

**Senior Housing Project Development
Financing Business Model White Paper**

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Abstract: this white paper demonstrates the opportunity to use the real property form of commercial real estate development financing via the self-administered syndication approach using an advanced business model. This approach seeks to augment and/or replace commercial bank mortgage financing with a high degree of certainty of outcome. This method provides access to third-party financing as early as the pre-construction phase and replaces the developer's financial commitment to the project, while demonstrating a near-term window gain of up to \$25.00:\$1.00 for the developer who uses this business model.

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Commercial Income-Producing Property Capital Finance White Paper

Key Point Program Q&A

This section is for the express purpose of providing very brief answers to the topical questions covered in this white paper.

What is the purpose of this white paper?

This white paper demonstrates a business model and market opportunity for commercial real estate developers to capitalize and build large-scale projects offering an unusually high profit opportunity based upon non-traditional capitalization methods. Specifically, this white paper demonstrates a development opportunity for a specific class of commercial income-producing property that, in most cases, can obtain sufficient capital financing to commence construction without a construction loan or with a construction loan having a LTV ratio of less than 20%. Indeed, in most cases no front-end construction loan is required.

What key advantages does this proposed methodology provide to developers?

This ability to develop a project that offers a very high level of potential profitability without having to accept full-recourse construction financing, without having to accept a long-term investment of the developer's equity funds, or an equity dilution as the price of doing business. The return structure suggests a 3-year development period providing a cash-on-cash return above 250% per annum and an internal rate of return in excess of 100% per annum.

What makes this method more or less workable than other conventional capital financing business models?

This methodology allows the developer seeking capital financing to sidestep the "gatekeeper" role played by underwriters by directly accessing the investing-public to make a proposal for financing that is not constrained by securities laws and is therefore more efficient than reliance upon the underwriting process that only favors the largest developers and companies at the expense of all others.

Why senior housing?

Senior housing is a well-entrenched property group that offers a stable and growing demand, very low failure rates for stabilized businesses operating as private-payor facilities and a business model that other commercial property types cannot hope to match. The proposed business model set forth in this white paper has an exceptionally long track record of success; the difference is how we organize and capitalize the resulting business.

Why entry-fee senior housing?

Entry-fee senior housing offers the developer the opportunity to reduce the lease-up risk (market risk exposure) to a 90 to 120 day window, eliminate the need for front-end construction financing and allow the developer to pick up their money off the table at the start of construction – no other property type can offer these benefits. In a recessionary business cycle, capital investors are not want to accept market risk exposure of any kind, so funding realities dictate that it be dramatically reduced. In expansionary business cycles developers can get away with building out the inventory and then seeking to fill it as the market expectation is that the economy will continue to expand and demonstrate demand. In a recession



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this is not true, so the (winning) idea must be “sell it then build it”. Entry-fee senior housing provides this important advantage.

What does the developer have to put up and what does the developer get?

The developer provides pre-construction phase capital financing only. The model suggests the developer would provide approximately \$1.2 million in working capital during the pre-construction phase. When construction commences, the \$1.2 million is refunded to the developer and the developer controls the project without having to accept any dilution of their equity ownership interest or odious mortgage financing terms. The developer owns a project valued at \$60 million that has approximately \$40 million in long-term debt. The total developer yield (adjusted for market) is expected to be \$25 million over the first three (3) years of the development.

Why Rainmaker Marketing Corporation?

This model’s unique features and benefits are based upon the market experience of our firm that includes over 400 senior housing consulting assignments for new project developments throughout North America and the Caribbean Basin. Rainmaker can provide a complete continuum of supporting services and consulting to help the nascent senior housing developer.



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White Paper Synopsis

The purpose of this white paper is to demonstrate a business model for developers and owner/operators of commercial income-producing properties. This business model addresses the shortfall of equity capital funding via the incorporation of additional sources of project financing not previously considered to be practical. This source of funding (commercial real estate syndication sales plans) can be used on a wide scale due to the impact of Internet and advances in communication technology. This business model demonstrates a profit-making opportunity as great as 25 to 1 that may be realized in as little as three (3) years, with a practical range of 12:1 to 20:1 being the most likely range of values pertaining to developer cash flows from a given project. This business model focuses on the senior housing industry because of the unique capital market opportunities that *only exist* in the senior housing industry and this white paper describes the means and methods that enable this business model to work. This funding source (commercial real estate tenants-in-common purchaser syndicates) has a *fixed acquisition cost* that can be efficiently modeled and does not require additional collateral pledges or dilution of the developer's equity interest.

About Rainmaker Marketing Corporation

This white paper was prepared by Clint Lovell of Rainmaker Marketing Corporation ("Rainmaker") for the express purpose of demonstrating a business model that can be readily supported by Rainmaker. To that end, this white paper is qualified in its entirety to the conflict-of-interest this approach may in fact create. Rainmaker is a commercial income-producing property development, capital finance and due diligence consulting services provider headquartered in Houston, Texas. Rainmaker has been engaged in the field of commercial real estate capital finance consulting since 1993 and has completed hundreds and hundreds of senior housing industry development-related consulting engagements throughout North America and the Caribbean Basin. Rainmaker is a for-profit Sub-Chapter S corporation that can trace its roots back to 1989 and has supported the full range of the commercial income-producing property development continuum, ranging from single-project developments to national multi-unit roll-outs.

Background Information

The current private-sector economy of the United States is suffering through an unprecedented recession due to the combination of a credit crisis, housing industry crisis and a monetary policy crisis that, altogether, threatens the global economy with the classic "doomsday" crash that looms over Wall Street, Main Street, Capitol Hill and 1600 Pennsylvania Avenue. The U.S. public equities markets are not expected to recover their lost values any time in the near-term window, though they are showing nice gains. The consequential losses owing to the loss of the additional expansion potential our economy would have otherwise been able to create had the recession not occurred are now forfeit and this just adds to the unemployment debacle we now face. As the impact of the anticipated hyperinflation/deflation period begins to surface and affect any potential recovery, developers are left with a very tight capital market that offers



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seemingly little real opportunity. The pool of available capital in the public equities markets has been, more or less, reduced by almost a third as a result of the market crash. This condition serves to limit capital investment to publicly-traded companies and very large private firms with very large asset pools, long track records and a willingness of developers to bet their own personal fortunes on the outcome. In many instances, the reduction in market capitalization has resulted in a mass of companies finding themselves in default of their balance sheet maintenance covenants, even though the company may be current with all its other creditor obligations. Lenders are looking to bail themselves out of any and all transactions that look shaky because the federal market intervention is not likely to succeed. The flaws in the fractional-reserve banking system approach that has stymied regulators since the inception of the Federal Reserve System in 1913 have now reached the point of “systemic criticality” – a total credit market collapse is now a real possibility. The equities markets and commercial real estate markets reflect these realities.

For the commercial income-producing property developer seeking to devise a business model that will attract capital in a contracting credit environment, this is a potential business nightmare that is refusing to go away. The choice seems to be to sit out on the sidelines and hope something comes along to change the dynamics of the market.

Evidently many people are asking the same questions and calling Rainmaker to see if there was anything a consultant had to offer. There have been so many queries in the past few months that I thought if I could commit it to writing in a technical document, then we could really demonstrate the value of the opportunity to all concerned parties – not the least of which is the value of retaining Rainmaker Marketing Corporation to assist in the production of the opportunity.

The economic reality is that the Federal Reserve System (“The Fed”) has changed its collateral requirements for commercial loans it refunds, requiring banks to increase their collateral to The Fed (August, 2009 bulletin), so they, in turn, can expand their liabilities and creating new cash the commercial banks desperately need in order to make new loans in the process. This means the market is going to have to *find ways of getting more cash on the closing table* – embracing those business models and property types that offer this advantage to the exclusion of all other activities – until the recession ends. In previous recessions this condition has meant that, in addition to pre-construction phase financing, the developer would be required to raise more equity, and that would mean that developers are fighting a losing battle because of the current recession’s impact on the pool of available capital investment effectively eliminates them from investment consideration (those of you who keep racking up lender rejection letters know exactly what I am talking about).

I am proposing that you *consider all your financing options* because; now more than ever, you are responsible for underwriting the financing of your project. The more you can get others to put up, the less you will have to put on the table; it is as simple as that and Rainmaker is going to show you a way of accomplishing that task in a way that is extraordinarily lucrative.



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Instead of opening a vein and heading out the door to dilute your equity stake consider what will happen if you take a huge equity dilution hit now. A premature equity dilution could be a trigger for all sorts of moral hazards. And if not immediately, what will happen if you hit a rough patch three years from now? What will you have to offer investors other than the prospects of picking your bones once the bankruptcy discharge order is adjudicated? Before a lender makes a loan they have to know how they are going to get the money back and what the odds will be for sustained performance of all duties owed to the lender for the entire time a given loan is outstanding. The investment banking market seems to be saying that if you are not part of the Fortune 500, then please don't bother applying. There are alternatives that can help. This white paper focuses on a structural fix that fits neatly into the market for most commercial income-producing property types; and more pointedly, the senior housing industry.

That alternative is a commercial real estate syndicate sales plan and you need to think about your goals and your tolerance for risk as the commercial real estate syndicate is designed to reduce the risk exposure of commercial real estate developers and provide a shortcut to the goal of complete construction phase project financing. I am recommending a self-administered syndication approach because listing the deal with a commercial real estate broker takes way too long and has low odds of success. A self-administered syndication can use the power of national media exposure to generate sufficient contracts to guarantee a likelihood of success necessary to make the transaction scheme work. To get there, you have to come to an understanding of how recessionary business cycles impact capital financing.

The first issue you must deal with in a recessionary business cycle is the reality that you must have an alternative (or an additional) means of obtaining capital investment that does not rely upon the investment banking industry or the commercial banking industry to make the transaction work. As long as you remain wedded to the idea that (somehow) the commercial banking industry or the investment banking industry is going to recognize the true value of your proposal, you are going to be spending money for little to no possible gain. There are no guarantees for obtaining capital financing in commercial real estate development, there are only varying levels of risk that require varying levels of investment to be made on faith. Your job is to eliminate the risks you cannot control or manage by your own hand to the greatest degree possible and then rely upon your own management abilities to control the risks within your reach to realize the success potential your plan presents. The banking industry represents a gateway to **distribution** for the sale of investment products, but the banking industry is not the only gateway available to you and that is the good news you really need to come to grips with to be successful. Distribution is the key and that is why selling commercial real estate interests can be made to work for your benefit – the sale of commercial real estate can be done on a public basis and is not constrained by the Securities Act of 1933, as would be the case with equity or debt security syndications. This key difference means commercial real estate sales represents a **distribution** channel for commercial real estate development financing **you** can access and control to **your** exclusive benefit and use to augment or replace commercial mortgage bank financing for your new construction project. Used correctly (and creatively), the commercial



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real estate syndication avenue allows the developer to replace the developer's capital in the transaction before construction operations commence. Are you paying attention now?

Commercial Real Estate Syndicates & Syndications

A commercial real estate syndicate is a group of purchasers seeking to own a defined real property interest (usually a special warranty deed of ownership) for the purposes of receiving investment income and a long-term capital gain opportunity. We are using the Tenants-In-Common (or "TIC" – pronounced "tick") real estate ownership plan (or "TIC Plan") that allows multiple investors to participate in the ownership of a real property interest (owning real properties as in a hotel, a retirement home, a retail shopping center, etc.) in exchange for cash consideration and some kind of business deal the parties agree upon to compensate the syndicate participants for their patronage. The cash consideration is used by the developer to fund a portion of the development, construction and operating activities associated with the project the TIC Plan real property interests represent. The TIC Plan approach is the most logical approach the developer will likely want to adopt for the following reasons:

- **Funding Access.** Access to proceeds of the sale during the pre-construction phase is the hallmark of the TIC Plan. This point/benefit cannot be overstated; and
- **Opportunity Attraction.** The potential purchasers get a very attractive opportunity that includes a locked-in, higher-yielding investment and a security position that is better than the bank. This means fewer sales barriers and that's the key to the whole program.
- **Equity Dilution.** The syndication of real property interests have nothing to do with the equity ownership interests – no equity dilution is necessary to complete a syndication sales program (though commercial terms may demand the consideration include equity ownership opportunities); and
- **Leverage.** The syndication process can create incredible levels of financial investment leverage most developers can only dream of¹ (as high as 25:1); and
- **Cost of Issuance.** The costs and time required to perfect and complete a TIC Plan syndication of real property interests can now, *cet. par.*, be pegged to a defined schedule of costs, thus opening the door for more syndication opportunities for more projects because there is a defined path to success that every commercial income-producing property developer craves. Whether you hire a syndicator or undertake the syndication on a self-administered basis, you now have the roadmap to success you have been waiting for; and
- **Replicable Business Model.** The program approach is designed to allow the developer to use the same working capital investment, *cet. par.*, to fund multiple projects.

In most states, TIC ownership sales are not subject to consumer protection laws, so the funds received may be applied to a schedule of payments that correspond to the pre-construction and/or construction phase draw schedules, if the business deal between the developer and the syndicate allow such funds to be applied in the manner we are suggesting. *This is a business*

¹ Meaning that for every dollar of seed capital the developer contributes to the project, the developer's net profit is expected to be the multiple shown (in this case, 25).



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deal point that cannot be overlooked because this can be the classic “gap financing” tool you have been waiting for all this time.

The disbursement schedule of the sales proceeds is pro-rated with the other sources of capital that constitute the construction phase budget based upon the business deal agreed upon at the time of sale (like any other contract). This means the project capital structure can be partially funded based upon, *cet. par.*, a contract purchase of a forward real property interest on a fractional basis. If you put up 10% of the gross funding of the syndicate, then you end up with a special warranty deed entitling you to 10% of the ownership of the real property and improvements that constituted the syndicate, or as may be otherwise agreed upon by the parties (you should have Rainmaker structure your deal so you don't screw this up and give away the store). This is a form of real property ownership that is used because it fits our needs more efficiently than a fee-simple ownership based plan where the investors own the business and the business owns the real estate. This means the syndication adds financial flexibility right when you need it the most. The TIC Plan approach is more appropriate than a condominium association ownership plan because consumer protection laws force the developer to escrow condominium ownership plans sales proceeds until construction is complete. Developers need to have the portion of funds represented by the prospective real property syndicate *to be in the funding pot at the end of the pre-construction phase and not the end of the construction phase as that means a construction loan would still be required.* The issue has an important additional benefit; it has nothing to do with the equity interests and can be treated as a new class of capital in the capital structure (sometimes called the “capital stack”). That means we can do some creative things that can change your business model in a fundamentally powerful way.

For this to work, the developer must be able to satisfy, *cet. par.*, the following condition precedents:

1. There must be a defined holding period – a pre-determined take-out buyer for the real property interests that guarantees to repurchase the interests on terms decided upon today. This is usually computed for the developer in a financial feasibility study (and we hope you select Rainmaker to do your project's financial feasibility study).
2. There must be an economically meaningful defined benefit – the economics have to be attractive to the investor and easily attainable; in short, a gut-cinch yield guarantee. In an expanding economy you can make bold promises and people will take the risk as their expectations are that the market will continue to expand. In a recessionary economic cycle, the developer must provide a guaranteed yield (capitated to be sure) because nobody is interested in hearing the same promises that ended in yesterday's financial disasters. This is purely a transaction structure issue the financial feasibility consultant should resolve without reliance upon the developer's future financial status or the transaction structure won't work and the deal will fail to fund.
3. There must be no substantive market risk in holding the real property purchase. This involves a restructuring of the development schedule for your project. *Entry-fee senior housing is uniquely suited to this requirement because entry-fee senior housing is the only industry where it is legal for us to sell a given living unit (an apartment) to two*

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different parties at the same time and the transaction be legal and ethical in every respect.

4. The developer must demonstrate that all other required funding will be available at closing. If you have pending security sales, these must be fully ready to close at the same time as the syndicate sales escrow closes. If you think your project may qualify as a private placement offering pursuant to the EB-5 non-recourse development financing program (Reg. S), then special considerations apply that your capital finance team should fully explain to you prior to you making your final determination on your capital funding solicitation business plan of operations. If you are going to be using tax credits of some type (e.g.: New Markets Tax Credits) then the qualified allocation plan, allocatee's funding letter and offering document (letter offering or placement memorandum) must be complete with a legal opinion and ready to close. These can be very expensive, so caution needs to be exercised if a private placement offering of securities is being contemplated.
5. The developer has to have the necessary capital to offset the pre-construction phase due diligence costs and the marketing and advertising costs associated with the syndication opportunity (this almost always works out to be around \$1,200,000 in the model demonstrated in this white paper to take a project proposal from a standing start (no site and no plans of any kind) to close of escrow). This requirement will in fact be less if a syndicator accepts the transaction proposal and has a ready market at hand to sell the syndication. If a self-administered syndication is used (as is the assumed case in this white paper) then the \$1,200,000 estimate becomes a working number with real weight to it as the developer must fund a marketing and advertising campaign of sufficient magnitude and scope to sell-out the syndication. This is a part of the transaction that has to have a very high level of confidence as to a guaranteed outcome, so the developer must seek to overkill the marketing to ensure there is no chance of failure for this most important part of the entire project's capital financing process; this means *the developer has to have an appreciation of the risks and the requirements for a successful outcome* regarding these issues.

The solution to these issues is a structure known as "stated yield" – the structuring of the investment is such that, more or less, it mimics the so-called "zero-coupon bond"². Essentially, it is a reverse arbitrage of real property interests where the developer sells a portion of the *future* real property interests (for the sake of argument, say 30%) to a group of people and/or companies that want to own these interests in exchange for cash consideration now and a contract that entitles them to various kinds of future income. They are buying these interests on a forward basis at a discount that works out to around 66.66% of the actual cost of development. The business deal will state that the developer (that would be you) will guarantee to repurchase the units in the plan of syndication in seven (7) years for an amount equal to 175% of the amount

² A zero-coupon bond is sold without a stated interest rate; instead, it is sold at a discount off of the face value of the bond and that discount becomes the bondholder's profit in the transaction.

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the syndicate participants are paying today, less any distributions the property makes to the syndicate in the intervening years.

The developer's goal is simple; distribute an amount equal to 25% of the purchase price (the syndicate's basis) over the course of the intervening years, thus reducing the buy-back percentage to 150%. If successful, this 25% of basis payment will equal approximately 10% of the property's total profit spread over the course of the first 5-year holding period; meaning the developer could, *cet. par.*, pay off the syndicate out of the developer's own pocket with no loan in just five (5) years with money to spare. This is important because 150% of 66.66% is 100%; meaning, the developer is agreeing today to purchase back these syndicate interests for a price that is equal to what it costs the developer to develop the property today. Let's test this in relation to three (3) of the five (5) requirements set forth above, in that:

- ***“There must be a defined holding period – a pre-determined take-out buyer for the real property interests that guarantees to repurchase the interests on terms decided upon today.” The developer is obligated to repurchase the inventory in seven (7) years and there will be significant security guaranteeing this outcome will come to pass.***
- ***“There must be an economically meaningful defined benefit – the economics have to be attractive to the investor and easily attainable; in short, a gut-cinch yield guarantee.” A 175% payback over a seven (7) year period is equal to paying an average cash-on-cash return of 25% per annum for each year of the seven (7) year holding period.***
- ***“There must be no substantive market risk in holding the real property purchase.” The market risk equates to making a bet that whatever the cost of development is today, these costs of development will be higher seven years from now.***

The last requirement requires us to discuss the other portions of the capital stack and why a senior housing property is being used to illustrate these issues.

Senior Housing Industry - Your Best Chance of Success

The senior housing industry in the United States is the gold standard of retirement living systems in the world with over 2.4 million living units in the system nationwide. The failure rate for existing senior housing businesses is less than five percent (5.00%) of operating properties for a given year and additional information can be obtained from the Department of Housing & Urban Development (www.hud.gov) regarding the strength and prospects for the senior housing industry. This is a stable, well-entrenched business that has incredibly strong growth prospects for the next 30 years due to our aging population here in the United States and enjoys a business model that is a proven financial performer. The current supply is woefully inadequate to caring for all our seniors. To put this problem into context, if we were to empty out all 2.4 million living units and restrict the occupancy of these units to those persons with a diagnosis of heavy dementia, aged 65 and older, the entire 2.4 million living units would be filled and still have a waiting list. The demographics definitely favor this business model.



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Senior housing presents the developer with a special opportunity that no other industry in the U.S. can offer; senior housing properties can sell a given apartment (or other living unit) twice, and at the same time, to two different buyers and it is all legal, ethical and copasetic. The senior housing industry delivers housing three (3) ways while multifamily housing developments (apartments) and the sale of housing units (planned communities) can only deliver a given unit (apartment or house) in two ways; you rent it or you purchase it. Senior housing communities offer of a third kind ownership called an “entry-fee estate” (commonly referred to as “entry-fee”) that is only available and used in the senior housing industry for the past 40 years and there are over 100,000 units of entry-fee senior housing in the U.S. today. Entry-fee senior housing is an established sub-market with strong financial and market advantages the developer cannot afford to ignore under any circumstances (much less those of recessionary business cycles).

Future residents pay an entry-fee that is adjusted for market and is roughly equal to what the purchase price of the real property interest would be if the unit was put up for sale in the real estate market, plus a spread that represents the unique added-value points that make senior housing different from regular multifamily (apartment) transactions. These entry-fees can be quite large (over \$1 million in some cases) and may be refundable when the senior moves out or passes on. The trigger is that once the senior moves out and the next tenant moves in pays their entry-fee, then the previous tenant’s entry-fee is refunded subject to the business deal conditions agreed upon when the resident originally moved into the senior housing community. Some communities are built with no portion of the entry-fee being refunded when the resident moves out, while others refund some portion up to 100%. The most commonly found entry-fee arrangement is 70% refundable after a certain vesting period has been met. *Rainmaker seeks to support those projects where it is practical to have a 100% refundable entry-fee.*

The practical effect is to create a pool of funding that now includes the following pieces to the capital stack:

1. Real Estate Syndication Proceeds.
2. Entry-Fee Pre-Sales Proceeds.
3. Tax Credit Financing Proceeds.
4. Developer Capital Proceeds.
5. Other Common Capital Contribution Proceeds.
6. Construction & Permanent Mortgage Loan Proceeds.

The goal is to create a capital plan that is “bullet-proof” and easy to understand. All stakeholders in the project must clearly see how their interests are being safeguarded, but not at the cost of anyone else’s interests because no commercial development project can be successful if any stakeholder has to be marginalized. This reflects back on the senior housing market selection – it has to be a market that supports a large project; a Continuing Care Retirement Community (or CCRC) that offers entry-fee housing and a project development profile based upon market conditions and not anything more than actual pre-sales you have in your hands at any one time. For this to be able to happen, you have to be able to reduce the amount of housing inventory you are going to build at any one time so that you reduce the market risk exposure of

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your investors and syndicate participants or the transaction will in fact fail. If you have to build all of the inventory in one fell swoop, this may not work because the construction mortgage financing term sheet will require, *cet. par.*, an enormous pre-sale burden be satisfied prior to advances being made under the construction mortgage financing loan agreement draw schedule; that won't help, it will only make things harder. Is this sounding eerily familiar, yet?

To make your program work you will have to be able to develop horizontally so that actual sales can drive the process in a meaningful manner. Luckily, there is, more or less, a direct relationship between dollars spent and pre-sales made for markets that have new product coming in at a sharp discount. Remember; we have to be able to demonstrate that everything is going to work in excess of our own inhibitions, or you will have to keep writing checks for pre-

construction costs, so good planning and good execution strategies perfected now will pay off in the long run. Reducing your project's total market risk exposure from an unknown/extended period of time to a 90-day pre-sales window will create confidence in your plans.

Business Model Tenet:
Choose a project site that is large enough to allow you to build out your project horizontally instead of vertically because a vertical project requires you to build (and therefore, pre-sell) all of your inventory at once. In a recession, this is extremely risky and your business model won't attract capital market support – no funding will be the end result..

The answer is that *we need to completely insulate ourselves from a market failure* to the best of our ability, so how do we do that? Well, one way would be to sell at cost; there will be more buyers for your product (whatever it is) if you sell it for what it costs you to develop and produce. That would be a steal in the senior housing industry because the expectation is that luxurious *living quarters command a premium over and above their cost*; a traditional market assumption that only rarely fails to please. But just in case, why not sell these for a loss too? Wouldn't that just about guarantee success? It would be a more substantive guarantee, so we will use this strategy to guarantee our future economic opportunity because; in a recession, the

developer needs a strategy that has, more or less, a guaranteed outcome or the developer is placed in the position of being bankrupted by a failure to attract capital in time to make the development work out. So, our focus will be on the steps, strategies and structures that, *cet. par.*, lend themselves to providing the developer with a course that has the highest practical level of a guarantee of outcome – where that outcome is a fully-funded project budget for construction and development.

The prototypical CCRC is, *cet. par.*, an \$80 million, 308-unit, 375,000 square foot retirement community having a campus-style setting that allows us to reduce the build-out market risk to as little as 10% of the total inventory. Now that's more like it – a manageable program. In point of fact; it's so manageable that *you could pre-sell each building's entire inventory before you*



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even start construction. When the building sells-out, you start construction, and when construction is complete, your building is 100% occupied and providing positive cash flow – from the “get-go”. You simply continue the process until the community is sold out. How do you know when the community is sold out? When the total net sales (new resident move-ins minus existing resident move-outs) is zero, then your sales are matching your resident turnover and no new development is then possible; construction stops and the rest of the property programs are built out when there is sufficient cash flow from ongoing operations to support the operations of the health care center whether there are any residents in the health care center or not. The timing of the health care center’s development is critical because if it requires any working capital to stabilize, the developer will be the one forking over the money.

Now we can answer the fourth requirement:

- ***“The developer must demonstrate that all other required funding will be available at closing.” By reducing the amount of inventory being built at any one time, the developer reduces the project success hurdle to an anthill because success is now dependent upon the developer’s willingness to sell interests at a loss in order to obtain capital. Selling at (what appears to be) a loss is a market unto itself because your competition will be loathsome to even consider it, much less enact it.***

The entry-fee sales will be made at a loss to the market, but not necessarily cost. These are subject to a careful analysis process to pick (what is hoped to be) the optimum sales price. In this regard, the true value of an expert market feasibility analysis report is of critical consideration. The market consultant must understand these capital finance issues as well as the market issues in order to render a report that has real meaning and most of them have little if any consideration for this issue.

There are no guarantees of success for the developer, but there is a way to increase the likelihood of success with safe and sound banking practices. Let’s look at the capital stack on a pro-rata basis with an assumed \$44 million initial phase development budget:

Developer Capital:	\$1,000,000/2.22%
Entry-Fees/Pre-Sales	\$24,000,000/53.33%
TIC Plan Real Estate Syndicate Sales	\$12,000,000/26.67%
Bank Loan:	\$8,000,000/17.78%
Total Proceeds:	\$45,000,000/100%

For the sake of demonstration, the bank loan was increased by \$1 million to correspond to the return of capital to the developer at the closing of the construction financing escrow.

Those numbers work out to a bank loan having a LTV ratio of less than 20%! So let’s see if everything is accounted for properly in terms of the following stakeholders:

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- **Developer.** The developer has to put in \$1 million (whatever the actual computed amount is that is dictated by the findings of the financial feasibility study – the attached model shows an expenditure of \$1,226,000) that covers all the pre-construction phase costs of this business model, plus the costs of marketing the syndicate. The developer receives the \$1 million back at close of the commercial real estate syndicate sales escrow. The developer is now facing a potential moral hazard because the developer is only risking future profits, not what would otherwise be the developer’s capital investment. The governor preventing “bad” behavior is the pre-sale requirement; before construction starts on a resident building, the building must be pre-sold. The developer also receives a development management fee; the net profit of which would put approximately \$1.5 million in the developer’s pocket within 180 days of the start of construction and another \$1.5 million net profit in fee income for the follow-on phase of construction and development. When the community is complete the developer can immediately sell the community and reap a total net profit of approximately \$20 million to \$25 million for a single property where the developer’s original investment was \$1 million. Clearly, the developer stakeholder is taken care of.
- **Future Residents.** The entry-fees are paid by future residents of the community and are used to pay for the development of truly extraordinary property amenities, larger living units and more luxurious accommodations and common areas. When the resident moves out and the next tenant comes along, the entry-fee is then refunded. Residents get a “champagne retirement living experience on a beer budget”. The entry-fees are at a subsidized rate due to the capital financing structure, so the discount makes it hard for future competitors to enter the market and the resident enjoys the benefit of the discount. Clearly, the resident stakeholder is taken care of.
- **Syndicate Participants.** The syndicate will receive their 25% per annum average cash-on-cash return and then exit the transaction. The syndicate will not have to pay any property taxes, insurance or maintenance costs associated with their investment, so the 25% per annum is almost all pass-thru to them. The syndicate will receive a buy-back agreement that is part of the closing that commits the developer to repurchase the contract at the stated sum and if the developer doesn’t perform, the syndicate gets the developer’s ownership without a court fight and subject only to the future capital financing requirements. This isn’t holding a gun to the developer’s head, this is strapping a time bomb to his waist. Clearly, the syndicate investor stakeholder is taken care of.
- **Bank.** The bank gets first-lien position (on improvements) for making the construction loan that has a LTV ratio of less than 20%. This loan is shielded from any appreciable market risk exposure and the developer uses the design/build approach to construction management so as to eliminate the lender’s construction risk exposure. All future construction is based upon current sales or current debt service coverage being demonstrated before there is an advance of credit so the bank is not placed in a significant capital risk position. Clearly, the bank stakeholder is taken care of (editor’s note: in most cases, the bank loan can be completely eliminated).



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The Business Model

The final step was to pull everything together into an integrated business model that structurally eliminates unsustainable levels of market risk exposure and has a very-high likelihood of success, provided; there exists, *cet. par.*, sufficient market opportunity to sustain the intended development programming. The opportunity is on the scale of as much as 25:1 return on investment for the developer's capital investment having a near-term window of approximately three (3) years; a truly staggering feat of financial investment leverage by anyone's measure that includes an internal rate of return to the developer exceeding 100% per annum for the projected holding period when everything is optimized and a material success has been achieved.

This all comes down to working capital and this business model has been specifically designed by me to give you the working capital necessary to survive a recession lasting as long as three years³. This is a business model with real teeth and a fall-back plan that doesn't include a trip to bankruptcy court as an essential feature if the going gets tough. The "all cash" business model means the developer can wage economic warfare and still go back to the well and obtain bank financing to build-out the property after the fact. This is a fundamental advantage your current business model cannot provide.

The longer it takes the project to sell out the entry-fee interests, the more it drains the working capital and (in a recessionary business cycle) working capital is almost always the developer's responsibility to fund. Nobody will lend it and few will put it up for new project developments where the developer does not have previous product development experience. The developer has to put up sufficient working capital, that:

1. Provides enough funds to complete all required due diligence documentation processes associated with the project. This would include market and financial feasibility studies, engineering, architecture, valuation, environmental, operations, marketing, advertising, construction and related disciplines through the Schematic Phase Architectural Phase only; and
2. Provides enough additional funds to pay for the costs of organizing and completing the process of syndication of real property interests (a fixed cost) that varies based upon the developer's election to either hire a syndicator or undertake the syndication on a self-directed/administered basis; and
3. Provides enough additional funding to accomplish the first two (2) objectives above and pay the costs of the initial 90-day pre-marketing program window that is used to attract buyer attention for prospective residents of the future project; and
4. Provides enough additional funding to accomplish all three (3) of the above objectives and pay the costs of the first 90-day marketing period for the first resident building to be pre-sold (i.e.: entry-fee presales) prior to the commencement of construction.

³ Three (3) years was chosen because the operating theory is that Americans will only give our political leaders one (1) congressional term (that being two (2) years) before replacing them with political leaders who will change course and do what is necessary to end a recession. This effectively limits the effects of a recession to no more than three (3) years.



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The business model requires a workable market opportunity. You will need to have a market feasibility study prepared that documents the size and scope of the potential market opportunity or the syndication will be placed at risk. The market analysis will tell us how long it should take to sell-out the project and all the other project particulars that must be ascertained prior to undertaking the design process and pre-sales programming. That time period becomes the project's new schedule; a development metronome if you will that seeks to pre-sell every living unit entry-fee in every building before you build the unit.

Each building has roughly the same size and square footage of space; **the variable is the number of living units in each building.** Odds are, they will be different because the building's construction start trigger is a sell-out of the building. So if more one-bedrooms are selling than would otherwise be the case, two-bedroom units may be cannibalized, increasing the number of living units in the building, but not necessarily increasing or decreasing the total size of the building. This may make the building permitting process more frustrating, but the outcome is well worth the effort; if you work with the local Permits Department and show them what you need to accomplish, there is likely going to be a fast-track permitting process to allow the pre-sales program to work in the way it is intended. Having said all that, if the building permit cannot be contrived in this way, then this model may not be workable because the job here is to pre-sell as much of the building as possible before you build, so you are always building to market and not building out speculative product that you have to wait to fill before you can move on to the next phase. The result is that each completed building represents positive cash flow from Day 1 of operations and that makes the syndicate proposal just that much stronger.

The construction program becomes the big issue facing the developer. In a recession nobody will believe the average real estate developer is capable of managing construction risk for the benefit of the lender, so the lender requires the developer to agree to a totally unworkable solution – joint and several recourse. The only workable solution for this predicament is to commit to delivering the project using the design/build method. This makes the contractor responsible for more than just the quality of construction, cost of construction, satisfaction of all vendor and sub-contractor payment claims and the timeliness of construction. The design/build approach ensures the contractor is (also) responsible for all related costs attending so-called “second dollar” change order costs where work has, for whatever reason, been incorrectly installed at the project, forcing the contractor to tear out all the work and rebuild it properly. Historically, contractors and architects have each blamed the other party for second dollar change order costs and suffice it to say that the design/build process eliminates this as a potential outcome. This approach, combined with the capital finance model that calls for extremely low Loan-To-Cost Ratio for the construction loan (being provided at the tail-end of the initial phase of development or not at all), gives you the basis for demanding the construction loan be non-recourse to the developer/borrower and have the lender accept this demand. You can always sell more real estate interests or increase entry-fees and use those proceeds to replace the lender. What I am showing you in this white paper is that you can

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replace the lender, eliminate all of the risk and expense associated with the entire loan acquisition process and make your project more financially attractive for your exclusive benefit.

This leads the discussion back to the commercial real estate syndicate. You have questions and concerns. You are unsure of how to proceed. You want to know how it can work and how it can fail. Like anything else, there are plenty of means and methods for undertaking the sale of real property interests pursuant to forming a commercial real estate syndicate and there are plenty of instances of success and failure out there to demonstrate the point.

We already know that we can structure (more or less) a business deal that is attractive to the investors, but we left it at that with no discussion about the syndication process, *per se*. The key is understanding the nature of the market opportunity before you. The definition of this market opportunity is that opportunity:

1. Wherein: there is a tract of land that has no less than 15 buildable acres, but not more than buildable 25 acres that can be purchased for a price not to exceed \$6.00/sf and is entitled for the intended use with a multifamily housing density of 30 living units per acre being preferred, but the density should not be less than 25 units per acre (or at least 325 living units for the entire real property parcel); and
2. Wherein: the necessary utilities are also present at the site property line and ready for connection; and
3. Wherein: a credible market study finds there to be a net buildable demand of no less than 300 units of entry-fee independent living senior housing over an assumed absorption period of no more than 30 months; and
4. Wherein: the market conditions suggest there is an opportunity for discounting entry-fee interests and still make the project capital funding structure work, including the presence of sufficient market opportunity to allow for the use of a very sophisticated commercial real estate syndication process to take place.; and
5. Wherein: the developer can find a design/building of sufficient size and experience to provide complete payment, performance and completion bonding for the proposed project and has definitive expertise in the construction systems that would be assumed to be used; and
6. Wherein: the developer has a qualified senior housing industry property management group to manage the day-to-day operations, marketing, advertising and sales; and
7. Wherein: the developer has access to up to \$1.2 million to fund a given project's pre-construction phase activities.

Business Model Tenet:
Use the design/build approach to managing all aspects of the construction and design processes and you will save money and eliminate undue risk-taking on the part of the lender. Remember that you will need TLC on the building permits.

So, the key points of alignment between you and your new business model are:



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- This business model requires the developer to have approximately \$1,200,000 to leverage an \$80 million deal where the developer stands to gain, *cet. par.*, approximately \$25 million over a three-year development period, assuming everything works out.
- The business model requires the developer to employ a commercial real estate syndication sales program to provide additional funding for the proposed project. The developer can employ a syndicator to undertake this process (provided the business deal meets the capital funding tests) or under this process on a self-administered basis.
- The business model requires the developer to develop an entry-fee Continuing Care Retirement Community so as to be able to sidestep the requirement of obtaining construction mortgage loan financing as a prerequisite to commencement of construction phase activities.

The end result of your efforts is a three-phase development program that can be used to “bootstrap” a much larger opportunity because the cash flows associated with the development of the property can be realized in a near-term window and applied to the pre-construction phase costs of other projects; you have a self-perpetuating roll-out as the prime result.

In terms of the senior housing property, you will be constructing the project in a three (3) phase program, to wit:

- The initial phase consists of the development of all site infrastructure needed for the project, the take-down of the land, the completion of all due diligence activities, the construction of the commons building and the construction of the first phase of approximately 120 entry-fee independent living facility (“ILF”) units; then
- The second phase focuses on construction of an additional 120 entry-fee ILF units (or whatever number the site and the market will bear); then
- The third phase focuses on the construction of the property’s “health care center” that provides assisted living care facility apartments of frail seniors and a locked dementia care facility program that is also licensed at the assisted living level that commences once sufficient cash flows from continuing operations exist to offset the operating and non-operating costs of the health care center whether it is occupied or not.

A prototypical pre-construction phase budget/schedule is provided on the following page. To find out more about what can be done, feel free to contact Clint Lovell at 281.537.1200.

END OF WHITE PAPER



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Pre-Construction Phase Cash Flows - Uses of Project Funds																												
308-Unit Entry-Fee Senior Housing Project Assumed Location: NE Houston Project Assumed Start Day: 4-May-10																												
Period Ending:	4-May	19-May	3-Jun	18-Jun	3-Jul	18-Jul	2-Aug	17-Aug	1-Sep	16-Sep	1-Oct	16-Oct	31-Oct	15-Nov	30-Nov	15-Dec	30-Dec	14-Jan	29-Jan	13-Feb	28-Feb	15-Mar	30-Mar					
	120-Day Project Pre-Construction Phase Due Diligence Period									90-Day Project Pre-Marketing Window						90-Day Project Initial Resident Building Pre-Sales Period												
Uses of Funds: Does Not Include Land/Site Control Costs																												
Syndication-Related Support Activities & Costs: \$1879.5K Budget																												
Market Feasibility Study: \$15K Budget		\$ 15,000																										
Survey & Soils Testing: \$13.5K Budget		\$ 7,500	\$ 1,500	\$ 1,500	\$ 1,500	\$ 1,500																						
Environmental, Wetlands & Related Consulting: \$8K Budget		\$ 3,500	\$ 1,500	\$ 1,500	\$ 1,500																							
Civil & Other Site Engineering Costs: \$27.5K Budget		\$ 10,000	\$ 2,500	\$ 2,500	\$ 2,500	\$ 2,500	\$ 2,500	\$ 2,500	\$ 2,500																			
Financial Feasibility Study: \$21.5K Budget		\$ 12,500		\$ 1,500	\$ 1,500	\$ 1,500	\$ 1,500	\$ 1,500	\$ 1,500																			
Legal/Organizational, Tax, Accounting/Auditing Costs: \$24K Budget		\$ 2,500	\$ 2,500	\$ 2,500	\$ 2,500	\$ 3,500	\$ 3,500	\$ 3,500	\$ 3,500																			
Conceptual & Schematic Phase Architectural Design Fees & Costs: \$280K Budget		\$ 25,000		\$ 3,500	\$ 3,500	\$ 3,500	\$ 3,500	\$ 3,500	\$ 7,500	\$ 55,000	\$ 10,000	\$ 10,000	\$ 10,000	\$ 10,000	\$ 10,000	\$ 10,000	\$ 55,000	\$ 10,000	\$ 10,000	\$ 10,000	\$ 10,000	\$ 10,000	\$ 10,000					
Pre-Opening Operations & Marketing: \$982.5K Budget		\$ 5,000		\$ 5,000	\$ 7,500	\$ 15,000	\$ 15,000	\$ 15,000	\$ 15,000	\$ 25,000	\$ 25,000	\$ 45,000	\$ 45,000	\$ 70,000	\$ 70,000	\$ 80,000	\$ 80,000	\$ 80,000	\$ 80,000	\$ 80,000	\$ 80,000	\$ 80,000	\$ 80,000	\$ 80,000				
Plan of Real Estate Sales Syndication: \$27K Budget				\$ 20,000	\$ 1,500	\$ 1,500	\$ 1,500	\$ 2,500																				
MEP/Construction Pricing/Value Engineering & Related: \$40.5K Budget				\$ 25,000	\$ 3,500	\$ 3,500	\$ 3,500	\$ 5,000																				
Website Design & Virtual Tour Video Production: \$40K Budget				\$ 15,000	\$ 10,000	\$ 7,500	\$ 7,500																					
Advertise, Market & Sell-Out of Syndicate: \$400K Budget				\$ 100,000	\$ 125,000	\$ 175,000															\$ 150,000							
Project Entry-Fee Sales Program-Related Costs: \$782.5K Budget																												
Architectural Marketing Deliverables: \$45K Budget				\$ 12,500	\$ 12,500	\$ 12,500	\$ 7,500																					
Other Third-Party Consultants: \$19.5K Budget				\$ 3,500	\$ 2,500	\$ 1,500																						
Development Management Fees: \$285K Budget		\$ 7,500	\$ 7,500	\$ 7,500	\$ 7,500	\$ 15,000	\$ 15,000	\$ 15,000	\$ 15,000	\$ 15,000	\$ 10,000	\$ 10,000	\$ 10,000	\$ 15,000	\$ 15,000	\$ 15,000	\$ 15,000	\$ 15,000	\$ 15,000	\$ 15,000	\$ 15,000	\$ 15,000	\$ 15,000	\$ 15,000				
Video Production, Models & Related Costs: \$205K Budget				\$ 25,000	\$ 20,000	\$ 20,000																						
Bidding, Letting & Related Costs of Design/Builder: \$31.5K Budget																					\$ 4,500	\$ 4,500	\$ 4,500	\$ 4,500	\$ 4,500	\$ 4,500	\$ 4,500	
Platting, Permitting & Entitlements: \$35.5K Budget																					\$ 4,500	\$ 4,500	\$ 4,500	\$ 4,500	\$ 4,500	\$ 4,500	\$ 6,500	\$ 6,500
Property Management Fees & Expense: \$81K Budget				\$ 4,500	\$ 4,500	\$ 4,500	\$ 4,500																					
Local/State/Federal Regulatory Review Costs: \$80K Budget																					\$ 10,000	\$ 10,000	\$ 10,000	\$ 10,000	\$ 10,000	\$ 10,000	\$ 10,000	\$ 10,000
Total All Costs for Period		\$ 15,000	\$ 31,000	\$ 53,000	\$ 25,500	\$ 70,500	\$ 72,000	\$ 201,500	\$ 218,000	\$ 268,500	\$ 271,000	\$ 71,000	\$ 91,000	\$ 91,000	\$ 121,000	\$ 121,000	\$ 141,000	\$ 175,000	\$ 128,500	\$ 128,500	\$ 128,500	\$ 128,500	\$ 130,500	\$ 130,500				
Cumulative Costs		\$ 15,000	\$ 46,000	\$ 99,000	\$ 124,500	\$ 195,000	\$ 267,000	\$ 468,500	\$ 686,500	\$ 955,000	\$ 1,226,000	\$ 1,297,000	\$ 1,388,000	\$ 1,479,000	\$ 1,600,000	\$ 1,721,000	\$ 1,862,000	\$ 2,037,000	\$ 2,165,500	\$ 2,294,000	\$ 2,422,500	\$ 2,551,000	\$ 2,681,500	\$ 2,812,000				
		Developer Provided Financing (if Commercial Real Estate Syndication Financing Method is Used.)																										
End of report...																												

Total Projected Developer Capital Required: \$1.25 Million.