Moderate Rehab vs. Value-Add: Heads You Win, Tails You Win

2017 Regional Seller Workshops
What is Mod Rehab?

- More extensive renovation plan
- $25K-$60K per unit
- Min. of $7,500/unit of interior work
- Fund up to lesser of 80% of “as-is” value or acquisition cost and up to 80% renovation cost
- Float (Interim) to Float or Fixed (Permanent)
- Sponsors – experienced, well-capitalized
Structure and Term

- **Interim Phase:** 2-3 years
  - Floating rate, uncapped
  - Typically Interest Only (IO)

- **Permanent Phase:** 7 or 10 years
  - Can be fixed or floating
  - If floating, a cap will be required

- **Initial Funding at origination (Initial UPB):**
  - Min. DSCR of 1.20x I/O based on As-Is NOI
  - Typical interim sized based on 7-year FRE sizing note rate

- **Rehab plan may not take DSCR below 1.0x I/O**

- **Initial Funding Plus Draws (Fully Funding UPB):**
  - Min. DSCR of 1.30x amortizing on As-If Stabilized Today NOI
Renovations

- Periodic draws monthly or quarterly as work is completed
- Allows for changes in construction budget under 20%; above that must be approved by Freddie Mac
- Renovation timing – up to 33 months (assuming 3-year Interim Phase)
- All units must be habitable within 6 months of conversion
- All renovation work must be complete within 3 months of conversion
- Priority Repairs, Operational Repairs and Green Improvements can be included in renovation budget and have escrows waived
- Replacement Reserves
  » Deferred during Interim Phase
In Comparison to Value-Add…

- 3+1+1 loan structure
- Renovation of $10,000/unit with a min. of $5,000 for interior upgrades
- Renovations not funded
- Up to 85% LTV upfront, down to 1.15x DSCR
  » Does not fund on renovations
- Must support 1.30x / 75% exit
  » Exit as if improved today
Additional Requirements

- Operating Deficit Guaranty
- Completion Guaranty for 80% of approved budget and all work initiated
- Borrower and Seller/Servicer will need to provide:
  - Pre-Construction Analysis Report
  - Construction and Development Budget
  - Construction Schedule
  - Lease-Up Schedule
  - Final plans and specifications for all renovations
  - Construction Contract
Requesting a Mod Rehab Quote

- Narrative should include:
  - Summary of renovation budget, scope of renovations and timelines
  - Tax analysis for both As-Is and As-If Stabilized Today scenarios
  - Sponsor’s experience and success with other types of mod rehab properties
  - Thorough rent increase/expense savings analysis

- Need 2 LSTs
  1) As-Is LST presents Initial UPB, As-Is NOI and Value & Interim Phase loan terms
  2) As-If Stabilized Today LST presenting Fully Funding UPB, As-If Stabilized Today NOI and Value & Permanent Phase loan terms
Underwriting: Third-Party Resources

- **Freddie Mac website:**
  

- **Mod Rehab Best Practices:**
  
  - [Appraisals](#)
  - [Property Condition Due Diligence](#)
  - [Sizing and Submission](#)
  - [Servicing, Renovation Monitoring and Draws](#)
Underwriting: Appraisals

- Conclude Two Values:
  1. As-Is Value
  2. As-If Renovated and Stabilized Today hypothetical market value

- Provide rents, property taxes, expenses, cap rates from properties with similar renovations
  » Must include separate sales and rent comparables for both value approaches

- **Freddie Mac Multifamily Green Advantage**<sup>SM</sup>: Additional Green values do not need to be provided by the appraiser.
Underwriting: Pre-construction Analysis Reports

- Engage the Architectural Consultant ASAP
- Replacement Reserve tables
  - Two Replacement Reserve tables:
    - As-Is Replacement Reserve
    - As-Stabilized Replacement Reserve
  - Schedule length will be total term plus two additional years
  - ESA: No added responsibilities