Land a Loan for Land Alone

Emphasize five elements when seeking land financing from private-money lenders

By **Daniel Edrei,** director of principals groups, Meecorp Capital Markets

With existing-home prices stabilizing, new residential construction prolific and the cost of money rising, many traditional commercial lenders have become gun-shy about financing land subdivisions and development transactions.

Land deals often are the first to be affected by a real estate market sway. Currently, lenders are restricting, reducing and even revoking lines of credit for land development. The supply of capital for these deals is shrinking despite growing demand. Even the best borrowers with extensive experience and proven track records are feeling the pinch as they try to raise the money they need to remain active.

For many developers, taking on a partner and forfeiting the lion's share of the equity seems the only viable alternative. Fortunately, however, they have another option: Seek out a private lender that specializes in such transactions and that has the willingness, patience and know-how to take on the additional risk.

The key to lending on land is patience. Traditional lenders cannot afford to be patient. They are working on thin spreads and have to worry about stockholders. Private-money lenders can afford to wait. Land isn't going anywhere. No one is making any more of it. Should there be a default, as history has proven time and again, the investment eventually will be recouped.

Brokers should consider five major points when evaluating a land-acquisition or development deal: 1. location; 2. value; 3. exit strategy; 4. loan to value (LTV); and 5. borrower qualifications. Of course there are other elements to consider in any financing, but brokers should help lenders understand how these five elements will protect their investment.

Location

Location is the foundation on which the loan is built. Smart lenders want to know what's going on in a particular market. What is the demand for the product? Is the area in transition? What new construction is going on in the area and how will it affect the subject property? Will the city help with further development? Are there governmental incentives and tax abatements to develop the submarket? Are there environmental challenges to consider?

Lenders like to understand why a buyer or lessee would be interested in a property. A feasibility study will be especially helpful.

Property value

The property's value is of utmost importance. It is a figure that lenders hope will move upward. Lenders love to do transactions that involve an immediate infusion of capital into the dirt. They will be most interested in hard costs, rather than soft costs that may prove irrelevant to another user. Every dollar that goes into actual development, preliminary or otherwise, will increase the property value.

After the infrastructure goes in, the property becomes exponentially more marketable. As residential units are built, collateral becomes even more secure. Every lender wants to see its caterpillar become a butterfly.

Exit strategy

The exit strategy can take on many forms. It may involve the sale of whole parcels of land, individual lots or housing units, or it could involve refinancing with more-conventional loans.

Without a solid exit strategy, however, a project will likely fail or the borrower default. This will lead to imminent foreclosure. Worse still, if the transaction has limited potential for a safe exit, it could become a big white elephant that can't be sold. If it can't sell, it has no value.

Astute private lenders have no interest in pursuing projects that are likely to fail. They are not in the "lend to own" business. They would rather see borrowers be successful and return to finance another project.

Loan to value

The LTV is the private lender's barometer for risk. Depending on the quality of the other variables, and assuming the transaction is acceptable, a comfortable LTV and/or loan-to-cost (LTC) ratio will solidify the loan. The location, exit strategy and borrower's experience will help determine the level of risk. Of course, the higher the risk, the lower the ratio.

There are times when the LTV will be broken into separate stages dependent on predefined phases of construction. For example, lenders might approve a loan based on 50-percent LTV

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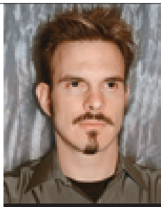

Daniel Edrei is director of principals groups for Meecorp Capital Markets, a privately owned commercial real estate lender and investment banker specializing in value-added commercial real estate projects. Contact him at (201) 944-9330, or visit the company's Web site at www.meecorp.com.

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on the land plus 60-percent LTC of the infrastructure and 70-percent LTC of housing development. Borrowers may sometimes be allowed to increase the LTV or LTC if they reach certain milestones or attain previously agreed-upon targets.

Borrower qualifications

Many find it curious that a borrower's qualifications are last on the list. But even the most-competent borrowers occasionally find themselves holding a property that cannot meet their initial expectations.

There are many unexpected variables that can influence a property. Market volatility may cause a shift in appetite for the subject property. The economic feasibility for the project can start to waver. Rising interest rates could sabotage an exit strategy that relies on refinancing. Faltering presales and preleasing or overly optimistic preconceptions could result in the deal lacking adequate cash flow. The list goes on.

Yes, experience speaks volumes, but the borrower's qualifications can only amount to icing on the cake. The private-money land lender likes to see the property speak for itself. If the other four points are weak, lenders will not be enthusiastic about the deal.

Every loan is a jambalaya of moving variables that affect the feasibility of financing and the overall success of the project. But the viability of financing through traditional lenders may, in some cases, be unrelated to a project's impending success. Sometimes certain loans simply fall out of fashion. To private lenders with patient money, however, those loans can represent new opportunities.

Executive Summary

The 5 points to evaluate in a land-acquisition or development deal:

1. **Location:** Location is the foundation on which the loan is built.
2. **Property value:** Lenders hope this figure will increase quickly.
3. **Exit strategy:** Without a solid exit strategy, a project will likely fail or a borrower will default.
4. **Loan to value:** This is the private lender's barometer for risk.
5. **Borrower qualifications:** Even the most-qualified borrowers occasionally have a property that cannot meet their expectations.

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