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THE POPULARITY OF LIFE COMPANY CONSTRUCTION TO PERMANENT, TAKEOUT FINANCING

By Antonio Hachem, Principal, George Smith Partners in Los Angeles

Floating-rate debt offered by banks for ground-up construction was very attractive in the recent past. With the increase to LIBOR, rising interest rates and the fear of unpredictability in the capital markets, however, borrowers are more attracted to longer-term debt construction financing with fixed rates at funding for the entire loan term. Construction to perm financing and takeout financing upon completion of construction — prior to stabilization with life insurance companies — is becoming more popular.

Life companies have experienced a high demand for their products through the first half of 2018. This demand is expected to continue through the end of the year and beyond. Life companies offer attractive fixed-rate terms from five to 30 years that can exceed the construction period. Having takeout financing available at the beginning of the loan process provides peace of mind to borrowers. These loans are assumable, and the borrower is able to increase loan amounts during the term of the loan without having to pay off the original loan. These top-offs or add-ons are done by amending the original loan documents and blending the new rate with the old rate. This has helped mitigate heavy pre-payment penalty structures, including partially locked periods, yield maintenance and/or step downs. Other benefits include limited to no post-closing covenants after stabilization, no minimum occupancy requirements, no impounds or reserves and no minimum net worth covenants.

Some borrowers maintain a few misconceptions about life company loans. A few falsely believe that the only way to receive higher proceeds is to obtain a new loan upon stabilization, or that life companies only lend on Class A and large-scale projects. Life companies are normally more conservative than other lenders when it comes to construction to permanent loans. Thus, a borrower should understand that they can receive more proceeds in the long-term once a property has performed and increased its NOI. Smaller-scale projects can get funding beginning at $10 million for multifamily in both primary and secondary markets.

If you want permanent financing at construction completion prior to stabilization, that is possible with life company loans. This cannot be accomplished with traditional permanent financing such as bank, CMBS or agency financing. Joint venture and preferred equity for ground-up projects is readily available — and permanent financing after stabilization is readily available — however, permanent financing prior to stabilization is only available through life companies. This type of financing is in demand by developers now that we are in a rising interest rate environment. Life companies also provide structured, high-leverage participating loans from 85 percent to 95 percent LTC for well-located projects with experienced developers.


Hachem

A client wanted to refinance a construction loan for a newly built, vacant, 54-unit multifamily project in Sherman Oaks, Calif. I proposed a 10-year loan from a life company. The client originally was not interested in a life company loan due to the pre-payment structure with yield maintenance, in addition to his uncertainty about owning the asset for the long-term. I explained to the client that this loan would become part of the marketability of the property. I demonstrated to the client that the loan was assumable and that a new buyer would appreciate the low fixed rate, in addition to potentially increasing proceeds in the future if the property exceeds projections.

Chasing interest rates is always a gamble. Consider locking in a long-term rate and allow yourself to focus on your next project. ■

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