Bridge Financing & Valuation Trends Amid a Changing CRE Landscape

Today's Speakers

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Webinar Outline

- Introduction
- State of the Market
- Valuation Trends
- Bridge Loan Program Overview
- Q&A

(Please submit questions at anytime via the questions tab of your control panel.)

Who is Arbor?

- Arbor (NYSE: ABR) is a national direct lender that provides debt capital for the multifamily, commercial and seniors housing & healthcare real estate industries.

- Arbor has extensive experience in mortgage origination and servicing, and has built a reputation for service, quality and flexibility.

- As a long-standing Bridge lender, Arbor can ease your asset's financial transition with a customized Bridge Loan to fit your business plan.

- As a leading Fannie Mae, Freddie Mac, FHA & CMBS lender, Arbor ensures your asset stays on the right financial path.

- Averaging over **$1.1 billion** in loan originations **per quarter** in 2017.

- Arbor has a **$15B loan servicing portfolio**, and is a primary commercial loan servicer and special servicer rated by Standard & Poor's with an Above Average rating. Arbor is also on the Standard & Poor's Select Servicer List and is a primary commercial loan servicer and loan level special servicer rated by Fitch Ratings.

Arbor's Loan Offerings

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Multifamily	Office	Hospitality
Seniors	Retail	Fannie Mae & Freddie Mac

Once a loan closes, it transitions to Arbor's tenured, in-house servicing team, which currently oversees a $15 billion dollar portfolio of commercial real estate loans.

Who is BBG?

- BBG is the second-largest firm offering in-house valuation and environmental and property condition assessment services in the United States.
- BBG has more than 20 offices in key markets nationwide, providing broad geographical coverage and local market knowledge in all major US cities.
- BBG provides services to real estate professionals including investors, lenders, mortgage brokers, attorneys, accountants, and service providers.
- BBG has made significant investments in state-of-the-art technology to deliver consistent, quality reports built on a continually updated national comp database.
- Over 30 percent of BBG appraisal professionals are MAI certified and offer extensive industry expertise gained through real-world experience.
- BBG Assessment provides a wide range of expertise including engineers, geologists, architects and other environmental professionals.

National Reach

Who is Chandan Economics?

- Chandan Economics is a leading provider of multifamily and commercial real estate research services to institutional investment and lending market participants.
- The firm's multifamily and commercial mortgage database includes loans made by banks, life companies, agency and CMBS lenders, and by a growing number of non-bank financial institutions.
- Chandan's analysis of lending market trends and its LoanComps® search tool are designed to enhance lenders' underwriting decisions and risk analysis, as well as inform policymakers and regulators.
- Most recently, Chandan Economics has expanded its analysis to include small balance multifamily loans, supported by its strategic partnership with Arbor.
- Founded by Dr. Sam Chandan, the firm is now managed by a team of world-class analysts who work closely with Dr. Chandan in setting the firm's strategic direction.

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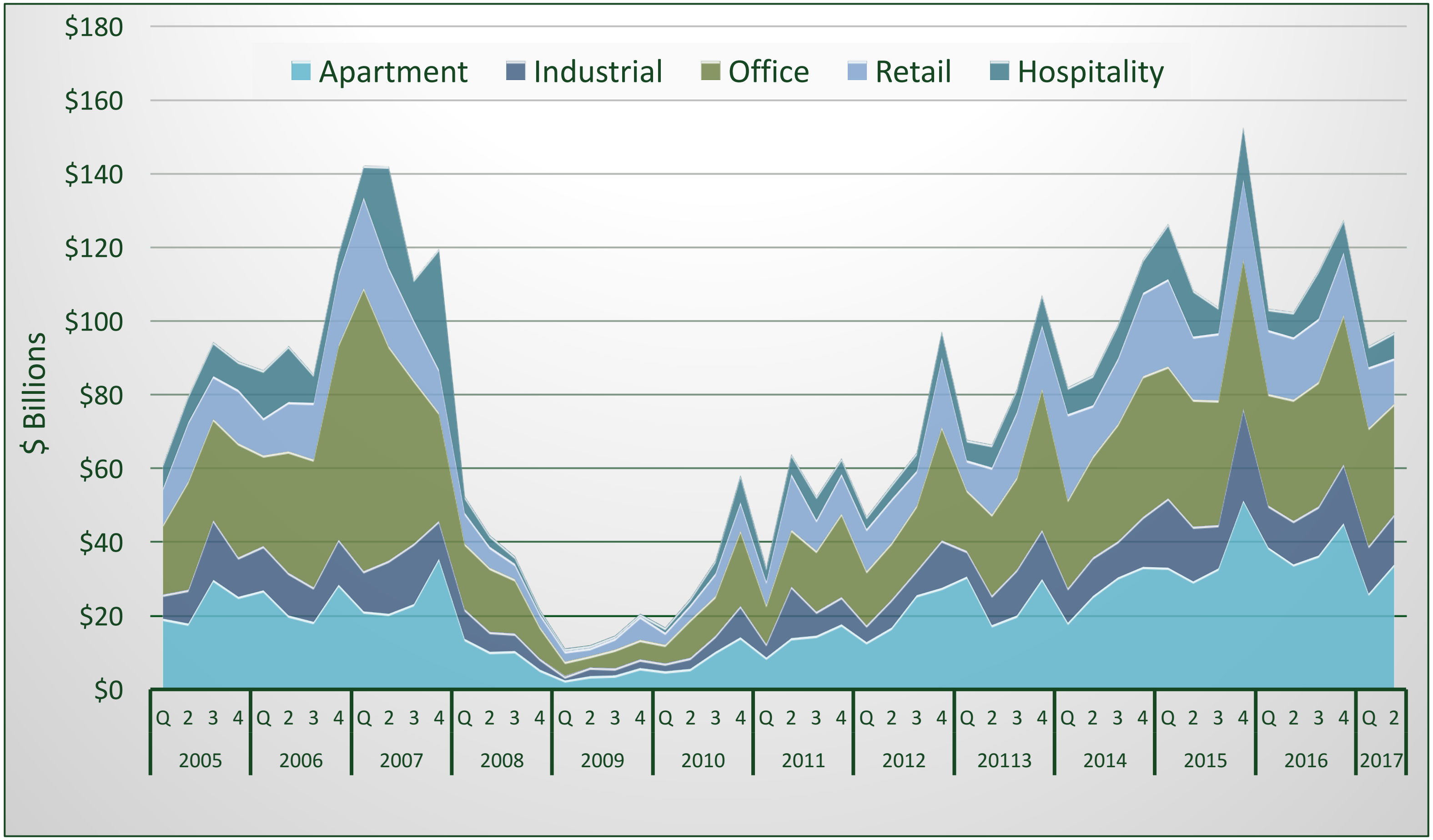
An Overview of
CRE Market Fundamentals

Transaction Volume

CRE Transaction Volume by Asset Class: 2005 – Q2 2017

United States, $2.5 Million and Larger



Source: Real Capital Analytics

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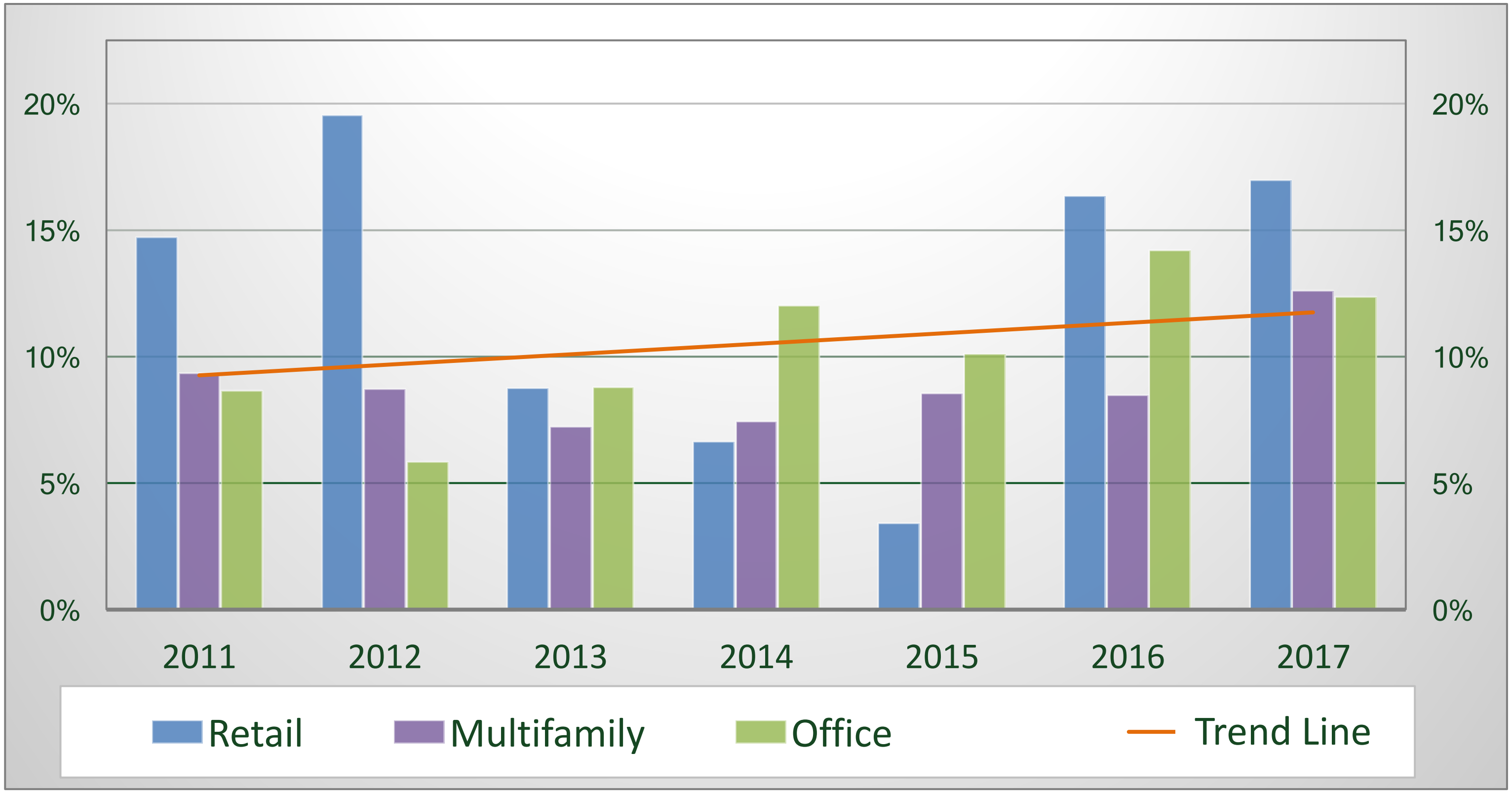
State of Value-Add

Model Estimate of Value-Add* and Lease-Up Investment Activity

(As a Percent of Total Investment Activity)



Source: Chandan Economics

*To define what was considered as lease-up/value-add, the analysis tagged transactions that were more than one full standard deviation from the mean occupancy rate for that asset class.

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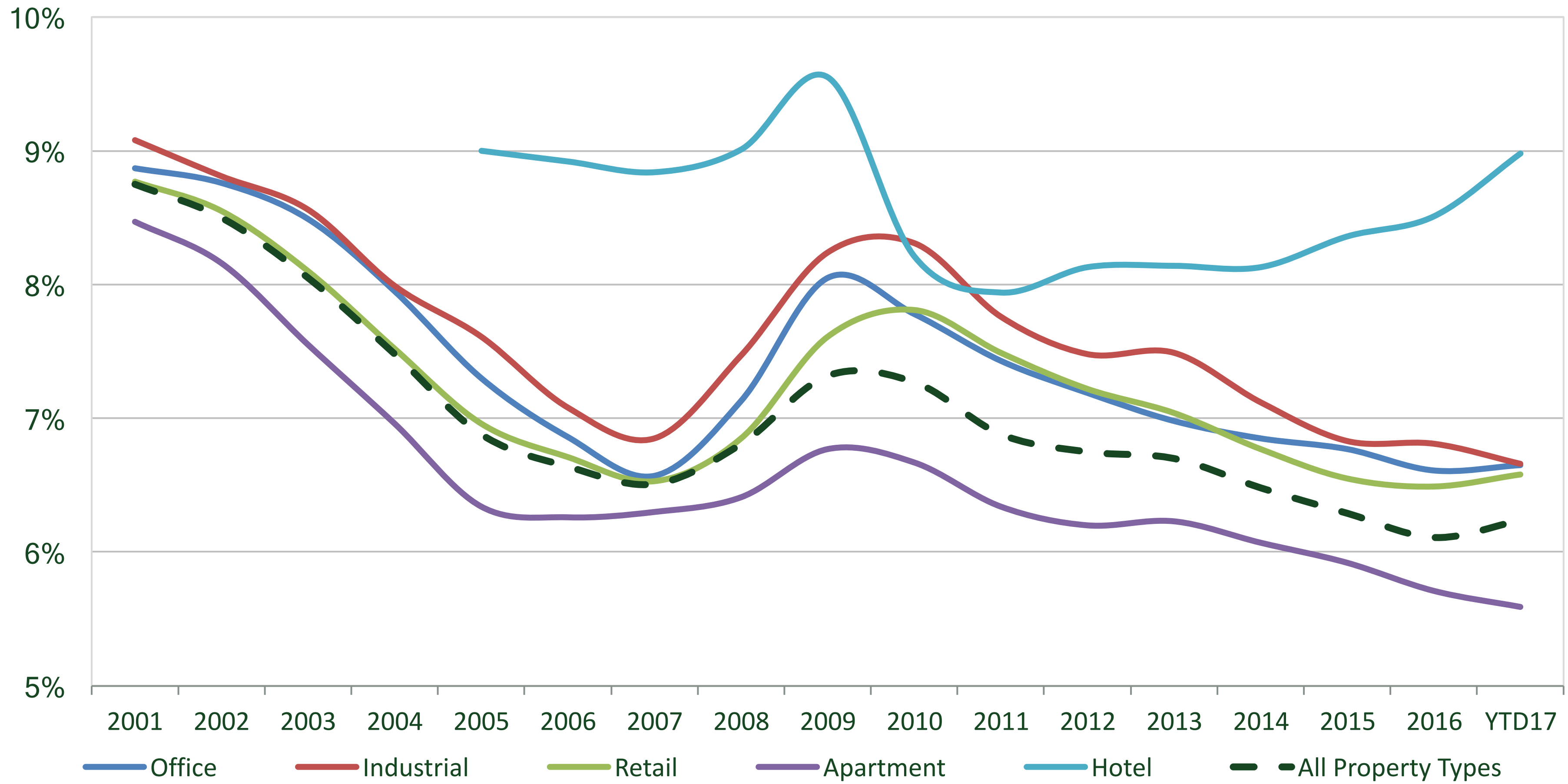
Cap Rates

Cap Rate by Property Type

United States, $2.5 Million and Larger, Annual

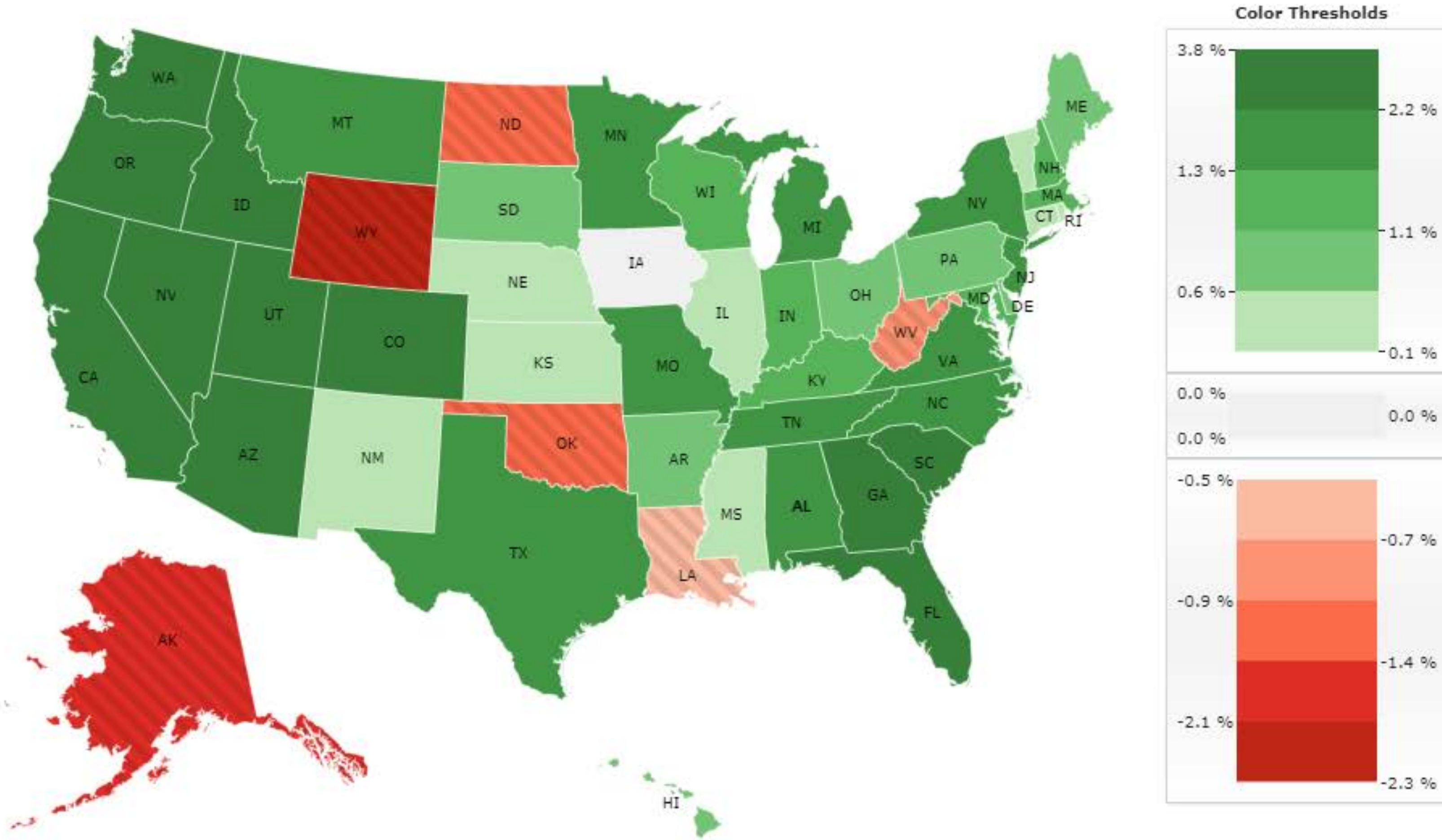


Source: Real Capital Analytics

Employment Growth

Employment Growth by State

Total Nonfarm, 12-Month % Change, Seasonally Adjusted, March 2016 to March 2017



Source: Arbor, U.S. Bureau of Labor Statistics

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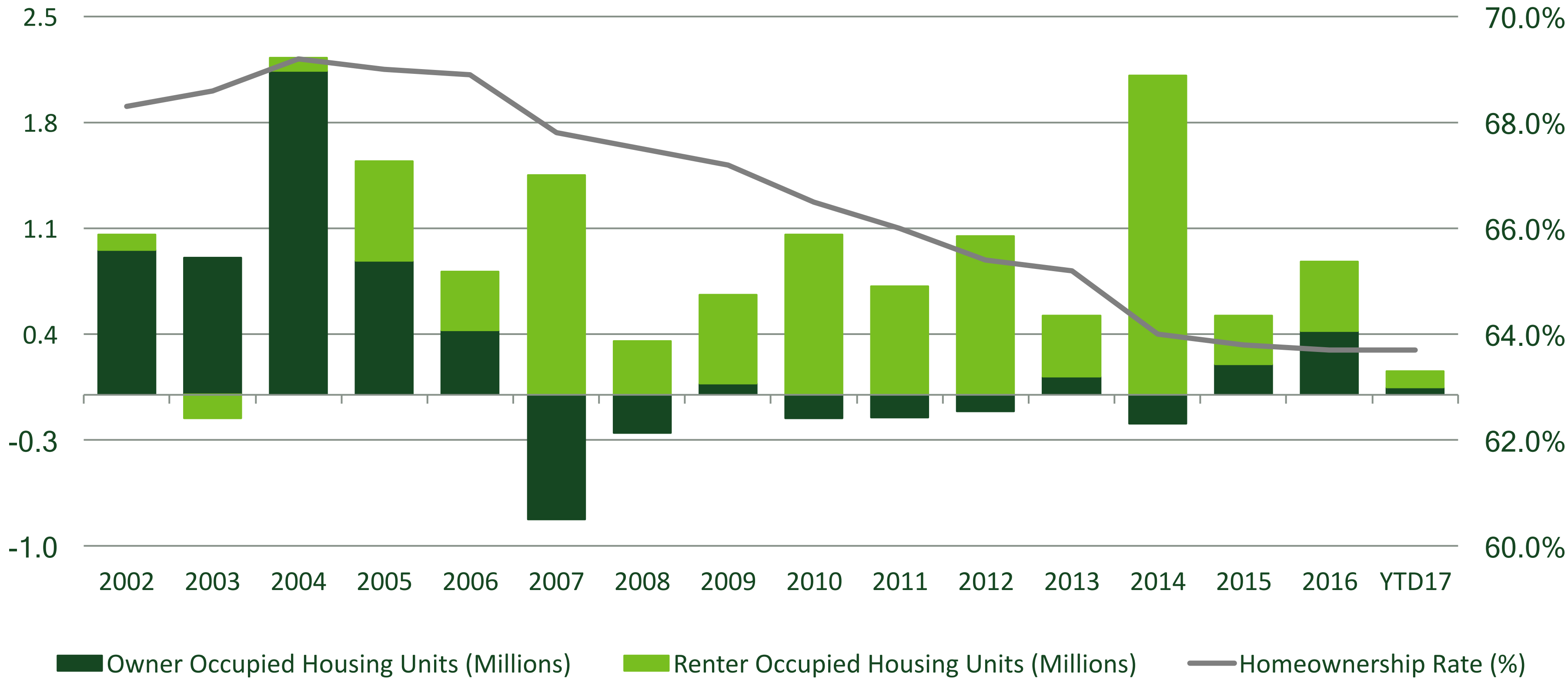
A Closer Look at Multifamily

Homeownership and Household Formation

Homeownership and Change in Household Formation

United States, Not Seasonally Adjusted



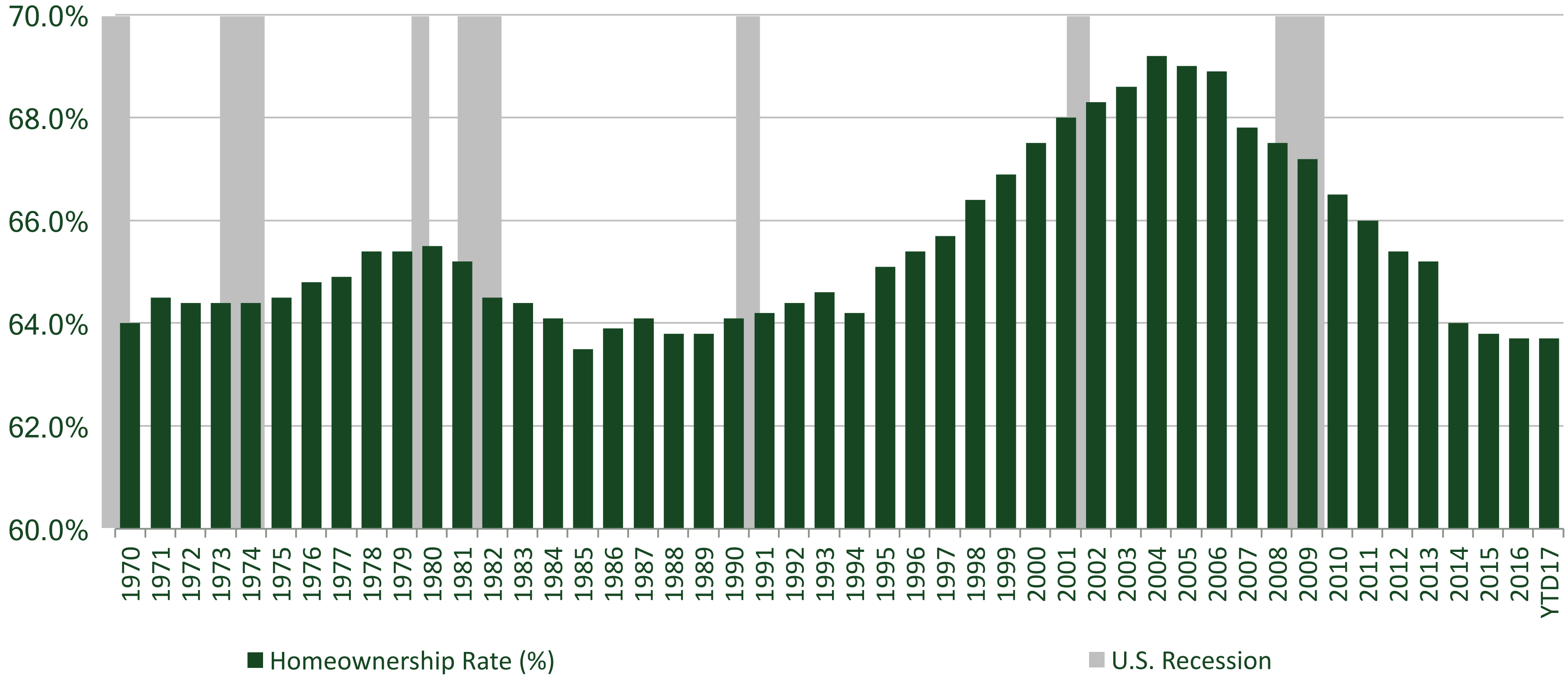
The homeownership rate finished Q2 2017 at 63.7%, up slightly from 63.6% in Q1 2017, yet has declined steadily since the peak of 69.2% during 2004. Household formation increased by 0.75% during 2016, as rental units increased by 463,000 compared to a gain of 418,000 for owner occupied units.

Source: Arbor, U.S. Census Bureau

Homeownership and Household Formation

Homeownership Rate

United States, Not Seasonally Adjusted



The homeownership rate finished Q2 2017 at 63.7%, up slightly from 63.6% in Q1 2017 and 62.9% one year ago. These compare with a high of 69.2% in 2004, during one of the biggest housing booms in history.

Source: Arbor, U.S. Bureau of the Census

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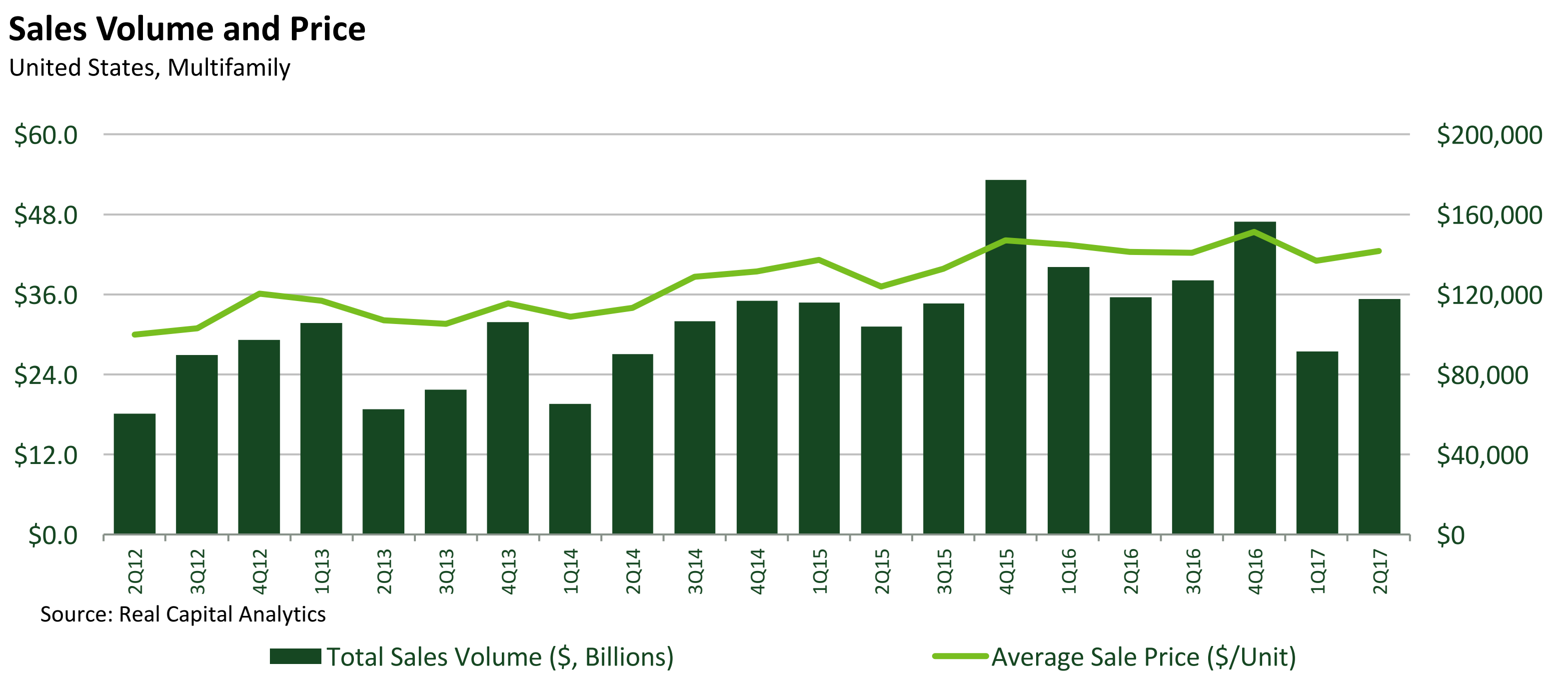
Fundamentals Continue to Improve



Multifamily asking rents increased 3.6% year-over-year as of 2Q2017. (Reis)

In spite of increased unit deliveries, national vacancy finished at 4.4% — up from 4.2% one year prior. (Reis)

Sales volume reached $35.2B in apartment transactions in Q2 2017, 11% higher than the fiver-year quarterly average of $31.8B. (RCA)

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Valuation Trends

Bridge Valuation Basics

Bridge Loans are typically used for value-add scenarios.

They typically require two to three estimates of value:

As Is

As of the effective date of value, typically the date of inspection.

As Complete

Date that the renovations are complete.

Stabilized

Date by which the property will have a stabilized income stream.

Renovations typically involve:

- **Immediate Repairs**: Fix items noted in Property Condition report.
- **Exterior Renovations**: Items that increase curb appeal such as lighting, playground, cameras, asphalt work, new roofing, landscaping, etc.
- **Interior Renovations**: Items such as new flooring, kitchen countertops, cabinet fronts, lighting, appliances and bathroom vanities.

Not Always a Straight Renovation Play

Sometimes a renovation is not planned.

An asset could be identified as having poor management. The new sponsor could use a bridge loan to acquire the property and then improve NOI with proactive management, reducing physical vacancy, credit loss and trimming expenses.

or

A bridge loan is an option for properties with an expiring LURA. In this case, LIHTC tenants paying below market rents will vacate in the foreseeable future as the asset converts to market rate.

Value-Add Methodologies

There are special considerations for determining an appropriate purchase price for property that is not stabilized.

What are the out of pocket costs to achieve stabilization?

Can the sale price be reduced in excess of those out of pocket costs?

What is the amount "profit/risk" to deduct from the sales price?

Value-Add Methodologies

How to determine an appropriate **'profit/risk'** rate?

Sometimes this requires employing a **Discounted Cash Flow** vs. the traditional method of **Direct Capitalization**…but it's best to keep the analysis simple, if possible.

Common profit/risk rates for like properties range between **25% to 150%** of total capex.

That dollar threshold is often **$100,000 to $5M** in total desired profits.

Profit/risk **allocations vary** by property, budget, capital outlay and risk level.

From a valuation perspective, the estimate of profit could represent as much as **75% of the total budgeted renovations**.

Value-Add Methodologies

What are the typical challenges?

- ✓ Substantiating Changes in Rents
- ✓ Substantiating Decreased Expenses
- ✓ Projecting RE Taxes Based on New Value*

*Pro forma tax expenses reflect an increase from the subject's current — typically in the range of **60% to 90% of the "As Renovated"** market value estimate.

Sales Comparison Approach

When analyzing sales comps, **adjust to the condition of the property at stabilized occupancy**. This will result in a **Complete/Stabilized** value. Deductions are made to arrive at the **As Is** value.

Sales Comparison Approach Value Indication "As Is" = As Renovated Valued – Renovation Cost – Lease-up	
Hypothetical 'As Is' Renovated Value:	$55,100,000
Minus: Cost of Renovations (Plus Profit)	- 11,000,000
Minus: Lease-Up (Plus Profit)	- $1,350,000
Considered 'As Is' Value Indication	= $42,800,000 (Rounded)

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Income Capitalization Approach

The buyer's **projected rents are analyzed in comparison to the market**. The pro forma is developed using **post renovation rents and expenses**.

Earned Gross Income (EGI) Comparison		
Year	**Amount**	**Change**
T-12 February 2017	$3,473,517	--
T-3 February 2017 Annualized	$3,534,284	1.7%
Year 1 Pro Forma	$5,278,466	49.4%
Appraiser Forecast	**$5,257,874**	**48.8%***

*Appraiser's forecast EGI is 48.8% higher than the most recent operating results. The Pro Forma assumes planned renovations are complete, and the subject is achieving post-renovation rates. This is similar to the buyer's budgeted data and is supported by similar complexes in the area.

Overall Capitalization Rates – Conclusion	
Source	**Indicated OAR**
Market Derivation Method	5.01% - 5.27%
National Investor Survey	5.15% - 7.76%
Local Broker Survey	5.00% - 6.00%
Band of Investment Technique	5.86% - 6.26%
BBG Estimate	**5.50%**

Net Operating Income ÷ R_O = Indicated Value	
$3,139,151 ÷ 5.50% = $57,075,465	
Rounded = $57,100,000	
Income Capitalization Approach Value Indication	
Hypothetical 'As Is' Renovated Value:	$57,100,000
Minus: Cost of Reno.(Plus 75% Profit)	- $11,000,000
Minus: Lease-Up** (Plus 75% Profit)	- $1,350,000
Considered 'As Is' Value Indication	= $44,750,000 (rounded)

**Lease-up (rent loss) costs are estimated by comparing in-place monthly effective gross income (EGI) with the post-renovation EGI ($295,430 vs. $438,156). Using the difference in EGIs, we then divided that value over the number of months in the renovation period to calculate the monthly loss. As is common, a potential buyer would also expect an allocation for profit during these 12 months.

What Does an Appraiser Need to Get Started?

- ✓ T12 and Past Two Years of Operating Statements
- ✓ Current Rent Roll with Unit Mix & SF Identified
- ✓ Site Survey
- ✓ Declarations of Land Use Restrictive Covenants for LIHTC (If Applicable)
- ✓ Pro Forma Budget (As Is and Post-Renovation, If Applicable)
- ✓ Detailed Renovation Budget

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Arbor's Bridge Financing Programs

Bridge Loan Program Highlights

- ✓ Acquisitions with a value add component, properties in lease-up, partner buy out, timing bridge
- ✓ Quicker execution for bridge than typical agency, bank, or CMBS financing
- ✓ Generally non-recourse (with typical "bad boy" carve-outs), interest-only
- ✓ Interest reserve with replenishment required for non cash flowing assets

Key Bridge Loan Terms

Bridge Loan Terms	
Loan amount	$5 million minimum
Term	Generally 1-3 years
DSC	1.10x “As-Is”, 1.30x-1.40x Stabilized. Lower DSC considered if payment is supported by pre-funded interest reserve or guarantees
LTV	Up to 75% stabilized
Interest rate	Floating rate over LIBOR. Spread varies based on risk and terms.
Recourse	Generally non-recourse with typical “Bad Boy” carve-outs, interest replenishment, and performance tests.
Security	First mortgage lien on subject property
Eligible Property	Multifamily, Office, Retail, Hospitality, Senior Housing, Student Housing, Industrial
Prepayment	Generally permitted
Sponsorship	Established track record and appropriate net worth and liquidity commensurate with transaction

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Sample Executions

Case Study – Acquisition, Renovation, Stabilization

Objective: Client is purchasing a multi family property currently 80% occupied as a result of down units.

Issue: Property currently does not support a traditional loan at a level adequate for the client to acquire and renovate the property.

Solution: Arbor provides an acquisition / renovation loan to bridge to an agency take-out.

Arbor funds a bridge loan at acquisition and reserves the required funds for renovations.

Client begins the renovation program with Arbor funding the costs from reserves held at closing.

With renovations completed and the property stabilized, the client can proceed with an exit loan secured by Arbor through various agency execution with no prepayment penalty.

Since Arbor funded the bridge and agency loan, the borrower does not incur an exit fee.

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Case Study – Rent Restriction Burn Off

Objective: Client is purchasing a multi family property currently subject to a LURA, restricting rents to a pre-determined level based on AMI expiring in 3 years.

Issue: Property currently does not support a traditional loan at a level adequate for the client to acquire the property.

Solution: Arbor provides a bridge loan allowing the time needed for the LURA to expire and the property to stabilize at higher net cash flow.

Arbor funds a bridge loan at acquisition reserving an adequate amount for interest payments.

Once the LURA expires, the client leases units based on market rents, producing stronger cash flow.

With the tenancy and property stabilized, the client can proceed with an exit loan secured by Arbor thought various agency execution with no prepayment penalty.

Given the restricted rents, traditional financing would yield lower proceeds.

Q & A

Panel Q & A

The floor is open to submit questions in the 'Questions' tab of your control panel.

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Interested in partnering?

Please reach out to
Gianni Ottaviano, SVP, Director of Structured Finance,
at **GOttaviano@arbor.com** or **(516) 506-4580**