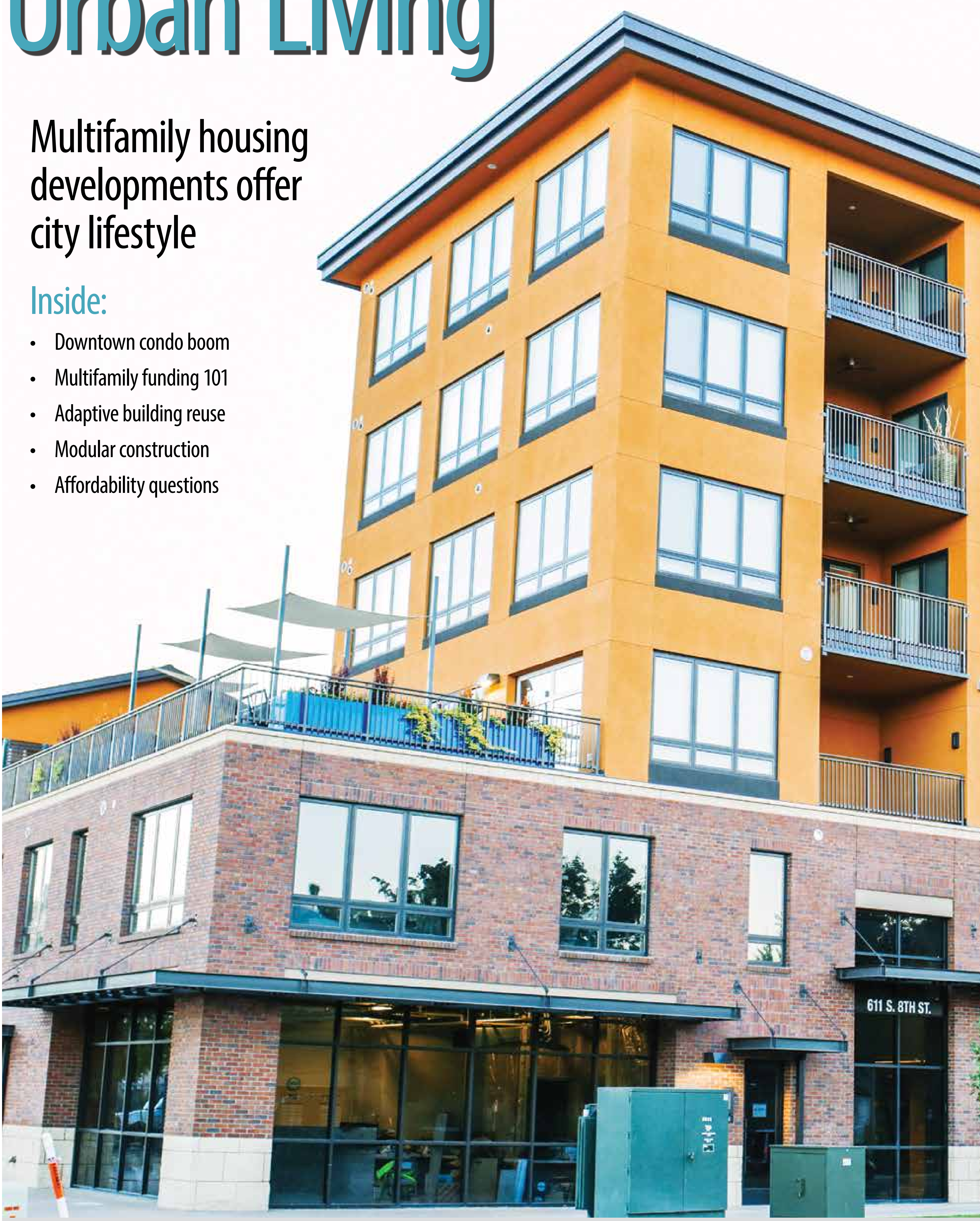
Urban Living

Multifamily housing developments offer city lifestyle



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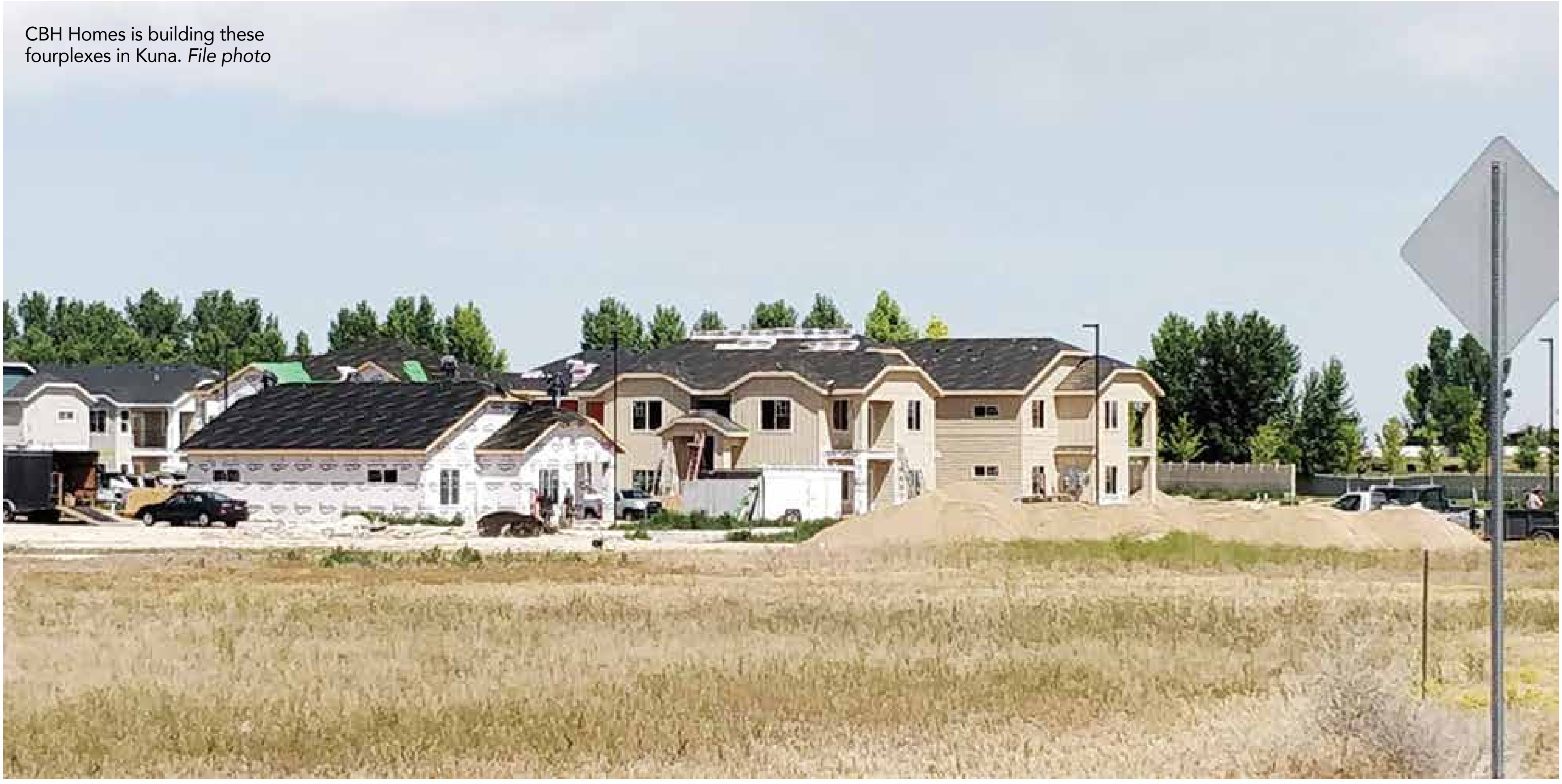


CBH Homes is building these fourplexes in Kuna. *File photo*

Multifamily housing funding 101

By Sharon Fisher
Idaho Business Review

Looking to build multifamily housing? You're in luck.

There are more tools than ever before to finance multifamily construction, financial experts say. The sorts of tools available depend on the kind of multifamily project the developer wants to build.

One factor is how many investors are involved, said Jeff Huhn, Boise metro market president for First Interstate Bank.

"For a private developer, that could be an individual or a single-purpose entity that is funded by a number of individuals who are investors," he said. "Most typical is simply a private individual, often a limited-liability corporation, between that private entity and the bank."

To underwrite such a loan, a typical developer needs to bring in 20% to 40% of the total project costs, said Keith Bagwell, senior vice president and credit officer for First Interstate Bank, who is responsible for commercial loans in Idaho of more than $1 million.

"The equity and capital that borrowers have had to bring in has increased simply because the cost to purchase the land and construction costs have continued to go up," he said.

In any downtown metropolitan area, renters have higher expectations in terms of quality, such as finishing, than in a more suburban area, Huhn said.

"It creates difficulty finding contractors with experience building that type of project, with higher costs to complete the construction."

The market has created demand for apartments all over Idaho, such as the Lake Apartments in downtown Coeur d'Alene. *Photo courtesy of Jim Schueler*

A typical multifamily project in downtown Boise, for example, costs $5 million to $30 million, Bagwell said. That would mean the equity requirement could be $1 to $6 million, or even higher, Huhn said, though they can cover it through the value of the land.

Many multifamily projects depend on Federal Home Loan Mortgage Corporation (Freddie Mac) or Federal National Mortgage Association (Fannie Mae) federal insured loans because they typically have better interest rates, said Coni Rathbone, partner at Portland-based Dunn Carney LLP, adding that they were the source of the majority of the loans in her company. National companies such as Berkadia Commercial Mortgage, JLL Securites and Greystone often do these loans, she said.

"It used to be that insurance companies were big players in this area," Rathbone said. "I don't think they are as big of a player anymore

"Opportunity Zones are other means to incentivize developers and property owners to develop and build projects in geographic locations that might otherwise be passed over because it doesn't provide return on investment for the developer. The incentives Opportunity Zones offer make them more compelling for individuals"

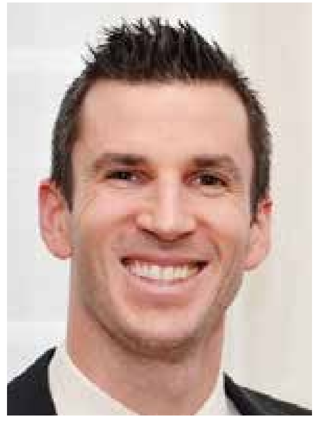
—Keith Bagwell, senior vice president and credit officer for First Interstate Bank,

because they can't compete with Freddie Mac in interest."

For example, she's aware of one $14 million apartment project with 3.86% interest and another apartment project in Boise, funded by Idaho Central Credit Union, at 4.25% interest, she said.

For that reason, developers sometimes get a group of investors together to raise money, Bagwell said. It can be a formal arrangement such as a Real Estate Investment Trust (REIT) or simply a group of people who pool their money.

"As Idaho has continued to get more national attention, we're seeing more groups from out of the area invest in real estate," he said. "The challenge there, from the financial side, is we want to make sure if we're lending to an individual or a company that we have strong sponsors."



Keith Bagwell

Coni Rathbone

"It's not at all uncommon for people to do securities offerings to raise the equities piece," Rathbone said. "Maybe it'll be three or four friends who come together for the equity. If it's a huge project, they may sell it on CrowdStreet Investing or one of the other portals."

Types of housing

Rathbone looks at multifamily real estate in four categories, she said. First is "affordable" housing, which is partially funded through government subsidiary. Next is "workforce" housing, which is intended for families with a median income of 60% to 120% of the region. Third is market rate, and fourth is luxury, she said.

The challenge with funding affordable housing, which uses a government subsidy, is that it comes with a number of additional government regulations, Rathbone said.

"Workforce and affordable are the same product, the same basic apartment, but workforce doesn't get subsidies," she said. "You can build workforce housing cheaper than affordable."

Rising land and construction costs are also affecting the type of multifamily units that are being built, Bagwell said.

"If you pull reports on construction throughout the Pacific Northwest, you'll see disproportionate luxury or higher-end units being built," he said. "With construction and land costs being so high, clients are already putting up so much cash getting the deals done," so they have to charge higher prices, he said.

"It pencils for them, but it doesn't work for affordable living for the population," he added.

Those costs also influence the size and scale of the projects, Huhn said.

"The land cost is so much higher that you want to get a bigger project because you're doing more units on less land with higher density," he said. "There are plenty of developers and investors doing smaller multifamily projects in suburban areas."

For example, developers are constructing groups of fourplexes in Treasure Valley cities such as Meridian, Kuna, Nampa and Caldwell, Kuhn said.

"Because the project is smaller, the investor or developer can come in with less required upfront," he said.

Fourplexes might cost $250,000 to $500,000, so for a $350,000 fourplex, 30% down would be $105,000, and the bank would finance the rest, Bagwell said. Fourplex requests in Kuna and Star have incrementally spiked over the past 18 months, he added.

And it's not just in the Treasure Valley. Northern Idaho cities such as Coeur d'Alene, Post Falls, Rathdrum and Hayden are also seeing these investments from people in western Washington, Bagwell said.

Due to market demand, developers of such projects are typically doing them either as an investment for a source of recurring revenue or already have a buyer lined up to purchase the project – often coming from California or Seattle – once it's completed, Huhn said.

"Those buyers are doing the same thing: Buying an income stream."

And it's not just the rising cost of housing that is juicing people's interest in apartments, said Rathbone.

"Millennials have changed that aspect entirely," she said. "They not only can't afford a house, but they don't want to be tied down."

The same is true for baby boomers, she added. "Generational changes have changed that view of home ownership."

Options after construction

Once the building is completed, developers have more options, Huhn said. When construction is completed and the complex reaches a certain level of occupancy for a minimum period of time, the project then qualifies for long-term financing by the U.S. Department of Housing and Urban Development (HUD).

"The advantage for long-term HUD is they can get a much longer amortization period to repay the loan, and they can get a very long – up to 40-year fixed – interest rate on that permanent financing," he explained.

And banks are fine with that.

"We don't go into construction and stabilization blind to the fact that that makes the most sense for our clients," Bagwell said. "There are some deals we hold on the books for 10 years, but others where we know that's the end goal, and we work in tandem with them to facilitate that."

Alternatively, a multifamily project could get sold to a REIT, though that doesn't happen much in Idaho, Huhn said.

"REITs are securities where they pull together money to build a variety of real estate projects," Rathbone said. "There's a number that just handle multifamily housing."

Like any trust, it has beneficiaries – in this case, the people who put in the cash – and it could have as many as 100 multifamily projects, she said. A similar form is a Delaware statutory trust, she added.

Alternative funding options

More recently, developers of multifamily housing have another funding option, Opportunity Zones. Opportunity Zones, a community development program established by Congress in the 2017 Tax Cuts and Jobs Act, are intended to encourage long-term investment in low-income urban and rural communities through tax breaks. Thus far, two – both involving multifamily construction – have been announced in Idaho: one in Twin Falls and one in Meridian, though workforce housing projects are also being finalized for Twin Falls and McCall.

"Opportunity Zones are other means to incentivize developers and property owners to develop and build projects in geographic locations that might otherwise be passed over because it doesn't provide return on investment for the developer," Bagwell said. "The incentives Opportunity Zones offer make them more compelling for individuals."

"Their existence is a great thing for the market," Huhn agreed. "They've been established in areas that, without those tax advantages, the project might not get done."

First Interstate is financing one such project that probably wouldn't be built if it weren't for Opportunity Zones, Bagwell said, though he couldn't specify the project.

Other types of financing include low-income housing tax credits, or LIHTEC, which come from the federal government.

"They're typically not on the same scale as the Opportunity Zone projects we've looked at, but they're another mechanism for more affordable housing that serves a greater population than luxury apartments," Bagwell said.

Urban renewal agencies can also help finance multifamily projects, such as The Afton condominiums in Boise, where the developer partnered with Capital City Development Corp. (CCDC), Huhn said.

"That was land owned by CCDC," he said. "They sold that land to the developer and had an agreement that, once each phase was completed, they would refund the cost of that land back to the developer. The cheaper land costs helped make the overall economics of the project work."

An artist's rendering of the future Old Town Lofts Opportunity Zone project in downtown Meridian. *Image courtesy of City Center Redevelopment*