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Nonrecourse loan options for smaller properties

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Much has been written about the strength of the Denver apartment market and the near historically low interest rates available for nonrecourse loans (loans without a personal guarantee) on larger apartment properties. Since banks, which generally require a personal guarantee, historically have dominated financing smaller apartment properties (those with approximately 100 units or less) less attention has been paid to available nonrecourse options.

Recently, very attractive nonrecourse options became available for smaller properties. Previously offered only on larger transactions, these options provide competitive rates and terms, such as the lack of personal guarantee, extended interest-only periods and leverage up to 80 percent of value. For owners looking to acquire or refinance smaller multifamily properties, there have never been more options. This article provides a brief description of the key characteristics of nonrecourse loans for smaller apartment properties.

- **Eligible properties.** Any multifamily property with more than five units and a loan amount of approximately $1 million or higher is eligible to take advantage of nonrecourse financing options. Depending on the specifics of the deal, certain student, military, foreign ownership, mixed-use, and land use restrictive agreement or Low-Income Housing Tax Credit properties also are eligible. Loans within major metropolitan statistical areas such as Denver receive the most-aggressive pricing, but nonrecourse lenders will consider loans in smaller markets both locally and nationally.
- **Competitive rates.** For higher-leverage loans, rates for five-, seven- and 10-year fixed-rate, nonrecourse deals are equal to or better than bank options. Approximate rates today for five-year deals would be around 4 percent, seven-year deals would be approximately 4.25 percent and 10-year deals would be approximately 4.5 percent. For lower-leverage deals, rates can be at or below 4 percent even for terms fixed for longer than 10 years. Substantial pricing reductions also are available for properties with at least 50 percent of units renting at or below 60 percent of the area median income. Rates generally are locked with a signed application and refundable deposit.
- **Leverage.** For acquisitions, nonrecourse loans are available for up to 80 percent of the purchase price, assuming a minimum debt coverage ratio of 1.20x is met. For refinances in which owners have owned their property for two years or more, nonrecourse loans are available up to 80 percent of the property's value. Leverage on properties owned for less than two years generally is capped at 90 percent of the owner's basis, which is the purchase price plus any closing costs and capital expenses incurred during ownership. These levels of leverage and DCR exceed recourse bank options.
- **Amortization and interest-only periods.** The standard amortization period is 30 years with interest-only periods available depending on the loan term. On a 10-year term, most properties qualify for three years of interest only. Most seven-year deals qualify for two years of interest only, with five-year deals qualifying for one year. The increased cash flow resulting from the interest-only period is crucial for those owners intending to execute a capital improvement plan. Full-term, interest-only loans are available at lower-leverage levels.
- **Terms available.** Fixed-rate terms of five, seven or 10 years are available for higher-leverage deals. For lower-leverage deals, fixed-rate terms of up to 20 years are available. "Hybrid" loan structures also are offered at all leverage levels. The hybrid structure provides a 20-year term with an initial fixed-rate period of five, seven or 10 years followed by a floating-rate period for the duration of the term. The hybrid loan structure provides prepayment flexibility during the floating-rate period should a sponsor want to sell the property or refinance into a fixed-rate loan.
- **Prepayment structures.** Property owners have numerous prepayment premium options, as shown on the chart. The "standard" prepayment premium would be a fixed percentage of the outstanding principal balance, starting at 5 percent, declining by 1 percent annually or biennially. For those owners who intend to hold their property for the duration of the loan term, yield maintenance is available, at a substantial rate savings. For owners who desire more flexibility, less costly options are available, generally starting at 3 percent of the outstanding principal balance in year one. Loans also are assumable for a 1 percent fee.

Small Loan Prepayment Options

	Pricing Adjusment	Prepayment Structure: 5-Year Term	7-Year Term	10-Year Term
Yield Maintenance	-15 bps (5 Yr) -20 bps (7 & 10 yr)	YM	YM	YM
"Standard" Prepay	0 bps	5-4-3-2-1	5-5-4-4-3-2-1	5-5-4-4-3-3-2-2-1-1
"Flex" Prepay	+15 bps	3-2-1-1-1	3-3-2-2-1-1-1	3-3-3-2-2-2-1-1-1-1
"Flex+" Prepay	+20 bps	3-1-open	N/A	N/A

Note: Numbers shown in prepayment structure reflect percentage of then-oustanding princial loan balance each year.

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Today, property owners have numerous prepayment premium options to choose from.

- **Closing process.** The closing period typically is 45 to 60 days. It generally takes 45 days to obtain a commitment with closing following in three to five days. Purchasers should consider this timeline when determining loan objection and closing deadlines in their purchase and sale agreement.

Closing costs vary by loan, but are comparable to most recourse loan options. Post-closing reporting requirements are similar to recourse loans and do not include the production of tax returns or DCR covenants.

It is impossible to determine where rates will be at the end of 2018, but with monetary decision makers balancing the need to increase rates in order to curb inflation with the desire to maintain the strength of the commercial real estate market, now is an excellent time to lock in rates that still are near historic lows and do not require a personal guarantee, before rates increase.▲