

## CLIENT CONSTRUCTION BUSINESS OPERATION AND PLAN

### STATUS:

Client (CL) is licensed as a Mortgage Banker and has a revolving warehouse line of credit from Warehouse Lending Group, Houston, Texas, to fund Fannie Mae/Freddie Mac and Jumbo non agency loans for sale into the secondary mortgage market. Client is also an originator of commercial and residential construction loans that are currently being “Brokered” to Life Insurance Companies and Private Equity Groups (PEGS).

**Over the past 12 months the increased demand for residential construction loans has grown significantly as the US housing market has recovered with significant pent up demand and a severe shortage of housing inventory.**

At the peak of the housing market in 2006 housing starts totaled 1,200,000 units. Housing starts tumbled to less than 400,000 units per year in 2008/2009 and are currently set to hit 537,000 for 2013.

Since the housing crash; excess inventories have been absorbed in nearly all markets and current demand far exceeds available supply. Due to regulatory constraints and new capital requirements the regional and community banks have not reentered the business of making residential construction loans and are not likely to in the near future.

In order to fill this lending void PEGS have been stepping up their lending volume. The challenge to PEGS is that while they have the capital to invest, they usually lack the execution platform to safely and efficiently make the investment into residential construction loans. CL offers private equity investors just that platform. CL manages an existing mortgage banking platform to originate all forms of consumer loans which provides the risk management key to pay off construction loans at maturity. Client will at all time control the “Take out Exit Strategy” (TOES) as part of its ongoing risk management policy. No take out commitment- No construction loan. CL has the front end marketing and origination network that provides the vehicle to generate a significant volume of construction loans and the expertise to underwrite and close construction loans in multiple states. In addition CL will service the construction loan and will use outside vendors such as Chicago Title Insurance Company or First American Title Insurance Company as the disbursement agent of all net construction loan proceeds. In addition CL uses an independent Appraisal Management Company to manage progress inspections, budget review, and lien waiver control. CL will close the “take out” loan upon construction completion- take out proceeds will pay down the construction line of credit and the process will repeat itself again.

The JV Partner/Investor/Lender may at any time review construction and take out loan files for quality and compliance. The JV Partner/Investor/Lender will receive a month end report of all construction disbursement activity and LOC activity from CL and its vendors. Absolute transparency is assured and available at any time to the JV Partner/Investor/Lender or their representative.

**Note:** The above description is provided as a description of the operation and the basis for talking points. CL management has a substantial background of experience gained from providing many years of service in Mortgage Banking, construction loan underwriting, loan administration, and credit underwriting. This business plan is intended to address and to take advantage of the current and the expected future void in community and regional Banks ability and willingness to originate and fund owner occupied residential construction loans and tract home loans. This is occurring at an important point in the economic recovery of the residential real estate market where pent up demand far exceeds available banking resources and housing inventory is at an historic low level.

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The reasons for many banks failure to re enter this market are varied from bank to bank but a summary of some of the reasons are as follows:

- 1.) Many banks are under capitalized by regulatory standards- still have non performing commercial loans
- 2.) Risk based capital standards are going up due to new regulations- banks are fearful of not meeting the new 15% tier 1 capital requirements (proposed for 1-1-2014) and therefore may have to shrink assets
- 3.) Many community banks no longer employ qualified and experienced construction loan officers and have not even had a functioning construction loan department for the past 5 years
- 4.) Most community banks do not originate simple Fannie Mae and Freddie Mac conventional loans that would enable them to control risks associated with the take out strategy of construction loans.
- 5.) Many Bank management teams view the regulatory environment as onerous and lack entrepreneurial abilities to visualize the opportunities and materialize the results.

### **PROCESS:**

#### **A.) CONSTRUCTION APPLICATION PROCESS**

##### **A.) Tract Builder (TB)**

Builder file complete and current  
Builder application  
Credit check- no unpaid tax liens, no open judgments, no bk in the last 3 years  
Financials  
License  
Insurance- Gen liability, bond  
References  
Site Inspection  
Tract Map, entitlements,  
Construction request documented  
Cost Breakdown  
Description of materials  
DRE project approval  
Permit- paid or to be advanced  
House is pre-sold owner occupied-  
Appraisal-from our vendor (LGI)  
Prelim  
Take-out (TOES) is underwritten and approved by CL

##### **B.) Owner Builder (OB)- owner occupied**

General Contractor package complete  
Cost breakdown  
Description of materials  
Construction contract  
Major bids provided  
Prepaid costs documented  
HUD1 on Lot  
Title Report  
Appraisal-from our vendor  
Take out exit strategy (TOES) loan approved by CL  
Plan review completed by our vendor

#### **2.) Loan Approval Process**

Construction and take out (TOES) approved by CL  
Investor construction loan approval- (if required-otherwise by CL)

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Commitment Letter signed by borrower and returned to CL  
Pre-construction start meeting scheduled-OB only  
Draw schedule  
Terms of loan agreement  
Change orders  
Contingency fund usage  
Retainage

### **3.) Construction Loan Closing Documents**

Loan docs Prepared and sent to Chicago Title Agency  
Executed loan docs returned to CL  
Warehouse package sent to LOC –Investor for funding  
Promissory Note  
Deed of Trust  
Construction Loan Agreement  
Draw Schedule  
Title Commitment  
Take Out Commitment  
Warehouse Advance Request

### **4.) Loan Funding**

Loan proceeds advanced to Chicago Title by JV Partner/Investor/Lender LOC  
Proceeds to Chicago Title are net of borrower interest and origination fee  
Title pays off lot (if required) and insures lenders lien position with ALTA Policy  
Title nets lender and vendor fees and remits balance to Chicago Title Agency Trust and Disbursement Account (LIP account) for borrower construction draws

### **5.) LIP (loan In Progress) FUNDS**

Funds will be held by Chicago Title Agency, Inc. in a construction disbursement account at Wells Fargo Bank- (if applicable) Fund disbursement process controlled by CTA Loan Escrow Trust and Disbursement Agreement  
Signed by borrower/builder/General Contractor/ CL and the Construction Loan Agreement

### **6.) DRAW DISBURSEMENTS**

Draw requested in writing by Borrower/Builder- (uploaded into CL Servicing Platform, CLP)  
Draws requested per draw schedule- either 7 part or % of completion  
Progress inspection report ordered/received by Appraisal Management Company  
Invoices and lien waivers reconciled to budget by CL  
Draw request reconciled with budget/change orders  
Date down title endorsement E122  
Draw request approved and entered into A.I.A. budget control worksheet  
CL instructs Chicago Title Agency to disburse draw to tract builder (TB) or  
Joint checks to owner builder/subcontractor/general contractor

### **7.) 5<sup>th</sup> INNING STRETCH (File Update)**

Prior to the 5<sup>th</sup> draw CL requires the following:  
Date down to Title Policy- (no mechanics liens)  
New appraisal report or recertification to value  
Updated credit report-c (credit scores-no new debt, etc)  
Collect all city or county inspection reports  
Budget review for completion schedule

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### **8.) LAST DRAW DISBURSED**

Less 10 % retainage to be held until Certificate of Completion recorded  
Certificate of occupancy issued by City/County  
Appraiser final inspection 1004D and recert of value issued  
All final Lien Waivers received  
Date down to title policy – E122  
LIP audit reconciled  
Certificate of Occupancy issued by local municipality

### **9.) Take Out Execution Strategy (TOES)**

Take out Loan Funded by CL Correspondent Division  
Construction loan paid off  
Construction loan release of lien recorded

**The process begins again so that construction funds are constantly deployed to maximize the ROI.**

### **MARKET:**

A report released by the USC Sol Price School of Public Policy in April of 2012 projects the population growth in California to increase by the year 2020 by 3,491,673 both from births and migrations into the state. It is expected that California will grow at slightly under ten percent per decade for the next several decades. The current California population totals close to 37 million people. These statistics are an indicator of what is going on in real estate in California currently. **What is being seen is a shortage of homes available which is driving more people to opt to buy or build a new home.**

**The impact of demand on the real estate market is reflected in CL receiving a continuing increase in requests for new construction financing.**

In reviewing the housing demand and population growth estimates in Arizona, Texas, and Nevada we see the same set of facts and circumstances that exist in California with population on the rise and increased housing demand due to the existing housing shortages and the availability of low rate mortgages for take out loans.

### **PLAN:**

CL seeks capital from a JV /Investor/Lender partner that has the resources to fund a significant volume of residential construction loans and who recognizes the value that our marketing, origination, underwriting, servicing, and risk management capabilities bring to the table.

A review of our projections will show that we are projecting to fund and close on 870 loans within a three year period. A substantially conservative number of loans based on the market availability and that the expectation of a continued flood of construction loan applications will continue.

In relationship to the total market opportunity that is taking place CL will be closing only a small number of loan requests that will be in the market place.

CL has the ability to process these loans with good security and protections for our partner while providing a nice interest return.

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The partner, if applicable, may be able to take advantage of offsetting passive losses from the passive income that could be generated from these loans which would increase the tax free rate of return being earned. In any event and if applicable the partner should check with their tax advisor.

Should the funding partner want to impact the market to a greater degree; CL can reset its goals to accommodate and close even more loans across a multi-state platform.

CL can customize and tailor the loan pool to fit the requirements of the funding partner. The size of the pool can range from a low of \$5 million to well in excess of \$150 million.