

PLANNING AND DEVELOPMENT CONSULTANTS INTERNATIONAL, INC.

Draft Final Report

WORKING GROUP SESSIONS ON CONSTRUCTION FINANCE

**St. Petersburg, 7-10 June 1994
Nizhny Novgorod, 14-16 June 1994**

Prepared for

**United States Agency for International Development
Bureau for Private Enterprise
Office of Housing and Urban Programs
Washington, DC**

Prepared by

**PADCO, Inc.
1012 N Street, NW
Washington, DC**

Contract No. CCS-0008-C-00-2057-00, TO #37

August 1994

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***Disclaimer:** Before using the Russian language version of the following overheads, the user is advised to check the accuracy and consistency of the translation due to the technical content.*

**WORKING GROUP SESSION ON HOUSING CONSTRUCTION FINANCE
14 - 16 JUNE 1994
NIZHNY NOVGOROD**

AGENDA

OBJECTIVES OF WORKING GROUP SESSION

- ▶ to identify the role construction lending should play in housing development;
- ▶ to share professional experiences and exchange views on real estate lending in general and construction lending in particular;
- ▶ to identify impediments and what methods and approaches are likely to be successful; and
- ▶ to develop action plans to address impediments and to implement promising approaches to construction lending.

Tuesday, June 14, 1994

9:30 a.m. **Session 1.1: OPENING AND INTRODUCTIONS**

- ▶ Official Opening and Welcome
- ▶ Introductions
- ▶ Goals and Expectations
- ▶ Working Group Session Objectives
- ▶ Guidelines
- ▶ Overview of the proposed World Bank loan project

Session 1.2: INTRODUCTION TO CONSTRUCTION LENDING

- ▶ Objectives
- ▶ A definition of construction lending
- ▶ Roles of developers, bankers, and city officials

11:30 a.m. **COFFEE & TEA BREAK**

11:45 a.m. ▶ Purpose of a construction lending program
▶ Benefits of construction lending
▶ Road map for construction lending
▶ Risks and rewards of construction lending

1:00 p.m. **LUNCH**

2:00 p.m. ▶ Legal Framework and risk assessment for construction lending in Russia: Panel

Discussion

- 2:45 p.m. **Session 1.3: MODEL CASE STUDY**
- ▶ Introduction to case study, purpose, and objectives
 - ▶ Construction costing
 - ▶ Evaluation of equity and assets
 - ▶ Team work analysis of case study

- 5:30 p.m. ▶ Discussion of case study

- 5:45 p.m. **SUMMARY AND CLOSURE**
- ▶ Burning questions
 - ▶ Feedback and evaluation of the day
 - ▶ Preview of Day Two and homework assignment

Wednesday, June 15, 1994

- 9:30 a.m. **Session 2.1: WARM-UP AND REVIEW**
- ▶ Open forum: questions and answers

Session 2.2: MODEL CASE STUDY

- ▶ Presentation of team work
- ▶ Discussion

- 11:15 a.m. **COFFEE & TEA BREAK**

- 11:30 a.m. **Session 2.3: IMPEDIMENTS TO CONSTRUCTION LENDING**
- ▶ Identification of impediments
 - ▶ Steps and strategies to overcome impediments

- 1:00 p.m. **LUNCH**

- 2:00 p.m. **Session 2.4: ACTION PLANS FOR IMPLEMENTATION**
- ▶ Actions and measures to create conditions for construction lending
 - ▶ Recommendations

- 3:00 p.m. **Session 2.5: LESSONS LEARNED & SUMMARY**

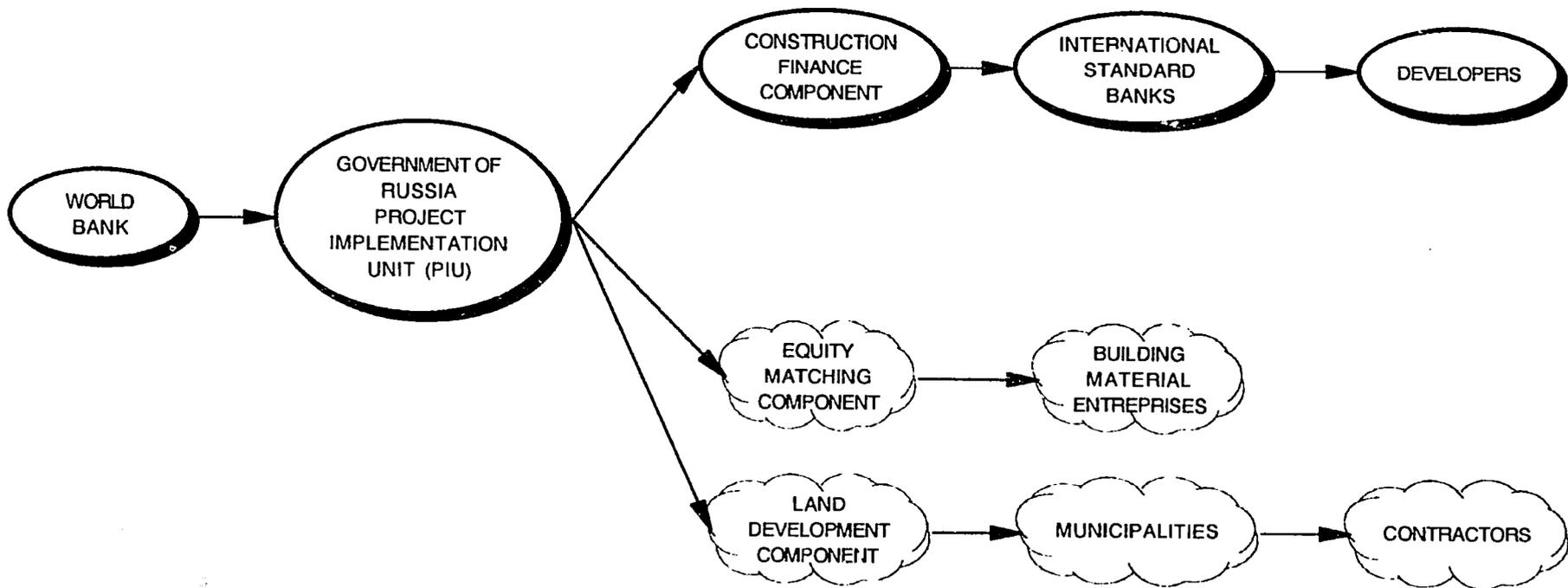
PARTICIPANT EVALUATION OF WORKING GROUP SESSION

3:30 p.m. **CLOSING CEREMONY**

4:00 p.m. [Optional] Individual consultations with working group specialists may be arranged.

5:00 p.m. **RECEPTION**

HOUSING FINANCE
LINE OF CREDIT



- Principal Objectives:

- ▶ To share professional experiences and exchange views on real estate lending in general and construction lending in particular
- ▶ To identify what role construction lending should play in housing development
- ▶ To identify impediments and what methods/approaches are likely to be successful
- ▶ To develop Action Plans to address impediments and to implement promising approaches to construction lending

- Roles

- ▶ Developers package, seek approvals, finance and build projects; must be willing to borrow at prevailing interest rates and under the other terms and conditions
- ▶ Bankers evaluate credit risk of developers and projects and provide debt financing; must be willing to manage risks and lend under prevailing economic conditions
- ▶ City Officials establish land use and building guidelines, review and approve projects; should be willing to stimulate or encourage housing development by ensuring land and infrastructure is available at economic prices

Road Map for Construction Lending

1. Developer with a Project Needing Construction Financing
2. Bank with Funds Willing and Able to Provide Construction Financing
3. Loan Application Submitted to Bank by Developer
4. Loan Review by Bank
5. Commitment Letter with Terms and Conditions Issued by Bank to Developer
6. Negotiation between Bank and Developer on Terms and Conditions of Commitment Letter

Road Map for Construction Lending

7. Satisfaction of Commitment Letter Conditions by Developer
8. Construction Loan Closing and Initial Disbursement of Funds to Developer by Bank
9. Additional Fund Disbursements by Bank to Developer as Construction Progresses; Bank Monitors Construction Progress and Quality
10. Developer Repays Bank Construction Loan Principal and Interest at Completion of Construction or Sell-Out

The Construction Loan — An Introduction

- **Purpose**
 - ▶ To provide the developer with a funding commitment in a confirmed amount to pay for labor, materials, and other project-related development costs
- **Benefits**
 - ▶ Provide cash to pay for labor, materials, and other development costs without having to rely on continued purchase proceeds from buyers
 - ▶ Help in controlling costs by enabling the developer to pre-purchase materials

The Construction Loan — An Introduction

- **Benefits (cont'd.)**
 - ▶ Help in controlling costs by enabling the developer to complete construction on time
 - ▶ Provide evidence to buyers that construction will be completed in a timely manner
 - ▶ Require developers to conform to established financing practices

Construction Loan Application Requirements

Project

- Type
 - ▶ single-family
 - ▶ multi-family
 - ▶ sale
 - ▶ rental

- Location
 - ▶ city
 - ▶ district
 - ▶ site
 - ▶ access
 - ▶ services

Construction Loan Application Requirements

- Total Project Cost
 - ▶ land
 - ▶ infrastructure
 - ▶ materials
 - ▶ labor
 - ▶ taxes and fees
 - ▶ professional services
 - ▶ administration/overhead
 - ▶ loan interest during construction

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Construction Loan Application Requirements

- Expected Project Sources/Revenues
 - ▶ developer's equity
 - ▶ buyers' initial payments
 - ▶ buyers' installment payments
 - ▶ construction loan proceeds
 - ▶ buyers' final payments

or

 - ▶ rental payments

- Environmental Issues
 - ▶ ground
 - ▶ air
 - ▶ water

Construction Loan Application Requirements

- Governmental and Other Approvals
 - ▶ zoning
 - ▶ utilities
 - ▶ design
 - ▶ construction
 - ▶ occupancy

Case Study Objectives

- To evaluate the advantages and disadvantages of a construction lending program from a bank's perspective
- To help prepare a preliminary loan application for a specific project
- To evaluate the proposed borrower and the proposed project for the bank and make a recommendation
- To present this recommendation to the bank's "Loan Approval Committee"

Team Case Study Objectives

- To prepare actual projects for financing
- To present projects to a “Loan Approval Committee”
- To discuss project preparation and loan application procedures
- To identify specific recommendations for improving these procedures

Construction Lending Risks

- The borrower may not have sufficient cash and loan funds to complete construction
- The project may not attract enough buyers at prices that will cover the costs
- The actual rate of inflation in building materials may exceed projections
- The actual rate of interest on the construction loan may exceed projections
- The borrower, due to other liabilities, may become bankrupt
- The bank, due to other liabilities, may fail

Repayment of Construction Loans

- Buyers' deposits, installment, and final cash payments on pre-sold units
- Buyers' cash payments as units are sold
- Developer's cash payment
- Short-term mortgages or installment loans (1-3 years) to buyers from banks
- Medium-term mortgage loans (4-10 years) to buyers from banks
- Long-term mortgage loans (10+ years)

- Primary Market

- ▶ Residential mortgage loans
- ▶ Mortgage loans (or permanent financing) for apartment buildings, etc.
- ▶ Primary lenders also may make land acquisition and development loans and construction loans

- **Primary Market Participants**

- ▶ Portfolio Lenders. The money that portfolio lenders use to make mortgage loans comes from deposits held by the institution as well as other sources, such as the Secondary Market. Examples of portfolio lenders include:

- Commercial Banks
- Savings and Loan Associations
- Credit Unions

- ▶ Mortgage Bankers. Mortgage Bankers obtain all of the money that they use to make mortgage loans from the Secondary Market.

- Primary and Secondary Mortgage Markets

- ▶ Primary Mortgage Market. Generally, the market in which mortgage loans are originated; that is, the market in which funds are lent to borrowers who execute mortgages as security for repayment of the loan.

Lenders in the primary market may originate loans and hold them in their own portfolios or sell the loans into the Secondary Market.

- Primary and Secondary Mortgage Markets (cont'd.)
 - ▶ Secondary Mortgage Market. The market where existing mortgage loans and mortgage-related securities are bought and sold; that is, the market in which lenders may sell mortgage loans (which they made to borrowers) to investors or the reselling of mortgage loans among investors.
- Primary and Secondary Mortgage Market Participants
 - ▶ Financial institutions can and do participate in both the Primary and Secondary Markets, originating mortgage loans, selling them, and buying mortgage-backed securities collateralized by them.

- Secondary Market Functions

- ▶ Provides liquidity
- ▶ Reduces the cyclical flow of mortgage capital
- ▶ Facilitates the distribution of mortgage capital
- ▶ Reduces the regional variations in the cost of capital
- ▶ Provides geographic diversification
- ▶ Links the mortgage markets to the capital markets

Location

- Site acceptable to intended market
- Good access by roads
- Good access by public transportation
- Accessible to:
 - ▶ schools
 - ▶ shopping
 - ▶ medical facilities
 - ▶ employment centers
 - ▶ recreational and cultural centers

Credit Information

- Financial Condition
 - ▶ Balance Sheet
 - Assets
 - » cash
 - » real estate
 - » motor vehicles
 - » accounts receivable
 - » personal property
 - furniture
 - jewelry
 - » other

Credit Information

- Financial Condition
 - ▶ Balance Sheet (cont'd.)
 - Liabilities
 - » mortgages
 - » loans payable
 - » accounts payable
 - » taxes
 - » other
 - Net Worth (total assets less total liabilities)

Credit Information

- ▶ Income Statement
 - Cash Flow from Real Estate Owned
 - Other Business Income
- ▶ Equity in Project
 - Land
 - Pre-Paid Expenses
 - » zoning fees
 - » building permits
 - » architect's fees
 - » site improvements
 - » building materials
 - » labor

Negotiable Elements of Construction Loan

- Amount
- Term
 - ▶ Time to construct
 - ▶ Time to complete sales or leasing
- Interest Rate
 - ▶ Fixed
 - ▶ Floating against an indexed rate
- Interest Payments
 - ▶ Monthly, quarterly, semi-annually, annually
 - ▶ Capitalized

Negotiable Elements of Construction Loan

- Fees to Bank
 - ▶ Application
 - ▶ Commitment
 - ▶ Servicing
 - ▶ Other
- How Fees Are To Be Paid
 - ▶ Up front
 - ▶ Pro-rated on a scheduled basis
 - ▶ Paid from loan proceeds
 - ▶ Other
- Guarantees

Commitment

- Purpose and security
- Loan amount
- Interest rate
- Maturity
- Extension options
- Repayment conditions
- Requirement for loan closing

Commitment

- Documents required:
 - ▶ Note/obligation
 - ▶ Mortgage
 - ▶ Construction loan agreement
 - ▶ Assignment of contracts
- Fees and expenses
- Disbursement terms and conditions
- Date by which commitment must be accepted
- Date by which loan must be closed
- Insurance requirements
- Title requirements

Commitment

- Environmental matters
- Survey
- Governmental approvals and permits
- Utilities

Environmental Issues

- Soil
 - ▶ On-site
 - ▶ Surrounding area
- Air
- Water
- Building

Loan Budget

CATEGORY	PROJECT COST	EQUITY	LOAN
Land	\$	\$	\$
Direct/Hard Costs			
Indirect/Soft Costs			
Loan Fees			
Interest			
	\$	\$	\$

Risks and Rewards

- Developer

- ▶ Risks

- Loan amount insufficient to complete construction
 - Bank does not approve work and refuses to advance funds
 - Interest rate increases
 - Sale proceeds not sufficient to repay loan
 - Exposure for interest and principal
 - Failure of lender (U.S.A.)

Risks and Rewards

- Developer (cont'd.)
 - ▶ Rewards
 - Greater certainty and efficiency in development process
 - Known source of funds to build project
 - Builder does not have to rely on periodic contributions from purchasers of homes to continue construction
 - Builder deals with fewer sources of funds (one bank as opposed to many buyers)

Risks and Rewards

- Banks
 - ▶ Risks
 - Builder unable to complete project
 - Builder's cost estimates incorrect
 - Builder becomes bankrupt
 - Units don't sell or buyers cannot obtain funds to close
 - Sale proceeds not sufficient to repay loan

Risks and Rewards

- Banks
 - ▶ Rewards
 - Income from interest and fees
 - Customer relationship leading to other business
 - Recognized as helping community develop by financing construction projects
 - Can provide mortgages for home buyers

Worksheet #1

Total Development Cost Budget

Project Name _____

Number of Units _____

<u>Cost Category</u>	<u>Cost</u>	<u>% of Total Cost</u>
Land	_____	_____
Construction Costs (Hard Costs)		
Shell	_____	_____
Finish	_____	_____
Development Costs (Soft Costs)	_____	_____
Builder's Profit	_____	_____
Required Sales Revenue	_____	100%

NOTE: The Development Costs above do not include construction loan interest or financing fees associated with the construction loan. These costs would need to be added.

Worksheet #2
Sources of Funds for Total Development Costs

<u>Source of Funds</u>	<u>% of Total Construction Funding</u>
Builder's Equity and/or Landowner's Equity	_____
Buyers' Installment Payments	_____
Bank Construction Loan	_____
TOTAL	100%

- Главные цели

- ▶ Обмен профессиональным опытом и взглядами на ссуды на недвижимость вообще и ссуды на строительство и развитие в частности
- ▶ Определение роли ссуд на строительство в развитии жилищного сектора
- ▶ Определения препятствий на пути развития и методов/подходов с наибольшей вероятностью успеха
- ▶ Разработка Планов действий с целью устранения препятствий и внедрения в сферу ссуд на строительство обещающих методов/подходов

- Роли

- ▶ Пакет строительных объединений, утверждения, проекты по финансированию и строительству; должны быть готовы получать ссуды под доминирующие в данный момент на рынке проценты, а также на других условиях
- ▶ Банки оценивают степень риска данного строительного объединения и проекта и предоставляют долговое финансирование; должны быть готовы идти на некоторый риск и предоставлять ссуды на доминирующих в данный момент на рынке условиях

- Роли (cont'd.)

- ▶ Городские чиновники определяют характер землепользования и основные направления в строительстве, пересматривают и утверждают проекты; должны быть готовы поощрять и стимулировать развитие жилищного сектора посредством создания гарантий обеспечения земель инфраструктурой по экономическим ценам

Дорожная карта для ссуд на строительство

1. Строительное объединение с финансированием проекта со строительными потребностями
2. Банки, готовые и имеющие возможность обеспечить финансирование строительства
3. Заявка на ссуду, поданная в банк строительным объединением
4. Изучение ссуды банком
5. Письмо, содержащее условия и обязательства, выпущенное банком и переданное строительному объединению

Дорожная карта для ссуд на строительство

6. Переговоры между банком и строительным объединением об условиях и обязательствах данного письма
7. Удовлетворение строительной компании письмом, содержащим условия и обязательства
8. Финальная стадия оформления ссуды на строительство и первичная выдача средств строительному объединению банком

Дорожная карта для ссуд на строительство

9. Дополнительная выдача строительному объединению средств банком по мере хода строительства; мониторинг банком хода строительства и его качества
10. По завершению строительства или продаже строительное объединение выплачивает банку основную ссуду на строительство с процентами

Ссуда на строительство — Введение

- Цель
 - ▶ Обеспечить строительное объединение фондовым обязательством в утвержденном размере с целью оплаты за труд, материалы и другие расходы по проекту
- Преимущества
 - ▶ Обеспечение наличностью, идущей на уплату труда, материалов и других расходов по проекту, освобождая себя от зависимости от постоянной прибыли с продажи покупателям
 - ▶ Содействие в контроле цен посредством обеспечения строительной компании возможностью приобретать материалы по предварительной договоренности

Ссуда на строительство — Введение

- Преимущества (cont'd.)
 - ▶ Содействие в контроле цен посредством обеспечения строительной компании возможностью закончить строительство в срок
 - ▶ Обеспечение покупателей доказательствами того, что строительство будет закончено в срок
 - ▶ Заставляет строительные компании отвечать установленным требованиям существующей практике финансирования

Требования, предъявляемые к заявке на строительную ссуду

Проект

- Тип
 - ▶ односемейный
 - ▶ многосемейный
 - ▶ продажа
 - ▶ аренда

- Местонахождение
 - ▶ город
 - ▶ район
 - ▶ окрестность
 - ▶ доступность
 - ▶ бытовые услуги

Требования, предъявляемые к заявке на строительную ссуду

- Общая стоимость проекта
 - ▶ земля
 - ▶ инфраструктура
 - ▶ материалы
 - ▶ труд
 - ▶ налоги и пошлины
 - ▶ профессиональные услуги
 - ▶ администрация/начальство
 - ▶ проценты ссуды на строительство

Требования, предъявляемые к заявке на строительную ссуду

- Предполагаемые проектные финансовые источники/доходы
 - ▶ собственный капитал строительного объединения
 - ▶ первичные взносы покупателей
 - ▶ задатки покупателей
 - ▶ поступления по строительной ссуде
 - ▶ окончательная плата покупателей
или
 - ▶ плата за аренду
- Вопросы экологии
 - ▶ земля
 - ▶ воздух
 - ▶ вода

Требования, предъявляемые к заявке на строительную ссуду

- Утверждение правительством и другими государственными органами
 - ▶ зонирование
 - ▶ коммунальные услуги
 - ▶ проект/дизайн
 - ▶ строительство
 - ▶ занятость

ЗАДАЧИ ИЗУЧЕНИЯ ПРОЕКТА

- Оценить преимущества и недостатки программы строительной ссуды с точки зрения банка
- Помочь в подготовке предварительной заявке на ссуду на отдельный проект
- Оценить кандидатуру предполагаемого должника и сам предполагаемый проект и дать соответствующие рекомендации
- Представить данные рекомендации банковскому “Комитету по утверждению ссуды”

ЗАДАЧИ ИЗУЧЕНИЯ КОМАНДЫ ПРОЕКТА

- Подготовить данный проект к финансированию
- Осуществить презентацию проекта “Комитету по утверждению ссуды”
- Обсудить процессы подготовки проекта и подачи заявки на ссуду
- Определить конкретные рекомендации по оказанию содействия данным процессам

РИСК ССУДЫ НА СТРОИТЕЛЬСТВО

- Должник может не обладать достаточным количеством наличности и средств по ссуде достаточных для завершения строительства
- Проект может не привлечь достаточное число покупателей по ценам, покрывающим все затраты
- Действительный процент инфляции в области строительных материалов может превысить предполагаемый проектом
- Действительная процентная ставка на данную строительную ссуду может превысить предполагаемую
- Должник, в связи с прочими обязательствами, может объявить банкротство
- Банк, в связи с другими обязательствами, может оказаться несостоятельным

ВЫПЛАТА СТРОИТЕЛЬНОЙ ССУДЫ

- Депозиты покупателей, задатки и окончательные сумму платежей при пред-продаже жилых единиц
- Выплаты наличности покупателей в случае окончательной продажи жилых единиц
- Выплаты наличности застройщиком
- Краткосрочные ссуды под недвижимость или ссуды на задаток (на 1-3 года), предоставляемые банком покупателям
- Среднесрочные ссуды под недвижимость (4-10 лет), предоставляемые банком покупателям
- Долгосрочные ссуды под недвижимость (10 лет и выше)

- **ОСНОВНОЙ РЫНОК**

- ▶ **ССУДЫ НАСЕЛЕНИЮ ПОД НЕДВИЖИМОСТЬ**

- ▶ **ССУДЫ ПОД НЕДВИЖИМОСТЬ
(ПОСТОЯННОЕ ФИНАНСИРОВАНИЕ) НА
КВАРТИРЫ, ЗДАНИЯ И Т.Д.**

- ▶ **ОСНОВНЫЕ ЗАИМОДАТЕЛИ ТАКЖЕ МОГУТ
ПРИБРЕТАТЬ ЗЕМЛЮ В СОБСТВЕННОСТЬ,
ПОЛУЧАТЬ ССУДЫ НА ЗАСТРОЙКУ ЗЕМЛИ И
ССУДЫ НА СТРОИТЕЛЬСТВО**

• ОСНОВНЫЕ УЧАСТНИКИ РЫНКА

▶ ПОРТФЕЛЬ ЗАИМОДАТЕЛЕЙ. СРЕДСТВА, ИСПОЛЬЗУЕМЫЕ ПОРТФЕЛЕМ ЗАИМОДАТЕЛЕЙ НА ССУДЫ ПОД НЕДВИЖИМОСТЬ, ПОСТУПАЮТ ИЗ ФОНДОВ ПРЕДПРИЯТИЙ, А ТАКЖЕ ДРУГИХ ИСТОЧНИКОВ, ТАКИХ КАК ВТОРИЧНЫЙ РЫНОК. ПРИМЕРЫ ПОРТФЕЛЯ ЗАИМОДАТЕЛЕЙ ВКЛЮЧАЮТ:

- КОММЕРЧЕСКИЕ БАНКИ
- СБЕРЕГАТЕЛЬНЫЕ И ДОЛГОВЫЕ АССОЦИАЦИИ
- КРЕДИТНЫЕ СОЮЗЫ

- ОСНОВНЫЕ УЧАСТНИКИ РЫНКА (cont'd.)
 - ▶ БАНКИРЫ ССУД ПОД НЕДВИЖИМОСТЬ.
БАНКИРЫ ССУД ПОД НЕДВИЖИМОСТЬ
ПОЛУЧАЮТ ВСЕ ФОНДЫ, ИСПОЛЬЗУЕМЫЕ
НА ПРЕДОСТАВЛЕНИЕ ССУД ПОД
НЕДВИЖИМОСТЬ, ИЗ ИСТОЧНИКОВ
ВТОРИЧНОГО РЫНКА.

- **ОСНОВНЫЕ И ВТОРИЧНЫЕ РЫНКИ ССУД ПОД НЕДВИЖИМОСТЬ**

- ▶ ОСНОВНОЙ РЫНОК ССУД ПОД НЕДВИЖИМОСТЬ. В ОСНОВНОМ РЫНОК, ИЗ КОТОРОГО ИЗВЛЕКАЮТСЯ ССУДА. ТО ЕСТЬ РЫНОК, В КОТОРОМ СРЕДСТВА ДАЮТСЯ В ДОЛГ ЛИЦАМ, КОТОРЫЕ ПРЕДОСТАВЛЯЮТ НЕДВИЖИМОСТЬ В КАЧЕСТВЕ ЗАЛОГА В ТОМ, ЧТО ДОЛГ БУДЕТ ВЫПЛАЧЕН.

ЗАИМОДАТЕЛИ В ОСНОВНОМ РЫНКЕ МОГУТ СОБИРАТЬ СРЕДСТВА С ТЕМ, ЧТОБЫ ДЕРЖАТЬ ИХ В СОЗДАННЫХ ИМИ ПОРТФЕЛЯХ ИЛИ ПРОДАВАТЬ ССУДЫ НА ВТОРИЧНОМ РЫНКЕ.

- ОСНОВНЫЕ И ВТОРИЧНЫЕ РЫНКИ ССУД ПОД НЕДВИЖИМОСТЬ (cont'd.)

- ▶ ВТОРИЧНЫЙ РЫНОК ССУД ПОД НЕДВИЖИМОСТЬ. РЫНОК, В КОТОРОМ ПРОДАЮТСЯ И ПОКУПАЮТСЯ СУЩЕСТВУЮЩИЕ ССУДЫ И ПРОЧИЕ ЦЕННЫЕ БУМАГИ, СВЯЗАННЫЕ С ССУДАМИ ПОД НЕДВИЖИМОСТЬ. ТО ЕСТЬ РЫНОК, В КОТОРОМ ЗАИМОДАТЕЛИ МОГУТ ПРОДАВАТЬ ССУДЫ ПОД НЕДВИЖИМОСТЬ (КОТОРЫЕ ПРЕДОСТАВЛЯЮТСЯ КРЕДИТОРАМ) ИНВЕСТОРАМ ИЛИ ПЕРЕПРОДАВАТЬ ССУДЫ ПОД НЕДВИЖИМОСТЬ СРЕДИ ИНВЕСТОРОВ.

- **УЧАСТНИКИ ОСНОВНОГО И ВТОРИЧНОГО РЫНКОВ**

- ▶ **ФИНАНСОВЫЕ УЧРЕЖДЕНИЯ МОГУТ И УЧАСТВУЮТ КАК В ОСНОВНОМ, ТАК И ВО ВТОРИЧНОМ РЫНКАХ, СОЗДАВАЯ ФОНДЫ ССУД ПОД НЕДВИЖИМОСТЬ, ПРОДАВАЯ ИХ, ПОКУПАЯ ЦЕННЫЕ БУМАГИ, ГАРАНТИРУЕМЫЕ НЕДВИЖИМОСТЬЮ В ВИДЕ ЗАЛОГА.**

- **ФУНКЦИИ ВТОРИЧНОГО РЫНКА**

- ▶ **ОБЕСПЕЧЕНИЕ ЛИКВИДНОСТИ**

- ▶ **СОКРАЩЕНИЕ ЦИКЛИЧНОСТИ КАПИТАЛА
ССУД ПОД НЕДВИЖИМОСТЬ**

- ▶ **СОДЕЙСТВИЕ В РАСПРЕДЕЛЕНИИ
КАПИТАЛА ССУД ПОД НЕДВИЖИМОСТЬ**

- ▶ **СОКРАЩЕНИЕ РЕГИОНАЛЬНЫХ РАЗЛИЧИЙ
В СТОИМОСТИ КАПИТАЛА**

- **ФУНКЦИИ ВТОРИЧНОГО РЫНКА (cont'd.)**

- ▶ **ОБЕСПЕЧЕНИЕ ВОЗМОЖНОСТЬЮ
ГЕОГРАФИЧЕСКИ РАЗЛИЧНЫХ
КАПИТАЛОВЛОЖЕНИЙ**

- ▶ **СВЯЗЬ РЫНКА ССУД ПОД НЕДВИЖИМОСТЬ
С РЫНКАМИ КАПИТАЛА**

МЕСТОПОЛОЖЕНИЕ

- Местоположение приемлемое для предполагаемой коммерческой реализации
- Свободный подступ дорог
- Наличие общественного транспорта
- Доступ к:
 - ▶ школам
 - ▶ магазинам
 - ▶ медицинским учреждениям
 - ▶ основным местам работы
 - ▶ центрам культуры и отдыха

ИНФОРМАЦИЯ ДЛЯ ПОЛУЧЕНИЯ КРЕДИТА

- ФИНАНСОВОЕ СОСТОЯНИЕ

- ▶ Баланс

- АКТИВ

- » наличные
 - » недвижимость
 - » автомобили
 - » accounts receivable
 - » личная собственность
 - мебель
 - драгоценности
 - » другие

ИНФОРМАЦИЯ ДЛЯ ПОЛУЧЕНИЯ КРЕДИТА

- ФИНАНСОВОЕ СОСТОЯНИЕ

- ▶ Баланс (cont'd.)

- Пассив

- » ссуды под недвижимость
 - » ссуды, подлежащие выплате
 - » счета, подлежащие оплате
 - » налоги
 - » другие

- Итого в наличии (общий актив за вычетом пассива)

ИНФОРМАЦИЯ ДЛЯ ПОЛУЧЕНИЯ КРЕДИТА

- ▶ Положение о доходе
 - Поток наличности со владений недвижимостью
 - Другие деловые доходы
- ▶ Собственный капитал в проекте
 - Земля
 - Пред-оплаченные расходы
 - » территориальные пошлины
 - » разрешения на здание
 - » стоимость архитектурного проекта
 - » работа по усовершенствованию строительной площадки
 - » строительные материалы
 - » труд

ЭЛЕМЕНТЫ, УТОЧНЯЕМЫЕ В ПРОЦЕССЕ ПЕРЕГОВОРОВ ПО ССУДЕ НА СТРОИТЕЛЬСТВО

- СУММА
- СРОК
 - ▶ Время на строительство
 - ▶ Сток до времени окончательной продажи или аренды
- ПРОЦЕНТНАЯ СТАВКА
 - ▶ Фиксированная
 - ▶ Плавающая относительно индексной ставки
- ВЫПЛАТА ПРОЦЕНТОВ
 - ▶ Ежемесячно, поквартально, раз в пол-года, ежегодно
 - ▶ Капитализированные

ЭЛЕМЕНТЫ, УТОЧНЯЕМЫЕ В ПРОЦЕССЕ ПЕРЕГОВОРОВ ПО ССУДЕ НА СТРОИТЕЛЬСТВО

- ОПЛАТА УСЛУГ БАНКУ
 - ▶ Рассмотрение заявления
 - ▶ Принятие решения
 - ▶ Услуги
 - ▶ Другие
- СПОСОБ ОПЛАТЫ УСЛУГ
 - ▶ Вперед
 - ▶ В установленной расписанием пропорции
 - ▶ С поступлений по ссуде
 - ▶ Другие
- ГАРАНТИИ

ПРИНЯТИЕ РЕШЕНИЯ

- Цель и обеспеченность
- Сумма ссуды
- Процентная ставка
- Срок погашения
- Возможность продления
- Условия выплаты
- Требования к выдаче ссуды

ПРИНЯТИЕ РЕШЕНИЯ

- Обязательные документы:
 - ▶ Долговая расписка/облигация
 - ▶ Ссуда под недвижимость
 - ▶ Соглашение о ссуде на строительство
 - ▶ Передача контрактов
- Расходы и пошлины
- Условия выдачи долга
- Дата, до которой решение должно быть принято
- Дата, до которой ссуда должна быть выдана
- Требования страхования
- Требования по владению

ПРИНЯТИЕ РЕШЕНИЯ

- Экологические вопросы
- Исследования
- Государственные утверждения и разрешения
- Коммунальные услуги

ЭКОЛОГИЧЕСКИЕ ВОПРОСЫ

- ПОЧВА
 - ▶ На строительной площадке
 - ▶ На прилегающей территории
- ВОЗДУХ
- ВОДА
- ЗДАНИЕ

БЮДЖЕТ ССУДЫ

КАТЕГОРИЯ	СТОИМОСТЬ ПРОЕКТА	СОБСТВЕН НЫЙ КАПИТАЛ	ССУДА
Земля	\$	\$	\$
Прямая/твердая стоимость			
Косвенная/ мягкая стоимость			
Loan Fees			
Проценты			
	\$	\$	\$

РИСК И ВОЗНАГРАЖДЕНИЕ

- СТРОИТЕЛЬ

- ▶ РИСК

- Сумма кредита недостаточна для завершения конструкции
 - Банк не принимает работу и не предоставляет средства
 - Увеличение процентов
 - Поступления с продажи недостаточны для выплаты долга
 - Раскрытие процентов и основной суммы долга
 - Невыполнение заимодателем своих обязательств

РИСК И ВОЗНАГРАЖДЕНИЕ

- СТРОИТЕЛЬ (cont'd.)

- ▶ ВОЗНАГРАЖДЕНИЕ

- Большая надежность и эффективность в процессе застройки
 - Известен источник фондов на строительство проекта
 - Строитель не должен полагаться на периодические вклады покупателей домов на продолжение строительства
 - Строитель имеет дело с меньшим числом источников финансирования (один банк по сравнению с большим числом покупателей)

РИСК И ВОЗНАГРАЖДЕНИЕ

- БАНК

- ▶ РИСК

- Строитель не в состоянии завершить проект
 - Расходная смета строителя оказалась неправильной
 - Строитель объявляет банкротство
 - Квартиры не продаются или покупатель не может получить средства
 - Поступлений с продажи недостаточно для погашения долга

РИСК И ВОЗНАГРАЖДЕНИЕ

- БАНК

- ▶ ПРЕИМУЩЕСТВА

- Доход с процентов и платы за услуги
 - Взаимоотношения с клиентом ведут к продолжению деловых отношений
 - Признание содействия населению в развитии путем финансирования строительных проектов
 - Может обеспечить ссуды под недвижимость для лиц, покупающих дома

РАБОЧИЙ ЛИСТ №1

Бюджет общих расходов на строительство

Название проекта _____

Количество квартир _____

<u>Тип расхода</u>	<u>Стоимость</u>	<u>% от общей стоимости</u>
Земля	_____	_____
Расходы на строительство (Твердая стоимость)		
Основное сооружение	_____	_____
Отделка	_____	_____
Расходы по застройке (Мягкая стоимость)	_____	_____
Прибыль строителя	_____	_____
Необходимые поступления с продажи	_____	100%

ПРИМЕЧАНИЕ: Приведенные выше расходы на строительство не включают проценты и стоимость услуг по ссуде на строительство. Данные расходы должны быть добавлены.

РАБОЧИЙ ЛИСТ №2
ИСТОЧНИКИ ФИНАНСИРОВАНИЯ
ОБЩИХ РАСХОДОВ ПО ЗАСТРОЙКЕ

<u>Источник</u> <u>финансирования</u>	<u>% от общего</u> <u>финансирования на</u> <u>строительство</u>
Собственный капитал строителя/собственный капитал землевладельца	
Вклады покупателя	_____
Ссуда банка на строительство	_____
ИТОГО	100%

CASE STUDY

**THE PETROGRAD BUILDING: THE BEGINNING
OF A CONSTRUCTION LENDING PROGRAM
AND A SUCCESSFUL RELATIONSHIP?**

Prepared for

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Prepared by

PADCO, Washington, D.C.

THE PETROGRAD PROJECT: THE BEGINNING OF A CONSTRUCTION LENDING PROGRAM AND SUCCESSFUL RELATIONSHIP?

The bank

Mr. Makarov, a senior lending officer at a major St. Petersburg bank, was at work in his office preparing a memorandum to the bank's president. The purpose of the memorandum, which is due no later than June 20, 1994, is to make recommendations on the two following questions:

1. Should the bank initiate a construction lending program for residential projects? What would be the advantages and disadvantages of such a program for the bank?
2. How might the bank respond to Nikita Smoliak's preliminary loan application for a construction loan for a proposed 150-unit residential project in Petrograd?

Mr. Makarov found that focusing on Mr. Smoliak's specific construction loan application request helped organize his thinking of whether or not the bank should initiate a construction lending program. Although the bank was generally familiar with construction lending, it did not have an active construction lending program.

The Developer: Nikita Smoliak

Nikita Smoliak is an aggressive developer and entrepreneur with a background in residential construction. He trained as an engineer at the University of St. Petersburg, where he received his degree in construction engineering in 1973. Mr. Smoliak has had extensive development and construction experience as a Vice President at Stroinvest, now a joint stock company, where he worked on the development of five eight-story block residential projects with a total of 1,100 units. In 1991, Mr. Smoliak left Stroinvest to form his own development/construction company known as Smoltech Corporation.

Mr. Smoliak capitalized his company with his own savings and a loan from his family. He also had a financial partner who was willing to invest in the company in return for a 30% interest in the Smoltech Corporation. Mr. Smoliak owned the remaining 70% of the company. He has already been able to pay back the initial capitalization loan from his family.

Since 1991, Mr. Smoliak's company has completed the construction of eight single family detached homes in St. Petersburg. One of these houses was recently completed for Mr. Makarov's boss, the president of the St. Petersburg bank. In addition to these single family projects, Mr. Smoliak had recently completed a forty eight-unit residential cooperative project in Primovskiy district.

The Smoltech Corporation's primary assets are,

Cash	
Accounts Receivable	
Construction Equipment	
Land and Real Estate Owned	_____
TOTAL ASSETS	_____ rubles

Smoltech Corporation's total liabilities are:

Accounts Payable	
Loan on the Construction Equipment	_____
TOTAL LIABILITIES	_____ rubles
TOTAL NET WORTH	_____ rubles

NOTE 1: The construction equipment loan is actually from a smaller St. Petersburg bank where Mr. Smoliak and the Smoltech Corporation currently deposit their funds. (At the time this case was written, \$1 USD = 1900 rubles.)

The Proposed Petrograd Project

The project for which Mr. Smoliak is seeking a construction loan from the bank is located in Petrograd, one of the prime inner districts within greater St. Petersburg. St. Petersburg has a population of approximately 5,000,000 persons and is the second largest city in Russia. The population of Petrograd is approximately _____. Petrograd is considered to be one of the more attractive residential neighborhoods in St. Petersburg.

The proposed project would be three interconnected buildings. There would be ten units per floor for a total of 50 units per building.

The site, approximately one hectare, is located in an attractive, quiet neighborhood with shopping, transportation and recreational amenities nearby. Adjacent property uses are primarily residential buildings.

The project site can be described as follows: SEE NOTE 2.

NOTE 2: The participant teams are expected to describe the attributes of an attractive, marketable site for the purposes of this exercise.

The Preliminary Loan Request

Mr. Smoliak and Mr. Makarov had a preliminary discussion related to the proposed project budget. Given his prior and on-going experience as a general contractor, Mr. Smoliak felt comfortable with his estimate for the actual "bricks and mortar" construction cost estimate of rubles for the units. Mr. Smoliak also felt comfortable with his estimate of rubles for other development costs. However, he was not as certain about the costs for some of the other budget categories, particularly infrastructure costs:

TOTAL DEVELOPMENT COST BUDGET

Land & Infrastructure	See NOTE 3
Construction Costs (Hard Costs)	
Shell	
Finish	_____ See NOTE 3
Development Costs (Soft Costs)	
(Architectural and engineering fees, legal fees, taxes, insurance, marketing, etc.)	_____ See NOTE 3
Developer's Profit	See NOTE 3
Required Sales Revenue	See NOTE 3

NOTE 3: The borrower would always be expected to provide these estimates to the lender. However, for the purpose of this exercise, the reader is asked to estimate these costs.

Mr. Makarov knows that he would need to have several more meetings with Mr. Smoliak to resolve questions about the total development cost budget. Specifically, Mr. Makarov pondered:

1. What value should be placed on the land?
2. How would construction interest and construction loan financing fees be estimated?
3. What should the developer's profit be?

The Market

Mr. Makarov knows that Mr. Smoliak's ability to pay back the construction loan is primarily dependent upon the successful sale of the 150 units at sales prices at or above the projected sales revenues. Although the bank would likely require a personal guaranty by Mr. Smoliak as well as a corporate guarantee by Smoltech Corporation, understanding the likely market conditions in Petrograd were very important to Mr. Makarov. In particular, Mr. Makarov would need to know whether the current strong demand for residential units would continue. He would also want to know the depth of the current market and whether the type of project being proposed by Mr. Smoliak is consistent with the projected market. Mr. Makarov wondered how he could get adequate market information to make a reasonable assessment of market conditions. As a construction lender, the bank is dependent upon a successful sales program to "take out" or pay-off the outstanding construction loan balance. Therefore, Mr. Makarov needs to be knowledgeable about the location, design, quality of construction, and market demand for the proposed project.

Construction Lending Program: Advantages and Disadvantages for Developers and Banks

All of Mr. Smoliak's prior projects had been financed through a combination of his own equity, landowner equity in the form of land development rights from the municipality and buyer installment payments. Mr. Smoliak's experience with this

manner of non-bank construction financing had been generally satisfactory but certainly not perfect. He thought that there might be some advantages to a more formal, institutionalized bank construction loan program.

Advantages of a Construction Loan Program for a Developer

Reduced Uncertainty

1. Mr. Smoliak thought that there would be less uncertainty in the development process if a workable bank construction loan program became available. On several of his projects, construction schedules had to be revised when buyers were unable or unwilling to advance funds. Schedule changes were particularly burdensome and costly once construction was underway. Having a valid construction loan commitment prior to construction start would eliminate this problem. Knowing that he had a commitment for sufficient funding to complete the building would reduce the risks for Mr. Smoliak.

More Efficient Use of Developer's Skills and Ability to Build Larger Projects

2. Mr. Smoliak thought that his greatest and most valuable real estate expertise was in finding sites, assembling development teams, securing necessary regulatory approvals, and building the project. However, he found that he was spending more and more of his limited time dealing with buyers to secure the financing necessary for his projects. When he was doing smaller projects, such as single family homes or six-unit buildings, the task of dealing with buyers was not as time consuming. He was now dealing with larger projects and expected to be doing significantly larger projects in the future. Therefore, negotiating with a single bank entity as opposed to numerous buyers was potentially a very attractive alternative.

Establishment of On-going, Efficient Relationships

3. Mr. Smoliak felt that there would be many advantages to establishing a continuing banking relationship with Mr. Smoliak's bank. All of his prior projects were separate transactions. For each of them he had to deal with new investor buyers to provide construction financing. There was no opportunity to use the successful relationships established with these investor buyers on future building projects. However, Mr. Smoliak knew that if he established a good performance record with Mr. Makarov's bank on the Petrograd project, that future borrowing from the bank would not only be likely but also easier. The bank would understand Mr. Smoliak and his corporation's strengths and abilities. Mr. Smoliak would understand the bank's review process and lending criteria. Each new deal would still need to be underwritten as a separate project. However, the existence of a prior successful business relationship between Mr. Smoliak and the bank would help simplify and expedite the lending process. In doing so, the level of uncertainty would be reduced. Mr. Smoliak was always happy to reduce the level of uncertainty in his business.

Maximization of Current Market Opportunities

4. Mr. Smoliak knew that good development opportunities existed today. He was anxious to use methods of construction financing that could expedite the development process and allow him to take maximum advantage of current market opportunities. Mr. Smoliak felt that the greatest constraint on his continued ability to successfully develop residential projects was not market demand, site availability, or internal staff capacity. Rather, the critical constraint was securing adequate construction financing. The lack of an acceptable lending program was inhibiting the growth of his company.

Independent Review by Bank

5. Although Mr. Smoliak was confident of his abilities, the fact that he would have to submit his design, market and business plans to the bank for review and approval would encourage an extra level of discipline and care for Mr. Smoliak and his corporate staff. Having an extra set of eyes review his project could be helpful and might result in valuable suggestions made by the bank that could save Mr. Smoliak from making costly mistakes. The bank would, of course, also monitor the actual construction of the project. Mr. Smoliak understood that it is critical for any construction lender that a project be completed within the estimated budget and in accordance with the bank approved plans and specifications.

Greater Market Deal

6. Mr. Smoliak thought that his marketing and sales program would be enhanced if the bank provided construction financing. Potential buyers would feel more comfortable knowing that the bank had reviewed and approved his project. The bank's construction loan commitment might be viewed as a sign of endorsement. Also, the bank's large depositor base might be a source of potential buyers. Both the bank and Mr. Smoliak shared a common interest in having a successful sales program.

Greater Credibility with Material Suppliers and Subcontractors

7. The bank's commitment might also enhance Mr. Smoliak's ability to negotiate with building material suppliers and subcontractors. The certainty of construction funding availability would be important to both of these entities.

Shorter Construction Period

8. Mr. Smoliak thought that the banks might also help solve a critical problem faced by him and other developers: the timely delivery of construction materials. Because of the long lead times required for certain materials, particularly pre-cast concrete, it was not unusual for construction of a relatively simple project like the one proposed in Petrograd to take as long as 18 months.

One of his former professors had recently visited Germany and was impressed by the speed and efficiency demonstrated by its construction industry. A building complex similar to the proposed Petrograd project could be built in less than nine months. Mr. Smoliak knew that placing advance orders for reinforcing and steel was also a common practice in many countries. Construction lenders in these countries understood construction scheduling problems and were willing to advance construction loan proceeds to guarantee timely material shipments.

If lenders were willing to advance construction loan funds to place advance orders for pre-purchase of construction materials, Mr. Smoliak thought that he could significantly decrease the construction time period. By decreasing the construction time period, Mr. Smoliak could reduce his construction and other development costs, his marketing risks, and his financial risks associated with inflation.

Reduced Risk for Investor Buyers

9. Another marketing advantage would be that the potential buyers' exposure to risk is reduced under a bank construction lending program. On his prior projects buyers would have to put up 30% of the projected sales price prior to the beginning of construction and an additional 60% after construction of the building shell and utilities was completed. The remaining 10% was due upon project

completion and issuance of Final Document of Approval by the municipality. If a project ran into troubles and was not completed, the investor buyer bore a significant risk. Under a bank construction loan program, the risk would not be fully eliminated because buyer installment payments would also be expected for at least a percentage of the units. However, the risk would be significantly reduced because the bank would be advancing construction funds along with the buyer and would therefore be sharing the risk.

Simplification of Land Purchase

10. Mr. Smoliak thought that securing building sites could be made more simple by the existence of an institutional construction lending program. Instead of negotiating complicated agreements with the municipality involving contributions to off-site infrastructure costs and/or the allocation of a percentage of the units, Mr. Smoliak could purchase the site at auction or offer to pay the municipality an agreed-upon land price from construction loan proceeds. For some landowners, the simplicity and lower risk exposure of getting a fixed land price and not having to become a "partner" in the development of the project would be a preferred method of selling a site.

Disadvantages of Construction Loan Program for a Developer

Although Mr. Smoliak thought that the advantages of a construction loan program outweighed any disadvantages, it was still important to list the potential disadvantages:

Potential Style Conflict

1. Mr. Smoliak recognized that the basic difference in operating style between an entrepreneurial development company and a bureaucratic bank could lead to conflicts between the two organizations. The bank's decision making process could be cumbersome and its real estate opinions could be very conservative compared to his. As the majority stockholder of his company, Mr. SMOLIAK < enjoyed being able to make quick decisions. He knew that bank decisions often had to be made by committee with fixed meeting schedules. Such a structure could delay decisions for months.

More Interference

2. Although the process of securing construction financing from investor buyers was time consuming, there were some advantages to this structure. These investor buyers were not experts on residential construction and did not feel that they had any review authority over Mr. Smoliak's operations. However, the bank would have expertise and would exercise its review authority. Therefore, Mr. Smoliak's degree of control would be less with the bank than with individual buyers. Moreover, if there was a strong disagreement with an individual buyer, the buyer could easily be replaced. It would be more difficult, costly and time consuming to substitute a replacement bank.

More Demands

3. A bank providing a significant percentage of the total construction funding required for a project is much more likely to make demands that individual buyers would not consider making. For example, banks will likely require higher levels of guarantees and collateral than would individual buyers. Banks might also require developers to maintain compensating deposit balances or be subject to other requirements that individual buyers would not find relevant or appropriate to request or demand.

Direct Rather than Hidden Interest Costs

4. Mr. Smoliak knows that the direct burden for interest costs during construction will be transferred from the investor buyer to him should a bank construction lending program be used. Previously, Mr. Smoliak did not have to borrow any funds to construct a project. Primary funding was provided by a non-interest bearing installment payment advanced made by investor buyers. Mr. Smoliak had to use working capital funds to finance early development costs such as permit, design and legal fees. However, these costs were not large. The financing fees and particularly the interest costs, given Russia's very high prevailing annual interest rates of 200% or more on ruble loans and 50% or more on foreign currency loans, would be significant, even for short term loans. These costs would have to be reflected in the projected sales prices.

In fact, the investor buyer indirectly "pays" interest because of the "opportunity cost" associated with making a non-interest bearing installment payment to the builder. However, Mr. Smoliak feels that most investor buyers will not recognize the "opportunity costs" (i.e. these same investor buyers could have deposited these funds in a bank and earned significant interest). Therefore, Mr. Smoliak is concerned that the sales prices of his units in a bank-financed project will appear to be higher than those for a project financed through investor buyer installment payments.

Advantages of a Construction Loan Program for a Bank

Mr. Makarov had spoken with his own colleagues and with other bankers in Russia and North America as he was drafting his memorandum to the bank president. His memorandum listed some of the advantages that might result from creating an active residential construction lending program.

Profit Opportunities

1. Construction lending presented a new business opportunity that could be profitable in itself and also create or sustain other profitable bank business. The spread on construction loans, the difference between the bank's cost of funds and the interest rate charged to the developer, is traditionally higher than the spread on a permanent loan. The reason for the higher spread on construction loans is that construction loans have more risk for the bank than permanent loans. Therefore, this higher risk is balanced by a higher return.

Other bankers have advised Mr. Makarov that construction lenders must be aware of and understand the risks involved in construction lending. Banks must do their underwriting and structure their loan commitments in a manner that best protects them from these inherent risks.

Community Commitment

2. A construction loan program would be visible evidence of the bank's commitment to the welfare of its primary market area: St. Petersburg. There appeared to be a strong demand for housing and it appeared that the lack of a viable construction lending program was slowing down the production of new housing.

Expansion/Retention of Bank Customers

3. This commitment to developers, the municipality and housing production could possibly help expand the bank's customer base.

- A. Developers would be encouraged or required to deposit their personal and corporate funds at the bank.
- B. Individuals familiar with the bank's commitment to its market area may support the bank by depositing their funds at the bank. The bank could, place a sign at the construction site indicating that it was providing construction financing.
- C. Developer borrowers would be encouraged to use other banking services at the bank.
- D. The bank would not lose good developer customers to other banks because other banks offered construction loans.

Competitive Advantage

- 4. The bank would develop a body of knowledge and expertise in residential construction lending that could distinguish it from other banks.

Preferred Lending Position

- 5. The fact that a bank provided construction lending for a residential project might place it in a preferred position to then make permanent mortgage loans to the investor buyers, when the economic climate is conducive. Given that the bank has reviewed the site and monitored the actual construction of the building, the bank should feel comfortable with the value of the security for its permanent loan.

Public Contribution

- 6. Over the long term, the bank will provide a public benefit by utilizing its residential lending expertise to encourage and ensure satisfactorily located, designed and constructed residential buildings. The bank will encourage high quality and responsible developers and discourage poor quality developers.

The body of knowledge and experience that the bank develops will be a valuable asset for the city of St. Petersburg and the country as privatization is implemented. The bank could play an important role in the development of housing policies and the creation of new construction and permanent financing instruments.

Disadvantages of a Construction Loan Program for a Bank

High Level of Risk

- 1. Construction lending can be a high risk business, especially when proper underwriting guidelines are not developed and followed. Losses can be significant if a developer fails to complete (or is late in completing) a project. Such losses are especially high for projects that cannot be done on a phased basis. The reasons for failure or delay could include:
 - A. The developer uses the construction loan proceeds to fund other projects or business ventures or for project costs not approved by the bank. This would be in violation of a standard construction loan term that requires construction loan advances be used only for bank approved project costs. Mr. Makarov enjoyed quoting one of the North American bankers he had met:



"Builders don't have any discipline ... give them a construction loan advance and they go out and dig a new hole instead of using the money to pay for materials on the job for which we originally made the construction loan."

- B. The construction cost estimate was too low and available funds are inadequate to complete construction.
- C. The developer, architect or contractor is incompetent.
- D. The builder goes bankrupt.
- E. Unforeseen site conditions or environmental problems prevent the timely completion of the project.
- F. Building material shortages delay project completion.
- G. The building does not comply with municipal regulatory codes and the City will not issue a Final Document of Approval.

Failure of Take-out

- 2. An anticipated "take-out" loan that would be used to pay back the construction lender is not forthcoming. For example, the borrower on a residential project that cannot be successfully marketed would not be able to pay back its construction loan.

New Stamina Requirements

- 3. The existing lending staff is unlikely to have the necessary level of construction lending experience and expertise required. New staff will probably need to be hired and existing staff will need to be trained.

Recommendation

Mr. Makarov felt that he had a decent understanding of Mr. Smoliak and the Smoltech Corporation. Mr. Makarov also hoped that he understood how a developer would assess the advantages and disadvantages of a construction loan program.

In addition to making a recommendation on whether or not his bank should initiate a construction lending program, Mr. Makarov would also need to outline the basic terms and conditions of a potential loan to Mr. Smoliak for his Petrograd project. Mr. Makarov thought that he should develop recommendations responding to the following critical issues:

- 1. Quality, experience and financial strength of the developer.
- 2. Acceptability of project location and basic design.
- 3. Likely market demand.
- 4. Acceptability of preliminary development budget.
- 5. Potential construction loan terms and conditions, such as:
 - A. Ruble or dollar amount of loan (i.e. size of loan bank would be willing to provide).

- B. Interest rate to be charged for the loan.
- C. Term of the loan/principal repayment plan.
- D. Financing fees required.
- E. Security/collateral/guarantee requirements.
- F. Pre-sale requirement (i.e. percentage of units that must be sold prior to the construction start).
- G. Release provisions (i.e. under what conditions will the construction lender release part of its mortgage lien to an investor buyer or to the investor buyer's permanent mortgage lender).

Mr. Makarov's report was due in one week. Although he had already done a lot of work, he knew that he still had a great amount of additional work to complete. His weekend trip to Helsinki would have to wait.

THE PETROGRAD PROJECT: THE BEGINNING OF A CONSTRUCTION LENDING PROGRAM AND A SUCCESSFUL RELATIONSHIP?

QUESTIONS FOR DISCUSSION

1. Do you agree with the construction loan program advantages and disadvantages as presented in the case study?
2. Can you suggest any additional advantages and disadvantages from a developer's or banker's perspective?
3. Do you think the bank should begin a construction loan program for residential projects? Be prepared to discuss the primary factors leading to your conclusion.
4. Assume that the bank decided to initiate a construction loan program for residential projects. As Mr. Makarov, would you be inclined to recommend a loan commitment for Mr. Smoliak's Petrograd project? What would be the basic terms and conditions of your recommendation? (Completing the attached two worksheets should help focus your thinking.)
5. If you were the developer, Mr. Smoliak, what terms and conditions would you propose to the bank?

WORKSHEET #1

Total Development Cost Budget (See NOTE 4)

Project Name _____

Number of Units _____

<u>Cost Category</u>	<u>Cost</u>	<u>% of Total Cost</u>
Land	25%	
Infrastructure		
Construction Costs (Hard Costs)		\$6.5 million
Shell		
Finish		
Development Costs (Soft Costs)	5%	
Developer's Profit	10%	
Required Sales Revenue	3.5 million	100%

NOTE 4: The Development Costs above do not include construction loan interest or financing fees associated with the construction loan. These costs would need to be added.

WORKSHEET #2

SOURCES OF FUNDS FOR TOTAL DEVELOPMENT COSTS

<u>Source of Funds</u>	<u>% of Total Construction</u>		
	<i>Orange</i>	<i>Green</i>	<i>Yellow</i>
Developer's Equity	10	25%	30%
Landowner's Equity (See NOTE 5)	50	60	20%
Investor Buyers' installment Payments	40	50%	-
Bank Construction Loan			
TOTAL	100%	100%	

NOTE 5: The equity value of the land in terms of use rights contributed by the municipality or the price at auction where full or partial payment is deferred until project completion.