Canadian Network of Community Land Trusts

# Financing CLT-led Acquisition Projects

## Considerations When Approaching Financial Institutions

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## How to use this resource

This resource is intended to support community land trusts (CLTs) in the process of approaching banks and credit unions to finance the acquisition of existing residential properties. Some of the advice contained here is also applicable to the process of getting financing for a new development project, but development financing comes with some additional considerations.

All financial institutions will have different processes for assessing loan applications; here we outline some key considerations, based on the experiences of Canadian CLTs.

***Dealing with financial institutions involves a lot of confusing jargon. People from equity-deserving communities often experience barriers in accessing financial lending processes because of systemic racism and historically inequitable banking practices.***

***Know that you have the right to ask questions, and you have a responsibility to your community to only agree to a loan that makes sense to you. Remember, the Network is here to help - don't hesitate to reach out to CNCLT and other CLTs for advice!***

## Financial Considerations

### The bottom line

It probably goes without saying: before anything else, financial institutions will consider the financial viability of your proposed project. Lenders need to ensure that the funds they lend will be repaid, and they therefore want to see that your project will generate the revenue necessary to cover your costs and pay back your loans. Getting to a pro forma (that is, a capital and operating budget for your building) that more-or-less balances is therefore essential before seeking out loans. All of the considerations outlined below effectively boil down to their impact on your likelihood of repaying the loan as planned.

When trying to make an acquisition project work financially, it is vital to keep in mind your CLT's mission and values. Some tradeoffs may need to be made to make a project viable - for example, finding ways to decrease operating costs or considering reasonable annual rent increases. However, there is only so far you can increase revenues or decrease costs in a project before its value to your community decreases. If the finances for a given acquisition are not working out, you may need to seek out further sources of equity (see this acquisition funding summary for ideas), or reconsider the property altogether.

### Debt coverage ratios

Your ability to comfortably pay back your loan is often summarized by your debt coverage ratio, or DCR. The DCR is calculated by dividing your monthly net operating income (NOI) by your monthly debt service, effectively demonstrating how much income is left after paying your costs. A DCR of 1.0 would mean you have *just* enough left over every month to pay your debts; this is considered low because if your revenues were unexpectedly low in a given month, or your costs unexpectedly high, you would find yourself unable to pay your mortgage.

Financial institutions typically have a minimum DCR for approved projects - this is often 1.25, although some socially-minded financial institutions will accept lower DCRs for projects that deliver social outcomes.

### Loan-to-value ratios

Another index financial institutions will look at is your acquisition project's loan-to-value ratio (LTV). The LTV is calculated by dividing the total mortgage being requested by the property value; the LTV is expressed as a percentage, where 100% would mean the mortgage was the same as the property value. A higher LTV is considered riskier for lenders and may therefore come with a higher interest rate.

## Organizational Considerations

Financial institutions want to know that your CLT has the **expertise**, **commitment**, **planning**, and **equity** necessary to see an acquisition project through and ultimately repay your loans.

### Expertise

Lenders will typically ask for information on the expertise and background of your CLT's staff and board of directors. It is important to be able to demonstrate that at least one person involved in leading your acquisition project - ideally the executive director or project coordinator - has an understanding of budgets, financial projections, and cash flows. It may also help to have someone on your board who has experience with your chosen lender in particular, both because you will better understand the lending process and because your lender will recognize the experience your team is bringing to the project.

Relatedly, it is beneficial to put effort into building long-term relationships with financing partners. Creating these relationships will enable the lenders to get to know your organization and build trust with those leading your acquisition projects. Having pre-existing relationships - before you urgently need to secure financing - will help the process of getting a loan go more smoothly.

### Commitment

Financial institutions look for indications that your CLT is serious about the project you are proposing to undertake. This can be demonstrated by intangible things, like enthusiasm and passion for the project, or evidence of community support underpinning the CLT's work. More tangibly, commitment to the project may be evidenced by the history of the CLT: financial institutions will typically ask for the previous 3 years of financial statements, which will demonstrate both your CLT's financial health and your seriousness as an organization.

### Planning

Lenders want to see that your CLT has carried out detailed financial and work planning, and that this planning is informing your acquisition project. Beyond the project-specific financial modelling that will be required, it is beneficial to be able to demonstrate that you have a clear plan guiding your work going forward, like a strategic plan, an organizational business plan, or a plan for the growth of your portfolio of land and properties. Lenders also want to know that you have a detailed plan for operating the property once it is acquired.

### Equity

In this context, equity refers to non-debt money or other assets that can go towards carrying out an acquisition, or that you can use to help pay back loans if necessary. If you are an early-stage CLT carrying out your first acquisition project, you may not have much equity of your own to contribute to the project yet. However, you should be able to demonstrate that you have a clear and feasible plan for getting equity that can go towards the acquisition - for example, a plan to apply for public grant programs or solicit donations.

Note that funds raised through community bonds are typically seen as debt by financial institutions - if you are planning on raising funds through community bonds, you should have conversations with potential lenders early on to understand how this might impact their lending.

## Property Considerations

A potential financial partner will also consider the property, or type of property, you are planning to acquire. Lenders care about the financial implications of the property's condition and value. Property-related considerations may be more important to financial institutions if your CLT is newer - that is, if they would already be taking on risk by financing an inexperienced organization, they may be less likely to take on risk related to the property being acquired.

Your CLT will typically be asked to provide third party reports regarding the property. This will inevitably include a building condition assessment (BCA) and may also include an appraisal and an environmental assessment; requirements will vary by lender and by project. Within these reports and the other information you provide, lenders will pay particular attention to:

- The location of the property, as it relates to the value of the land;
- The age of the building, which will have a bearing on its remaining economic life (i.e., how long the building will be able to continue to be tenanted - it will be difficult to secure a loan that lasts longer than the building's estimated remaining economic life);
- The state of the building, particularly any major capital works that may be needed in the short-to-medium term, as identified in the BCA - lenders will want to know that you have accounted for all capital works in your financial calculations and can cover the costs to maintain your building.

## Other Considerations

### Planning for the worst-case scenario

Financial institutions want to know that you have a plan to pay them back, should things go wrong. This includes situations where the building you have acquired can no longer feasibly be maintained, situations where you are unable to make loan payments, or situations where the lender no longer has confidence in your organization. These scenarios will be detailed in your loan agreements, including the lender's own exit strategies. It is important to consider back-up plans ahead of time to be able to demonstrate preparedness and set your CLT up for success.

### Social & environmental outcomes

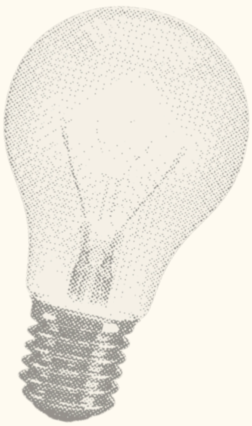
Some traditional financial institutions will not factor positive social and environmental outcomes into their decision-making. However, they may have some leeway to take on small, riskier projects where positive impacts can be demonstrated. In addition, credit unions and values-based institutions tend to prioritize projects that deliver community benefits like affordable housing.

If this is the case, you should be prepared to make an argument for why your proposed project will deliver community benefit. When it comes to acquisition projects, you can argue that they help address housing shortages; preserve existing affordability; stabilize neighborhoods by maintaining tenant stability and reducing turnover; and deliver faster results when compared to new development projects.

### Do you want what they're selling?

Loans are a product that financial institutions sell. They care about being paid back, but they ultimately want to sell to you. This means that in some cases, you may qualify for a loan that is not ultimately in the best interests of your organization. For example, consider a scenario where acquiring a property will necessitate getting a mortgage so large you will need to charge unaffordable rents to pay it. Or, consider a scenario where your building's revenues just barely cover your costs and your mortgage payments, and you therefore do not have reserves sufficient to replace the building's roof in 10 years.

For these reasons, you might want to have higher standards for your project than your lenders require - that is, you should ensure your cash flow will be positive for at least the first 10 year period, with funds available to cover all capital works identified in the BCA as well as surplus funds to build up capital reserves.



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