



Using Debt Capital and The Secondary Market to Scale Production: Fools Gold or Pay Dirt

Habitat Capital

Section 1

Introduction

Presenters

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Management

Habitat Capital

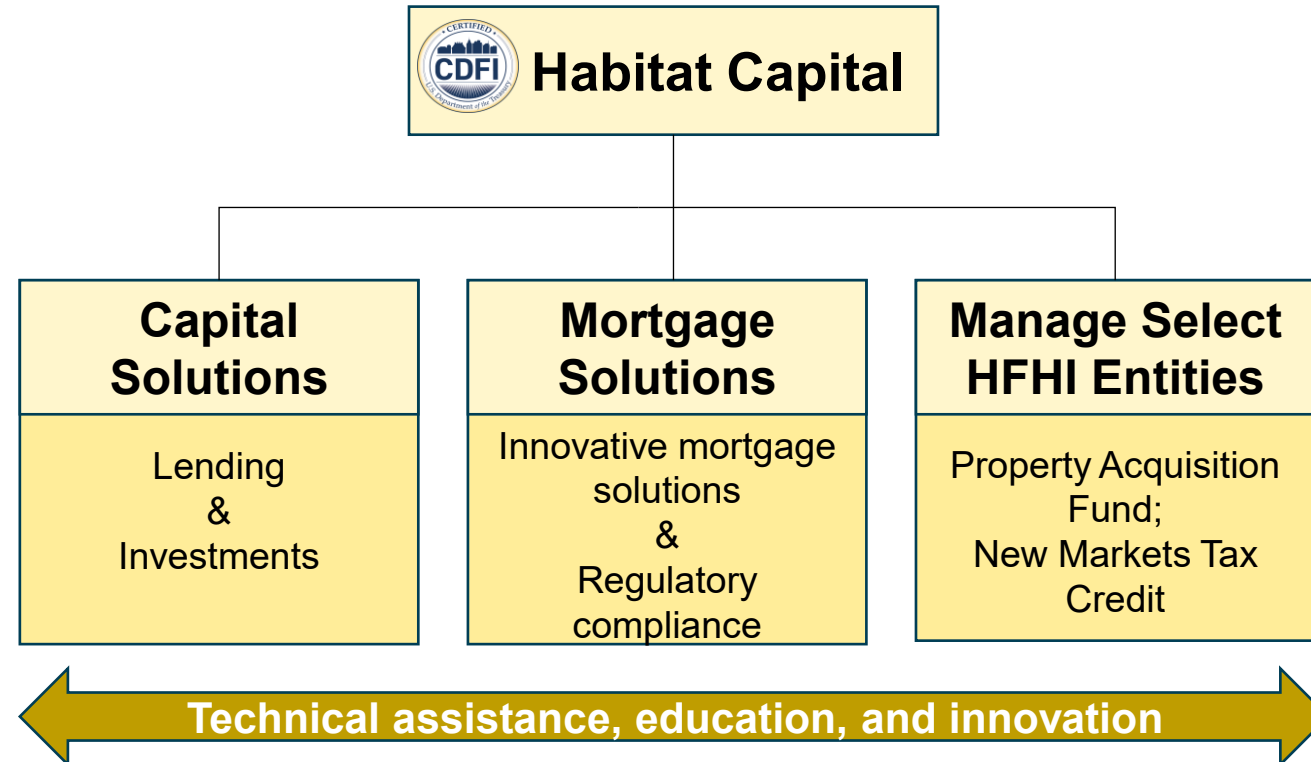
Habitat Capital Overview

Habitat Capital (HCap), a wholly owned entity of Habitat for Humanity International and a nationally certified Community Development Finance Institution (CDFI), supports Habitat affiliates' work as affordable-mortgage lenders, homebuilders, sellers and partners for housing and community solutions.

We serve a network of independently operated Habitat affiliates working in communities across all 50 U.S. states, Washington, D.C., Guam, and Puerto Rico

What we provide:

- **Low-cost, flexible capital** to support affiliates' work as nonprofit real estate developers and homebuilders.
- **Support for the development** of affordable mortgage financing and secondary market options.
- **Help for affiliates** to build capacity in the work that they do as real estate developers, homebuilders and mortgage lenders.



Agenda

1. Introduction
2. Putting Borrowing in Context
 - Market Conditions
 - HFH is Not a Typical Homeownership Developer
 - Risks & Benefits of Borrowing
3. Borrowing for HFH Affiliates
 - Types of Borrowing
 - Measuring Leverage & Risk
 - How to Prepare for Borrowing
4. What does Habitat Capital do?
 - How Can We Help You?
5. Conclusion



Section 2

Putting Borrowing in Context – Market Challenges

Market Challenges

Recent market forces have dramatically challenged affiliates' business models

Significant land
and construction
cost increases

Almost no entry
level homes
hitting the market

Dramatic
house price
appreciation

Demand outstrips
availability of
homeownership
subsidies

Market Challenges

Over the last ten years nationwide, there have been significant land and construction cost increases

**Labor and materials
increased 56%**



**Land increased at least 60%
nationally – and as much as 300%
in some contexts**

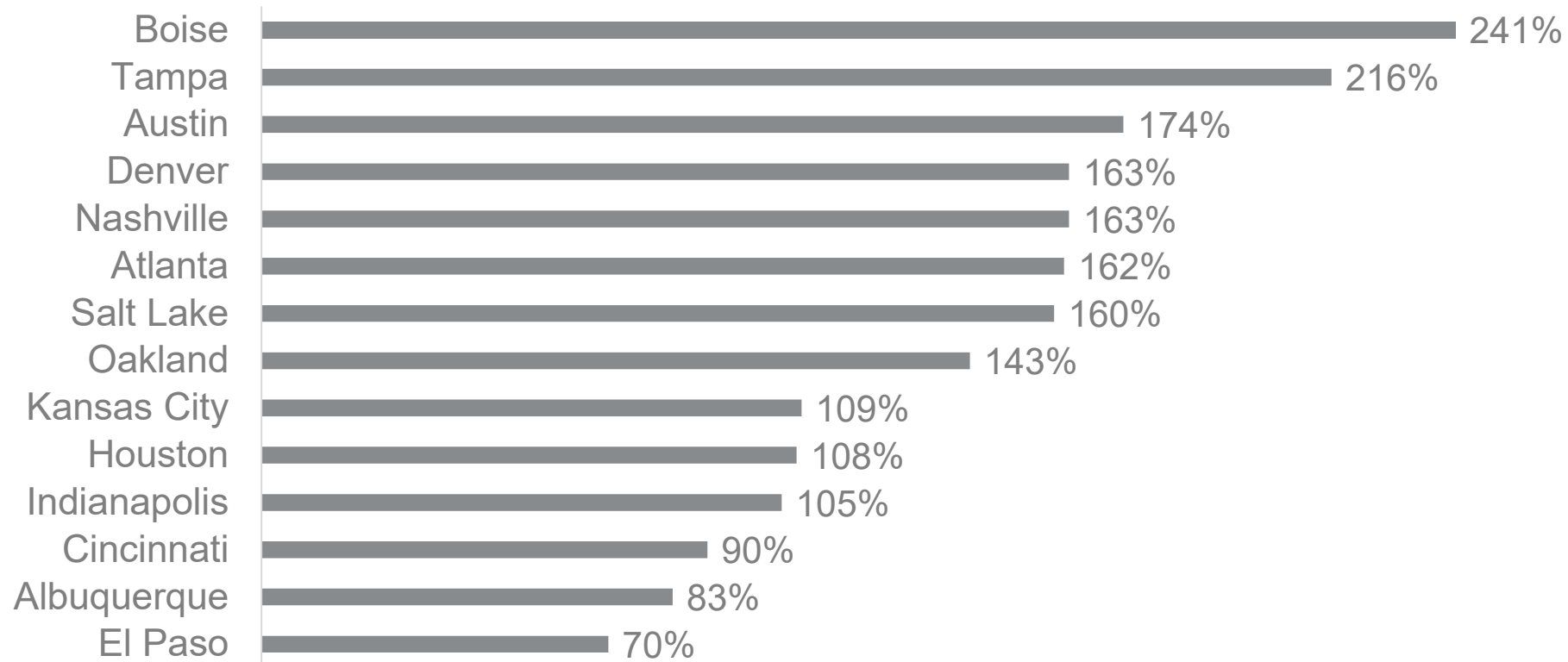
**A house that cost \$120,000 all-in to produce in 2012
now costs at least \$190,000, and as much as \$300,000 in some regions**

Sources: Turner Construction Index <https://www.turnerconstruction.com/cost-index>; Social Security Average Wage Index <https://www.ssa.gov/oact/cola/awidevelop.html>; Working Paper 19-01: The Price of Residential Land for Counties, ZIP codes, and Census Tracts in the United States. Joint Center for Housing Studies. “America’s Rental Housing 2022”; Costar Land Index.

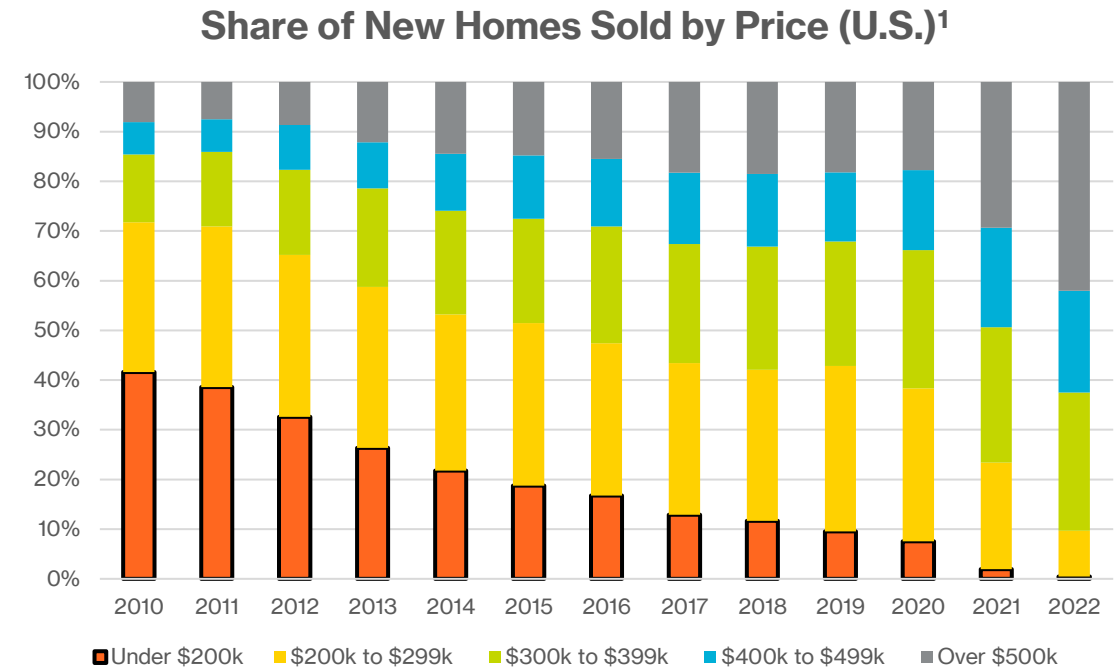
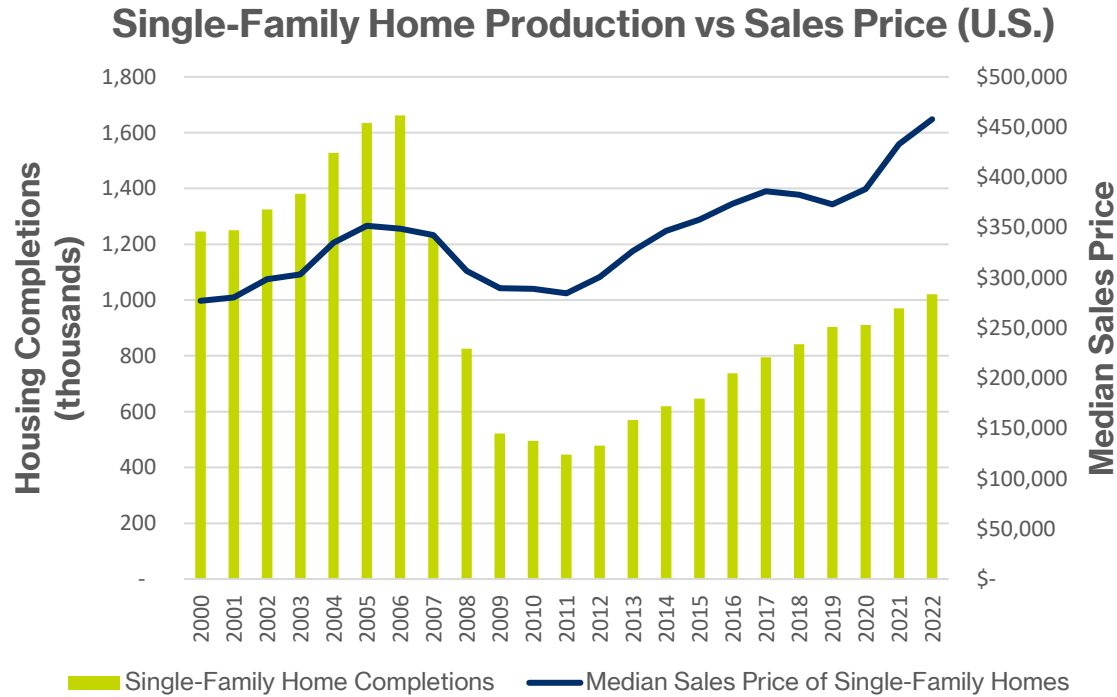
Market Challenges

There has been dramatic house price appreciation in most markets

Average house price increase in Metro Area from 2012–2023



U.S. Affordable Housing Problem



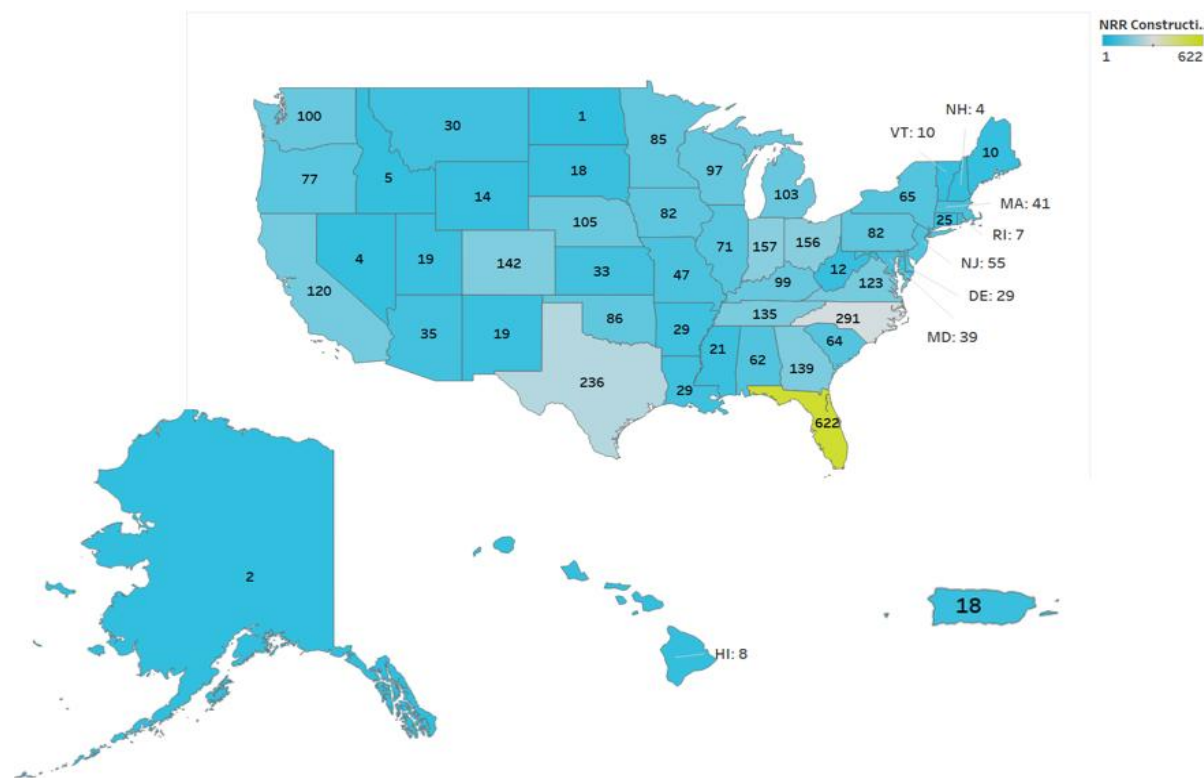
A long-term decline in new single-family housing supply and increasing cost of living has led to an affordability crisis for low to moderate-income households.

Building of smaller, more affordable “entry level” homes (smaller than 1,400 sqft) is 80% lower than in the 1970s.³

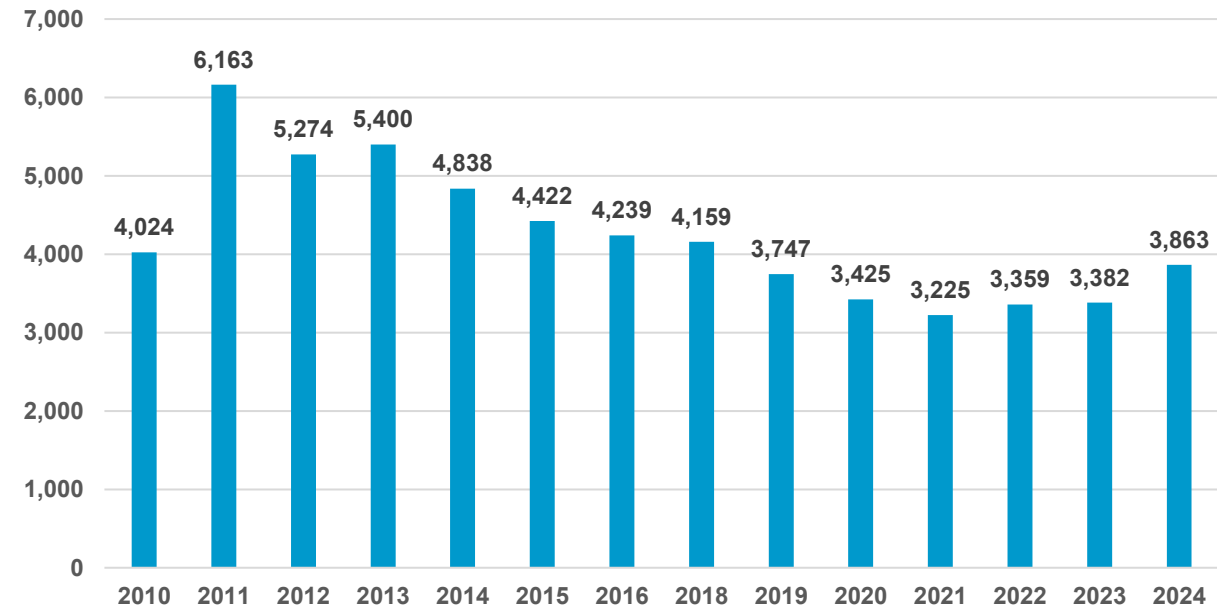
Today, these “entry level” homes account for less than 10% of all newly constructed homes.⁴

Habitat U.S. Affiliate Production

HFHI U.S. Affiliate Production - FY24



HFHI U.S. Affiliate Historical Production



Habitat affiliates struggle against the increasing costs of land and building materials in addition to added costs of being mortgage lenders.

These challenges coupled with the unique pressures of doing affordable lending, have resulted in a 2% YOY average decline in production over the last decade.

Section 2

Putting Borrowing in Context – HFH is Not a Typical Homeownership Developer

Important Terms

- **Equity**

- **The contribution by a developer or sponsor to a development project.** For a non-profit developer this includes cash contributions, grants / donations, in-kind donations, sweat equity. Equity is considered to be “at risk” because it will likely be lost or significantly diminished if the project fails. In non-profit finance, equity is often used interchangeably with net assets.

- **Debt / Loans**

- **The financial contribution to a project that has an expectation of repayment,** and has some sort of collateral (real property, all or some the assets of an organization) pledged to the lender if the project fails.

- **Leverage**

- **The amount of debt divided by the amount of equity in a project or organization.** The more debt there is in a project or organization, the higher the leverage.

HFH is Not a Typical Homeownership Developer

Traditional Habitat Financing Model

- **Raises cash & in-kind contributions from donated sources to construct & rehab new homes**
- **Sometimes uses public subsidy, but is not reliant on it**
- **Avoids borrowing wherever possible**
- **Makes a direct, 0% mortgage to a homeowner as a form of “developer financing”**

HFH is Not a Typical Homeownership Developer

	Traditional Habitat affiliate model	Typical non-profit affordable homeownership model
Use of Borrowing	Equity heavy mode that requires lots of cash from fundraising.	Borrowing is typical, even in homeownership.
Sources of Homeowner Financing	Homeowners first mortgages are financed through mortgages from affiliate to homeowners (called “developer financing” in other contexts)	Other affordable homeownership developers are usually taken out at sale by a first mortgage originated by financial institutions.
Use of Subordinate Subsidy / “Soft” Mortgages	Use of subordinate mortgages from the developer to homebuyers is typical of both models	

HFH is Not a Typical Homeownership Developer

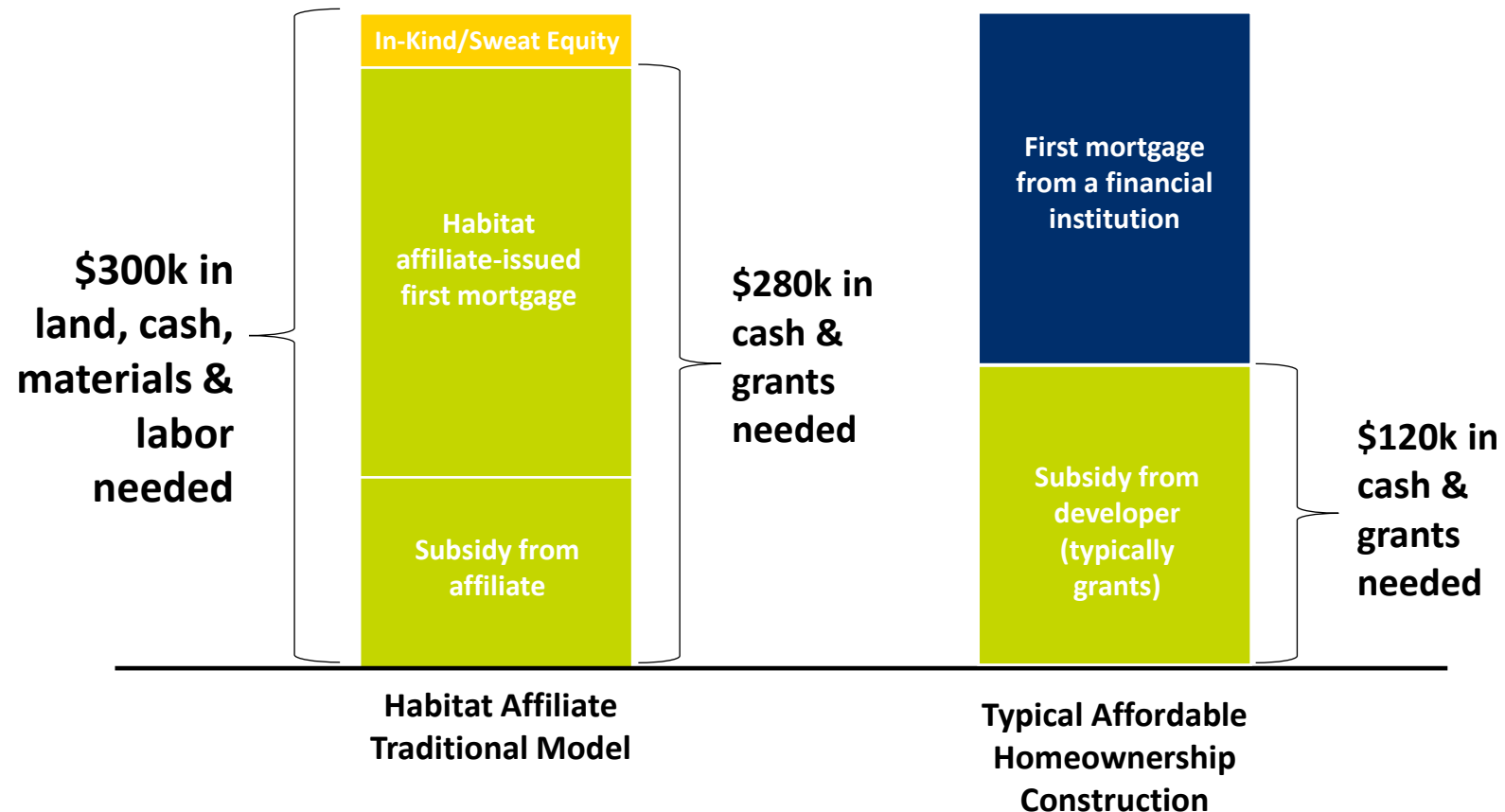
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Traditional HFH Model vs. Other Non-Profit Affordable Housing Developers

The traditional Habitat mode of directly issuing developer financing to homeowners is unusual in affordable homeownership.

- Other affordable homeownership developers are usually taken out at sale by a combination of first mortgage from financial institutions and grants from public sources.
- The traditional Habitat model requires more cash fundraising per home.

Permanent Financing Sources for a Single Home



What are the implications of this low-leverage model of Habitat affiliates?

High equity model has historically been important to Habitat's mission. Use of equity & "Habitat Mortgages" enables serving the lowest income households. This is relatively unusual for homeownership programs and is an important distinguishing feature of Habitat's mission.

Developer financing limits liquidity. Affiliate-issued mortgages creates a long-term, illiquid asset on the organization's books.

Liquidity is necessary to build. Without borrowing, the only other sources for affiliates following the traditional model is fundraising / grants, earned income from ReStores, and cash flow from mortgage repayment.

What are potential types of borrowing that can increase liquidity for Habitat Affiliates?

How could these affect their mission?

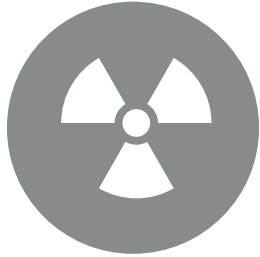
Section 2

Putting Borrowing in Context – Risk & Benefits of Borrowing

Risks & Benefits of Borrowing



**What are the
benefits of
borrowing?**



**What are the
risks of
borrowing?**



**What are the
costs of not
borrowing?**



The Benefits of Borrowing



Increase Scale

Greater scale and capacity to complete more projects



Leverage Your Equity

Equity can be leveraged while retaining ownership and control



Speed of Execution

Do not need to wait to finalize every commitment before starting project



Predictability

Predictable cash flow and repayment schedule



Liquidity

Ability to realize value much sooner



Smooth Out Cash Flow

Equity alone is usually insufficient for a time-sensitive business that has a lumpy cash flow.



The Risks of Borrowing



Extra Costs

Higher cost to the project from interest and closing fees



Process Requires Time

Longer process to close – must be approved by a lender



Collateral is at Risk

What happens if the project fails to be completed?
You could lose collateral to a lender



Recourse to your Organization

If the project fails your lender is protected from losses up to the amount you borrowed - some types of borrowing have recourse to the organization.



What are the costs to Habitat affiliates of not borrowing?



More Limited Pace of Development.

Tying up assets in illiquid investments (mortgages) means that most new construction financing needs to come from new cash fundraising efforts and earned income. This limits the pace of development to the size of those sources.



Present Cash is more Valuable than Future Cash.

In the long run, land & construction costs are likely to be significantly higher than any return on cash from a 0% (or even a 3% mortgage).



More Sensitive to Project Cost Increases.

100% of project cost increases comes from extra affiliate subsidy, rather than being shared between debt and equity.



Opportunity Cost of Being Less Liquid.

Affiliate missing out on return on investing cash reserves if they are deployed into a non-interest-bearing project.



Organization is Less Liquid.

Less cash available for other mission / essential activities.

A Tale of Two Affiliates

Base for both organizations:
50 mortgages with annual cash flow of \$300,000
Annual fundraising of \$1,500,000

Opportunity:
A Parcel of land available that costs \$1,000,000



Habitat Uses Equity
"HUE" Affiliate



Habitat Uses Lots of
Leverage
"HULL" Affiliate

Option 1: Acquisition Loan

Base for both organizations:
50 mortgages with annual cash flow of
\$300,000
Annual fundraising of \$1,500,000

Opportunity:
A Parcel of land available that costs
\$1,000,000



Habitat Uses Equity
"HUE" Affiliate

HUE **waits 6 months to
raise enough \$**; may lose
ability to purchase



Habitat Uses Lots of
Leverage
"HULL" Affiliate

HULL **borrow \$700,000
from a CDFI to buy land
in 3 months**



HULL is able to complete
the purchase in 3 months
Pays \$85,000 in interest over two years

Option Two: Mortgage Sales

Base for both organizations:
50 mortgages with annual cash flow of
\$300,000
Annual fundraising of \$1,500,000

Opportunity:
A Parcel of land available that costs
\$1,000,000



Habitat Uses Equity
"HUE" Affiliate

HUE waits 6 months to
raise enough \$; may lose
ability to purchase



Habitat Uses Lots of
Leverage
"HULL" Affiliate

HULL sells cash flow from
34% of its mortgages to a
bank they worked with in the
past to raise \$1,000,000

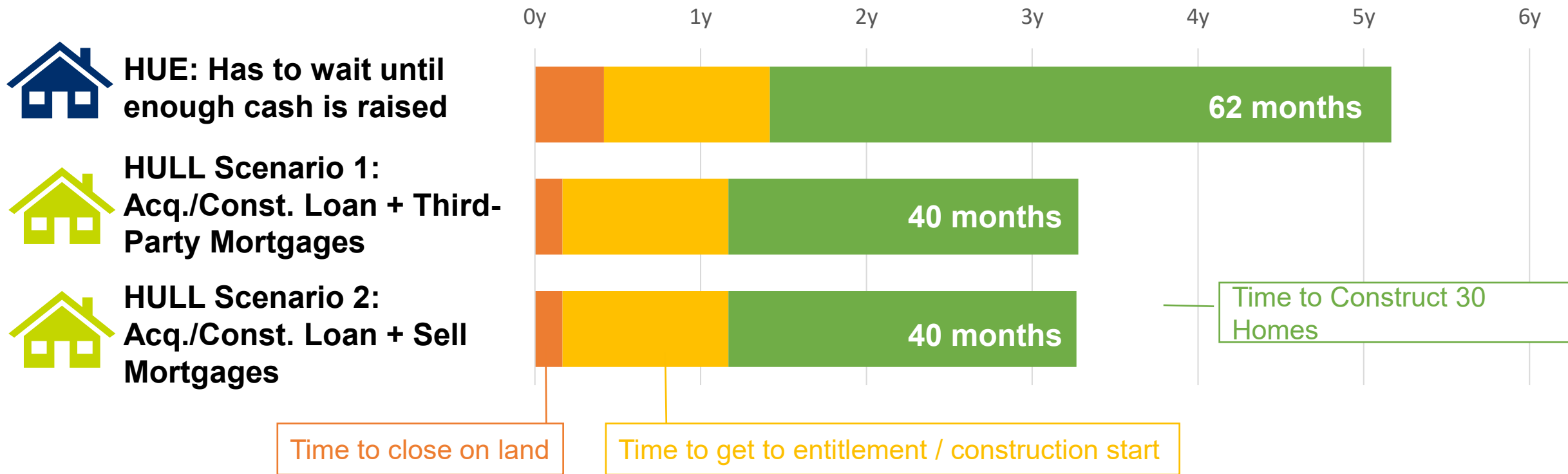


HULL is able buy the land within a matter of weeks
HULL pays legal costs for transaction and has lower
future cash flow until project is completed

Putting it Together

HUE has to wait to progress in each stage until it has enough cash.

HULL is able to borrow in several ways to accelerate its homebuilding project.



Under the same fundraising assumptions, by borrowing HULL is able to acquire the land, entitle the project, and build 30 homes in about 40% less time than HUE.

Section 3

Borrowing for HFH Affiliates – Types of Borrowing

Types of Borrowing

Project Borrowing

- Acquisition / Predevelopment Loans
- Construction Loans
- Permanent / Term Loans
- Forgivable Loans

Organizational Borrowing

- Mortgage Leveraging
- Organizational Line of Credit
- Working Capital Loans

Exercise: How does my organization borrow or lend?

Select all types of borrowing that your organization does:

- ☐ No borrowing
- ☐ Predevelopment loans
- ☐ Acquisition loans
- ☐ Construction loans
- ☐ Bridge loans
- ☐ Source of capital for homebuyer mortgages
- ☐ Operating lines of credit
- ☐ Other

Acquisition/ Pre-Development Loans



Purpose

For purchasing property and closing costs.

May also be used for pre-development costs (e.g. design, environmental, etc.)



Typical Loan Features

Secured by property.

Loan balance due in full within 12-36 mo., or at construction closing.

Good to Know

Pre-development loans differ from acquisition loans in that they typically are smaller, only used for pre-development costs, and in some cases, may not be secured by property.



Benefits

Able to acquire a property when available / able to accelerate development schedule

Risks

Adds cost & repayment deadline that could stress the project.

Is sponsor on hook / do you lose the land if project doesn't go forward?

Construction Loans



Purpose

Covers hard (construction materials, labor & overhead) and soft costs (architectural, engineering, professional services, etc.).



Typical Loan Features

Loan amount up to 50-80% of total project cost.

Due in full at project completion, typically <36 months.

Secured by the property.

Good to Know

Some affiliates use organizational lines of credit in place of construction loans. These are more flexible and involve less oversight of the project from a financial institution. However, they are likely to be available in smaller amounts.



Benefits

Able to move as the project's physical conditions and material availability allow rather than be constrained by liquidity

Risks

What happens if you don't complete the project or costs increase?

Adds variable rate debt to project costs

Permanent / Term Loans



Purpose

Typically covers repayment of construction financing sources for a building with rental income.

May also be used to refinance an occupied, stabilized property.



Typical Loan Features

Secured by property. Subordinate liens are possible from some sources.

Repaid over time from cash flow from building. May have a balloon payment at maturity.

Good to Know

These are not to be confused with homeowner mortgages, where the homeowners is the borrower and either the Habitat affiliate or a financial institution is the lender.



Benefits

Able to spread the cost of the acquisition / construction out over a long period of time

Risks

What happens if the financial or physical conditions of the underlying property change?

Forgivable Loans



Purpose

To provide subsidy for a project that cannot generate enough economic value to support its full cost.



Typical Loan Features

Debt is often forgiven when a specific period of time has passed and the project has remained in compliance.

Good to Know

These differ from permanent / term loans in that they are intended as a source of subsidy and are not intended to be fully repaid in exchange for a project keeping to its intended mission. They are almost always from either a public or philanthropic source.



Benefits

Nice if you can get it!

Risks

Can come with programmatic restrictions, prevailing wage requirements, that are less flexible than unrestricted support etc.

Mortgage Leveraging



Purpose

To provide liquidity for an affiliate, often for construction of new homes / repair work or another social venture



Typical Features

0% mortgages are sold or pledged at a value below their current face value ("par") that provides a rate of return to an investor.

Good to Know

This arrangement is used by many Habitat affiliates as a source of liquidity. They typically work with a local bank or a market aggregator to leverage these loans.



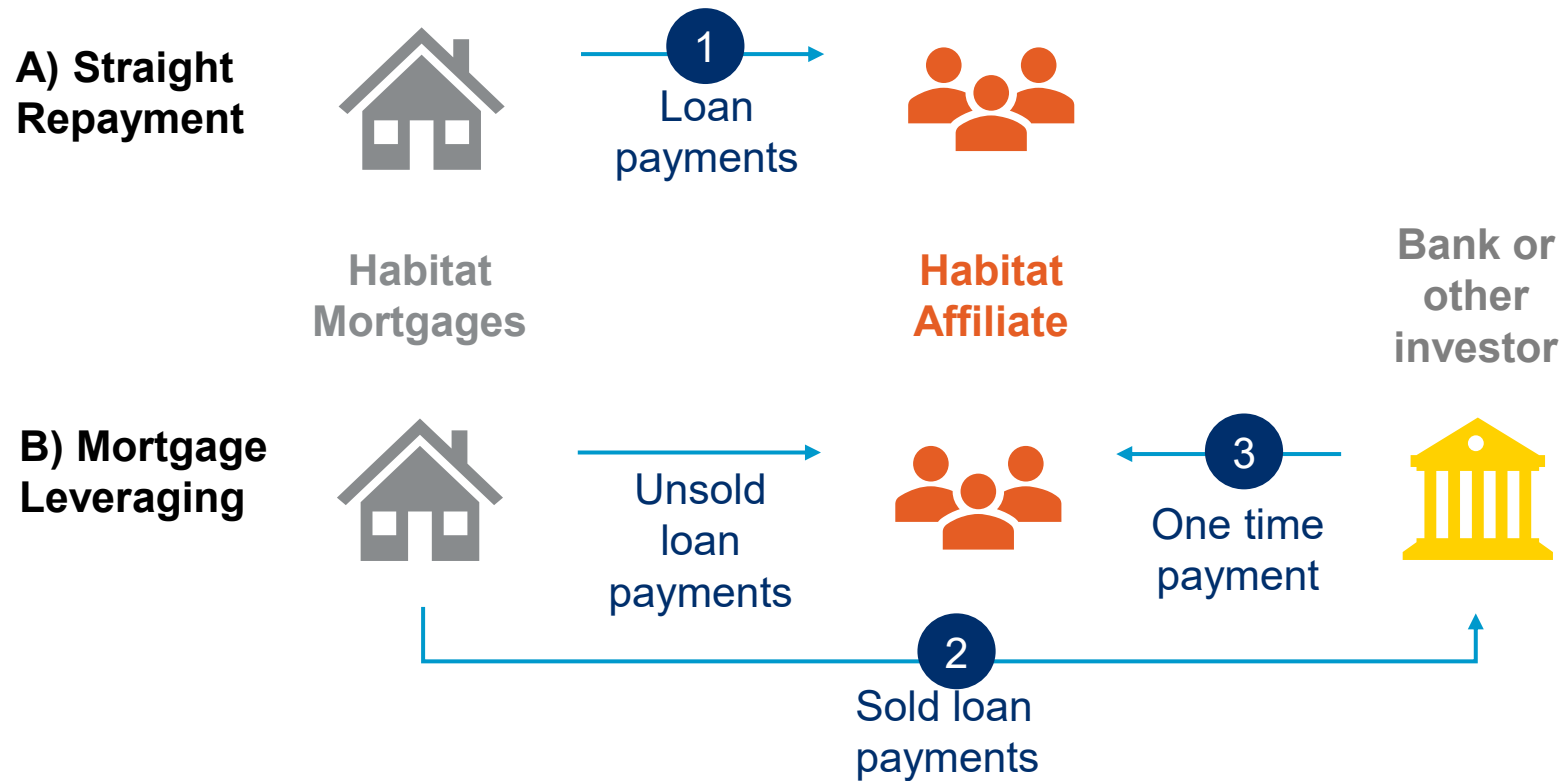
Benefits

Turns an illiquid asset into cash that can be used to buy land, develop new homes or repair existing homes

Risks

What happens if the performance of the underlying mortgages declines? What happens to homeowners in delinquency?

Mortgage Leveraging



Affiliate B has a larger amount of cash available to reinvest in its mission upfront rather than waiting for cash flow and fundraising.

How It Works

1. Affiliate makes 30-year, 0% loans to Habitat homeowners
2. Affiliate sells the long-term cash flow from mortgages (either through a loan sale or pledge of receipts) to an investor
3. Investor pays affiliate an amount cash up front at a discount from the principal amount of the mortgages (typically 60-80%)

Types of investors include:

- Banks seeking CRA credit
- State HFAs / Housing Authorities
- High Net-Worth Individual

Organizational Line of Credit



Purpose

To provide *temporary* liquidity for an affiliate, often used to fund construction or to bridge cash flow until expected revenue arrives.



Typical Features

Variable rate debt. Typically allows flexible draws and repayments.
Typically full recourse to organization.

Good to Know

This is a type of loan used by many small businesses and is often part of a relationship package with a local bank. As an affiliate grows, it will be more difficult to use this type of loan to fund construction draws given its limited size.



Benefits

Can help smooth out periodic cash flow shortages.
Can be used as construction financing source for smaller projects.

Risks

Can become a difficult hole to dig out of if used to plug structural operating deficits rather than periodic cash flow shortages.

Working Capital Loan



Purpose

To provide longer-term capital for an organization to have sufficient liquidity to achieve its mission.



Typical Features

Typically fixed-rate debt with defined principal & interest payments.

Good to Know

This type of loan is less available for non-profit organizations but can be a helpful way to increase liquidity with a predictable debt payment.



Benefits

Can help smooth out periodic cash flow shortages. Can be used as construction financing source for smaller projects.

Risks

If organization fails to thrive, debt payment can be a burden and may need to be restructured.

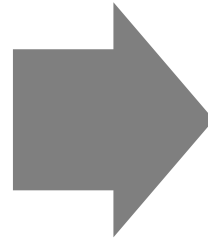
Section 3

Borrowing for HFH Affiliates – How to Prepare for Borrowing

How to Prepare for Borrowing

1. Discuss with affiliate leadership

- A. What is our current state of borrowing?
- B. Can borrowing benefit our affiliate?
- C. Identify and quantify the risks



2. Prepare your organization

- A. What kind of borrowing makes sense?
- B. Financial check-up
- C. Borrowing essentials
- D. Expertise & resources
- E. Addressing attitudes and perceptions

How to Prepare for Borrowing

Step 1 *Start a conversation among leadership – staff and board – about where borrowing may help advance your mission.*

A. What is our current state of borrowing?

- Are we more like HUE (Uses Equity) or HULL (Uses Lots of Leverage)?

B. Can borrowing benefit our affiliate?

Specifically, how would it affect:

- Liquidity?
- Scale of programs?
- Speed of execution?
- Other benefits to our mission?

C. What are the risks of borrowing and how can we mitigate them?

- Specifically, discuss the following:
- What are the added costs to projects? How would they be covered?
- What is the risk to a project and possibly the organization?
- How would we find a lender that is a good match for our affiliate?
- How would it affect our mission?
- What real life experience is behind concerns around borrowing from individuals on the leadership team? Are these experiences applicable?
- What else?

How to Prepare for Borrowing

Step 2 *Get ready for borrowing by reviewing the following*

- A. What kind of borrowing makes sense
- B. Financial check up
- C. Borrowing essentials
- D. Expertise & resources
- E. Addressing attitudes and perceptions

Get Ready: A) What Kind of Borrowing Makes Sense?

Project Borrowing

- Acquisition / Predevelopment Loans
- Construction Loans
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- Forgivable Loans

Organizational Borrowing

- Mortgage Leveraging
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Get Ready: B) Financial Check-Up

Lenders are assessing the following:

Financial Health of Borrower

CAMEL is the methodology used by Habitat Capital and many other lenders to measure financial health

- **Capital** (Capital structure and capitalization)
- **Asset Quality** (Performance and practices)
- **Management**
- **Earnings** (Structure and Performance)
- **Liquidity** (Financing and Operating)

Strength of Project

- What is the collateral and what is its value?
- What is the source of repayment and how reliable are those future receipts?
- How developed is the project plan, budgeting and acquisition of permitting and approvals to proceed?
- What is borrowers' experience with similar projects?

Get Ready: B) Financial Check-Up

These are the key financial metrics Habitat Capital will review in looking at the creditworthiness of a Habitat affiliate

Financial Metrics	Description	Fair	Good
Mortgage Delinquency	% of mortgages over 60 days delinquent / performing mortgages	$\leq 10\%$	$\leq 5\%$
Debt to Net Mortgage Receivables	The affiliate's proportion of liabilities to net mortgage receivables	$\leq 50\%$	$\leq 25\%$
Debt to Net Assets (or Debt to Equity)	Affiliate's level of overall leverage	$\leq 125\%$	$\leq 75\%$
Increasing/Decreasing Net Assets	Measure of change in affiliate's net worth	$\leq 2.0\%$	$\leq 7.5\%$
Quick Ratio	Affiliate's ability to meet short-term obligations through its most liquid assets	≤ 1.5	≤ 2.5
Self-Sufficiency Ratio (Earned Rev./Ops. & Fin. Expenses)	Affiliate's ability to operate without external funding	$\leq 30\%$	$\leq 40\%$
Defensive Interval (Days Cash on Hand)	Number of days an affiliate can operate without any additional revenue	≤ 90	≤ 120
Debt Service Coverage	Affiliate's ability to meet its current year debt payments	≤ 1.5	≤ 2.0

Get Ready: C) Borrowing Essentials

The following materials are essential to have ready prior to initiating any borrowing.

Minimum Organizational Requirement

- ☐ Audited financial statements
- ☐ Must be in Good Standing with HFHI
- ☐ Aging mortgage portfolio report if appropriate

Proposed Project Materials/ Information

- ☐ Project plan and/or narrative
- ☐ Proposed budget / sources and uses
- ☐ Project timeline

Get Ready: D) Expertise & Resources

- Identify independent experts who may be available from your board, staff, volunteers, or organizational partners
- Allow time for research. Talk to the experts, especially those who are not looking for a business opportunity with your affiliate
- Many lenders will want your business. Do your homework before you talk to them.
- Consider conducting informational interviews with...
 - Peer Habitat affiliates that have borrowed to find out how they have navigated this.
 - Habitat Capital staff who can answer your questions about the process and options
- Be ready to quantify costs (time, labor, money) of fundraising vs. borrowing to take advantage of a new opportunity.

Historical & Current Snapshot

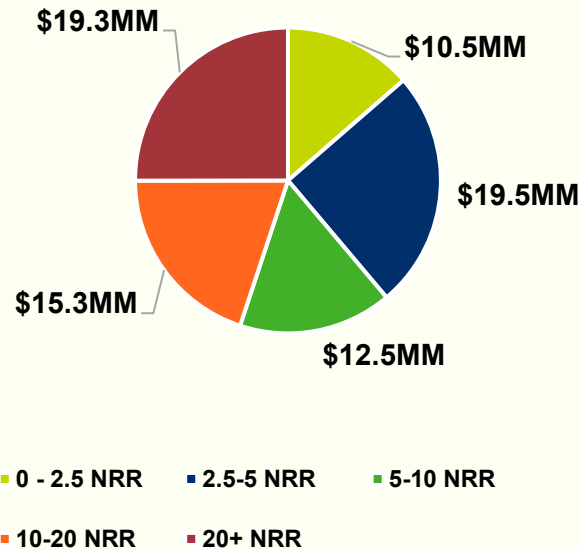
Historical Usage
(AAR & FlexCAP)
1997 - 2018

Habitat Capital
2018 – 2025

1997 – 2018 Highlights

- Over **\$200MM** loaned
- Over **2,600** Homes built, repaired or rehabbed
- Over **9,000** people housed
- Used in **44** States

Lending by Affiliate Production



Current Lending Highlights

90

Loans Outstanding

\$870,000

Average Loan Size

2,500+

Homes Created

110+

Affiliates Served

~\$55 Million

Amount Outstanding

\$5 Million

Largest Loan

57%

Avg. Homebuyer AMI

30

States Served

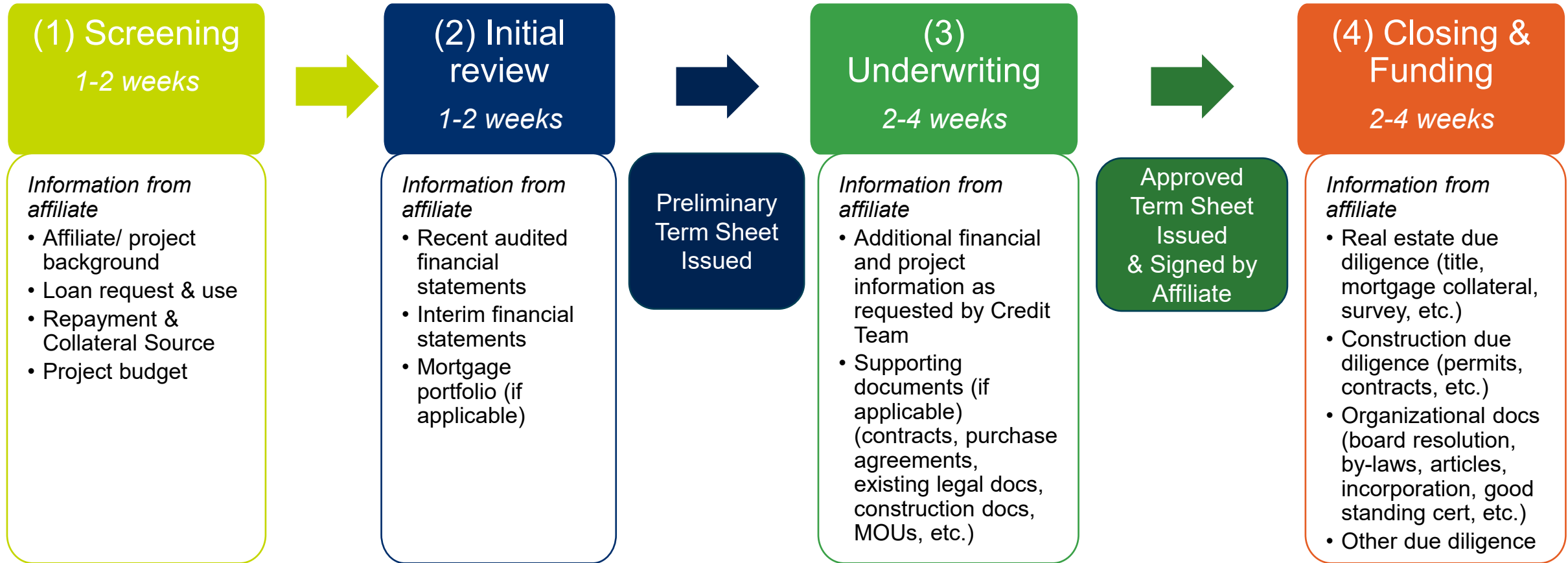
Standard Products

Loan Products	Description	Typical Loan Amounts
Predevelopment	To pay early-stage investments in design, environmental and structural assessments, and planning available for projects that are highly likely to proceed to construction.	\$100K – \$1.0MM
Acquisition	Loans to pay for purchase price and closing costs of property acquisition, where there is development plan in place. (land banking is generally ineligible).	\$100K – \$5.0MM
Construction	Loans to construct projects. For hard and soft building and improvement costs including new construction, substantial or moderate renovations, and leasehold improvements.	\$100K – \$3.0MM
Bridge Loans	Financing to bridge the timing gap between expenses needing current payment and cash from committed or anticipated sources of capital not yet available.	\$100K – \$3.0MM
Working Capital	To pay for costs associated with the day-to-day expenses experienced by stronger affiliate borrowers.	\$100K – \$1.5MM

Habitat Capital differs from other lenders:

- More flexible with affiliate collateral
- More flexible products than banks
- Better pricing compared to CDFIs
- **Interest Rates:** 4% – 6% and fixed upon closing
(Rates fluctuate due to market conditions, please check in with the Habitat Capital team for current rates)
- **Fees:** 1% – 2% depending on complexity of transaction

Habitat Capital Lending Process



What We Do- Affiliate Examples



Blue Ridge (VA)	Austin (TX)	Pensacola (FL)
Project Activation Loan (PAL) to support pre-development work at a 7-acre site for 120 mixed-income units, including 40-60 Habitat homes. The remaining units will be sold to a market-rate developer. Loan Amount: \$100,000 Loan Purpose: Pre-development Projected Units: 120 single-family homes	Loan to support the development of 30 homesites from national market-rate developer Taylor Morrison. Lots will be developed into affordable homes for low-to-moderate income families between 80-120% AMI. Loan Amount: \$1,850,000 Loan Purpose: Acquisition Projected Units: 30 single-family homes and condominiums	High Impact Loan (HIL) to bridge funds between the construction and sale of homes for low- and moderate-income families, 80 percent of which are expected to be Black or Indigenous People of Color. Loan Amount: \$1,000,000 Loan Purpose: Production Projected Units: 40+ affordable units

Thank You!

Questions? Reach out to
HabitatCapital@habitat.org

