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Perception Is Reality in How Lenders See Builders

More than ever, creditworthiness is in the eye of the beholder, says one financial consultant.

By John Caulfield

A design center can be a good tool to help a builder showcase and market its houses and communities. But will the cost of such a center make sense to lenders when that builder needs to restructure its debt?

Brad Foster cautions that such a facility "is putting money into something [builders] can't sell." Considerations about generating cash flow, he contends, must drive the business plans of any builder that eventually will need to tap outside lending sources to refinance or expand.

Foster, whose past experiences include executive stints with several builders including serving as interim CFO with Orleans Homebuilders, is now managing director with the corporate finance and restructuring practice of FTI Consulting, with offices in Baltimore and West Palm Beach.

He spoke with *Builder* recently about what builders should be thinking about when they're looking to refinance their operations.

Foster sees a regulatory climate that, while easing a bit lately, has an agenda to "keep the clamps" on lending practices within the housing arena. This environment is being affected by new lending standards for qualified mortgages and rules that determine whether a residential mortgage is qualified based primarily on a borrower's ability to repay. Foster believes the government has "overcorrected" for past lending excesses, to the point where mortgage loans are becoming harder for banks to remarket to investors. And the relative ability of borrowers to secure mortgages is a key factor in how quickly and broadly the housing market recovers.

Few builders need to be told that banks view lending for residential acquisition and development as problematic. Hedge funds and private equity are filling some of this void, says Foster. "The funds are out there, but reloading a land bank using mezzanine equity can be expensive." These institutions also take "a very narrow view of risk," he observes. So lending is less about a creditor's patience with a particular project than the project's potential risk and return.

This is why Foster believes syndicate financing could be here to stay for a while longer, because it allows lenders to mitigate risk. However, such agreements "can be like the tail wagging the dog" for builders that end up jumping through hoops and making operational decisions to meet debt obligations and covenants.

Lenders ultimately want to work with builders they are confident can repay their debt. Therefore, builders need to "open their eyes to how others see you," says Foster. That means presenting business plans that are "realistic, believable, and sellable." Devising such plans often requires builders to ask themselves questions like "are you the most efficient deliverer of products?"

Many builders have already "trimmed the trees" by reducing their overhead. But some still have perceptual blind sports, such as one of Foster's clients, a builder/developer that, in an effort to make itself more attractive to lenders, started slashing staff. "But the president [of that company] didn't want to give up his personal driver," says Foster. "So the optics were a problem."

Credit: FTIConsulting

FTI Consulting's managing director Brad Foster says that builders looking to restructure their debt need to see their operations through the prism of their lenders' perceptions.

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