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Construction loans harder to get in '90s

By Doug Funke
staff writer

This article, the third in a series about banking in southeastern Michigan, explores lending practices relating to commercial development and home mortgages.

Bankers generally have decided on their own — without much of a push from federal regulations — to tighten the screws on developers and builders who want to borrow for new projects.

"(Federal) standards haven't changed. The environment in which the developer operates has changed," said Justin L. Moran, a consultant to the industry and a spokesman for the Michigan Bankers Association.

"For developers in the last few years, it has clearly become more difficult to get loans. That's simply a reflection that many types of development are overbuilt."

Robert Heinrich, president of the Metropolitan National Bank of Farmington, agreed that market forces and good business sense rather than government edicts give rise to policies in every lending category.

"When you experience losses, you start looking where they're occurring and start tightening lending criteria in that area," he said.

HOME MORTGAGES, equity loans and refinancings are more readily available because they're safer, Moran said. The collateral, the house or condo, is valued as more than just an investment. And the amount of money loaned for a residence is much less than for commercial ventures.

"Everyone has to live somewhere," Moran said. "If everything goes wrong, you (the banker) are going to recover most of what you lose anyway when you sell the house.

"There has never been a question on the availability of money for home mortgages," Moran added. "For the last 56 years, qualified buyers have had no problem. In the last few years, it has been easier than ever."

More mortgage money has become available due to secondary financing markets and the rise of federally-chartered, privately-owned companies like the Federal National Mortgage Association.

"I'm not really working with a (supply) limit . . . because I'm selling off and always getting money back to work with," Heinrich said.

MOST BANKS sell their residential mortgages fairly quickly, Moran said. "The (secondary) market is so busy, so active, you can't get your arms around it."

Banks that sell mortgages on secondary markets make their money on origination fees and a small monthly fee for continuing to service the mortgages. The packagers like GNMA, FNMA and other syndicates, earn a small cut by packaging the mortgages.

Secondary mortgage buyers, which can be pension funds, insurance companies and maybe even other banks, lock in long-term interest income at perhaps a half percentage point less than the original mortgage rate.

When interest rates skyrocketed in the late '70s and early '80s, banks responded with adjustable rate mortgages.

"Qualifications for buyers I don't think are more stringent today than 10 years ago," said Sam Kreis, vice president of construction lending for Comerica.

GENERAL RULES of thumb — no more than 28 percent of monthly gross income applied to the mortgage payment (interest, principal, taxes and insurance) with total debt not to exceed 38 percent of monthly gross.

Mortgages also can be used as bait.

"It's an ideal vehicle for a bank to make good customer relationships," Kreis said. Customers with a mortgage at a bank are likely to have a checking account there as well as a credit card and maybe a money market account.

Bankers use some basic principles on loan decisions whether the applicant is a first time buyer looking for a starter home or a veteran developer/builder of a multi-million dollar office complex.

"The essence of being a lender is managing risk," Moran said. "They look at character, cash flow and collateral."

Cash flow is especially big.

"BANKS ARE very worried about the ability of real estate developers to sell, lease or rent properties," Moran said. "In the last couple of years, it's very hard to demonstrate cash flow on buildings unless you have tenants to line up."

Richard Roeser, a Birmingham office developer and president of the Building Owners and Managers Association, recalls the days when structures went up on speculation.

"I can say we have more difficulty today than in the past," he said. "They (banks) are probably (requiring) preleasing of 60-80 percent now and banks will take a hard look at the credit worthiness of the leases," Roeser said.

Developers also have to put more of their own money into projects now before even applying for a construction loan.

Like 30-50 percent compared to 0-20 percent during the building boom, said Keith Sant, manager of the Southfield branch of Cushman & Wakefield, a commercial real estate firm.

"THE MORE equity a landlord has to put to a project, the less risk is perceived for the lender," Sant said.

Developers typically finance a construction loan through a bank for 18-24 months at a rate one or two percentage points above prime. The money is doled out as the project progresses, with the developer paying monthly interest on the outstanding balance.

During construction, the developer tries to line up tenants and permanent financing from insurance companies, pension funds, real estate investment trusts and maybe even other banks.

The permanent loan is paid back from rents. That loan is usually at a lower interest rate than a construction loan since it's less risky, Roeser said.

Bankers like a shorter payback period, three to seven years with a 10-year maximum, for even a permanent loan, Moran said. The payback period may be 15-25 years from other lending sources.

Developers who are doing commercial projects now are scrambling for an equity stake before even pitching banks for construction loans.

"Money is not as readily available in the development community as well as in all business communities," Roeser said.

So partnerships and syndicates are formed for even seed money.

EYE *on* BANKS

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— Justin L. Moran
bankers association

Spending by consumers to bring end to recession

By R.J. King
special writer

When will the recession end? With the advent of peace at hand, lower oil prices and affordable interest rates are expected to buoy consumer confidence and revive everything from auto sales to new-home construction.

That's the optimistic outlook, at least. But with such vexing problems as unemployment, reduced overtime, a nationwide credit crunch and embattled real-estate and banking sectors, the economy could be down for months.

"A recession is always a tough thing to shake," said Tim Brennan, a professor of economics at Madonna University in Livonia. "Once a few industries start to slow, and the media picks up on it, all of a sudden you have a national crisis on your hands."

Most consumers, said Brennan, are confused. They want to know which way the economy will go and when the recession will end. But with so much conflicting data, there are no easy predictions.

"There's plenty of money out there, but it's not being spent," Brennan said. "People see the stock market going up, but at the same time unemployment is rising. For the economy to recover, consumers have to start spending money again."

WHILE THE STOCK market had been heading toward all-time highs with a few downturns following the allied liberation of Kuwait — a sign, if history is a reliable guide, that a comeback is in the making — disturbing trends still linger.

Since June, 1.6 million Americans have lost their jobs. In addition, consumers have held tight to their credit cards as installments dropped $2.4 billion in January, meaning people are borrowing and spending less, a fact underscored by sluggish retail figures.

Spending is vital to a recovery, said Brennan, as consumer expenditures account for two-thirds of the nation's gross national product and was the sole spark leading to the comeback from the last recession a decade ago. But how to convince consumers to reach deep into their pocketbooks? And will consumer spending again be the catalyst for economic growth?

David Provost, president of the Bank of Bloomfield Hills, cautions against optimistic predictions. Baby boomers, he said, who were part and parcel of the economic expansion during the '80s, are aging and saving money for retirement and their children's education.

"Spending by baby boomers is much more conservative today than it has been since 1984," said Provost. "Instead of flashy purchases like caviar, baby boomers are stepping back and making more conservative purchases."

ANOTHER SIGN of fiscal restraint — since Iraq invaded Kuwait on Aug. 2, deposit transactions have risen sharply at the bank while lend-

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Tax return bell tolls next week

April can be the cruelest month, thanks to the arrival of the taxman. But you can look back on the tax season without remorse if you review this last-minute filing checklist drawn up by the Michigan Association of CPAs, based in Farmington Hills.

• Don't deduct reimbursed expenses. Pat's annual medical expenses came to $3,700. As he understood the tax law, these expenses were deductible to the extent that they exceeded 7.5 percent of his adjusted gross income (AGI), which was $36,000. Thus, on his tax return, he deducted $1,000. What he failed to take into account was that his insurance company had reimbursed $3,000 of his medical costs. Because of that, Pat could not deduct a single cent of his unreimbursed expenses.

Before mailing your tax return, carefully review your miscellaneous, medical and casualty-loss deductions to ensure that you have not accidentally included any expenses reimbursed by your employer or insurance company.

• Check the correct filing status box. This is important because it dictates the tax rate you will use to calculate your tax liability. Your filing status also determines whether you are eligible to claim certain exemptions, deductions and credits.

• Review your W-2 and 1099 forms. You should attach to your return a W-2 form from each employer for whom you worked, showing your wages and the amount of income and Social Security taxes withheld. If you receive a pension or annuity, you should receive a Form W-2P. Be sure the total income for all W-2 forms submitted corresponds to the figure you enter on your return. The IRS asks that you staple your W-2 forms to the front of your Form 1040 about half way down the page. You should not staple though the entire return.

Banks, brokerage firms, and other institutions issue 1099 forms to report the interest and dividends your investments have earned. Unlike W-2 forms, 1099 forms do not have to be attached to your return (unless tax withholding is shown on these forms). The forms should be checked to ensure you have reported all the interest and dividends attributed to your accounts.

• Provide Social Security numbers for dependents. On your 1990 return, you must report a Social Security number for any dependent who was at least 2 years old by the end of 1990. Next year, you will have to report Social Security for any dependent who is at least 1 year old. Failure to list this number may result in a $50 penalty. Also, if you are claiming a tax credit for child or other dependent care, you will need to provide the taxpayer identification number or Social Security number of the care provider, along with

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