

# Debt-Free Development - Lower Cost Housing - The Challenge and one possible solution

## Ty Albright's Experiment



Ty Albright – Corporate Days - at the family Ranch

**This is my opinion based on my experience – About me:**

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I had a 30+ year career in Commercial Real Estate and Finance – much of it with GE Capital Commercial Real Estate.

I've been “retired” for 6+ years now and doing stuff.

I always had a passion for building community and finding solutions for affordable housing.

**I understand big corporate real estate investment, risk management, development and finance. There are more ways to lose money in real estate than make money.**

# Lower Cost Housing

## Key Obstacles to affordability

**Municipalities** often prohibit or make difficult alternative proven solutions. Anything “different” or not typical is discouraged. Success often requires special “consultants” (corruption). Urban and suburban municipalities tend to have more barriers to entry than do rural locations.

**Home Mortgage Debt** is NOT typically available for anything other than traditional housing. The industry is tooled for mass volume production and anything “not typical” requires specialized underwriting and typically offers less favorable terms if it can be found. This reduces home resale value.

**Appraisal Industry** is designed to support the Mortgage Industry – they typically will not assign “value” to superior construction nor alternative construction.

These restrictions make innovative solutions difficult: alternative construction / Barndominiums / multi-family units / modular housing

# **The Home Mortgage Industry – why it limits your choices**

Home mortgages are packaged into large “mortgage backed securities” and resold. To enable this the type of loans made, and the type of home construction financed needs to be standardized.

Home mortgages are a volume business. Appraisals are often “check the box” and mass produced that rely upon local sale comparables – which drives down valuation on new construction.

Mortgage lenders want to loan on “standard” built construction – they do not want to take the risk of anything non-traditional because this takes too much time to understand / explain. Anything non-typical will be difficult to package and re-sale.

# Appraisals – how they impact your ability to obtain a mortgage

Appraisers often only fill out forms and put numbers into a financial model to determine “market value”. Recent sale comps are used to determine “value per sq.ft.”

The job of the appraiser is to give the mortgage lender assurance that a loan is made based on an appropriate value – this tends to result in undervaluing – a buyer often needs to challenge an appraiser to get full value.

## Appraisal #1

9/28/20

1,457 SF

2BR / 2Bth (2<sup>nd</sup> floor counted as an “above garage” apartment flat).

1.5 stories

**Value = \$186K (\$127/sf)**

Sale Comps / SF = \$85, \$103, \$104, \$115, \$118

Cost Approach:

1,457sf = \$90/SF

655sf apartment = \$16/SF

**Total cost = \$193K**

Appraisal was sloppy with multiple errors – I had to contact appraisal company to get errors corrected – this illustrates challenges you may experience.

## Appraisal #2

9/28/20

2,104 SF

3BR / 3Bth (2<sup>nd</sup> floor counted as a 1BR / 1Bth apartment ).

1.5 stories

**Value = \$230K (\$109/sf)**

Sale Comps / SF = \$111, \$114, \$134, \$139

Cost Approach:

2,104sf = \$90/SF

**Total cost = \$241K**

Appraised value increase:

Market Value = +24%

Cost approach = +25%

**Per Appraiser – Cost to build exceeds market value. Actual Cost = \$275.6K (\$131/SF).**

## **“Lower income / Lower wealth” Challenges.**

Many people do not have any savings so can not make a down payment.

Many people lack the needed Credit Rating to qualify for a loan.

## **Consequences**

Most “lower income / lower wealth” people end up as renters.

If able to buy - prefer an old run-down house at a lower cost over a well made new house at a higher cost.

**Big Conglomerates are buying up inventories of single family homes and turning them into rental units.**

# THE WALL STREET JOURNAL.

REAL ESTATE

## Blackstone Bets \$6 Billion on Buying and Renting Homes

Deal for Home Partners of America, owner of over 17,000 houses in U.S., is latest sign Wall Street believes housing market will stay hot

The business is attractive to investors because growth can come from both rising home prices and rent increases. The S&P CoreLogic Case-Shiller National Home Price Index, which measures average home prices in major metropolitan areas across the nation, [rose 13.2% in the year that ended in March](#), up from a 12% annual rate the prior month.

Big home owners are purchasing based on a 5% gross yield, and after management costs netting 4%.

This is a historic low yield – possible because of historic low (some say subsidized) interest rates – resulting in historic high housing prices.

A house that rents for \$2,000 / mth = about \$20K/year net, equals  $20K / .04 = \$500K$  value

# Rental

I was unable to sell the house so turned it into a rental – for \$1,600 / mth

Locals thought the rent was too high. Typical rentals in area (older homes) is \$900/mth for a 2BR / 2Bth home – a small 1BR / 1Bth apartment as low as \$500/mth. Recently rents are moving up.

Outsiders from California, Texas, elsewhere were interested in renting.

There is a demand from transient workers: Windmill Builders, Medical Marijuana growers, Oli Field workers (none now), other industrial workers.

720 E. 4th St.		
	<u>Annual</u>	
House Cost :	275,600	
Rent (\$1,600/mth) :	19,200	
Tax :	(1,200)	
Insurance :	(2,644)	
R&M / other :	<u>(1,600)</u>	
NOI :	13,756	
Yield :	4.99%	

# Cost of Construction – Impact of recent inflation



Recent cost increase in lumber (as much as +3X in recent times) and all building supplies – it is unknown what the cost of House #2 will be.



# Cost of Construction – Impact of recent inflation

Trade off is speed for cost.

Construction took 2 years.

Total cost of construction = \$124 / SF

**With 50' x 150' lot = \$131 / SF (total cost = \$276K)**

Offer to purchase (rejected) \$230K (\$110/SF)

Recent cost increase in lumber (as much as +3X in recent times) and all building supplies – it is unknown what the cost of House #2 will be.

Existing Homes in Sulphur OK (older with many in need of fix-up) sell for \$90/SF - \$110/SF

Antidotal: cost of new construction reported by other developers: DFW area = \$187 / SF, Scottsdale or Sedona AZ = \$300/SF

Even though the total cost of new development in rural areas can be lower (largely driven by lower land costs) – your appraised value will also be lower since sale comps will largely come from older housing stock – this impacts your ability to get a mortgage.

# Overview – here is one way it can be done

The following is overly simplified to illustrate how the “Rotation of Equity” could work:

Form a land acquisition and development LLC. You need \$400K up-front investment. One individual could do this if they had equity or you could get multiple investors - You have 8 lots for 8 homes and 8 investors. Each investor contributes \$50K equity ( $50 \times 8 = 400$ ).

Upon completion of the house #1; Investor #1 purchases the house from the LLC (gets a traditional mortgage) – the sale proceeds fund construction of house #2 – repeat process until all homes are built. The ending cash balance (equal to the original investment) is then returned to each investor.

If profits are made from each house the “big pay-off” occurs following sale of the final house.

Assume Total Cost / Home remains stable - how "rotation of equity" could work								
	Total	Per House #1						
Total Site :	130.0	16.3	< 8 lots ; $130 / 8 = 16.3$					
House #1 construction :	270.0	270.0						
Total Investment :	400.0	286.3	Profit					
Mark-up Profit :		0.0	0.0%					
House #1 Sale Price :		286.3						
Each investor / home buyer invests \$50K; $50 \times 8 = 400$								
House :	1	2	3	4	5	6	7	8
	(000s)	(000s)	(000s)	(000s)	(000s)	(000s)	(000s)	(000s)
Initial / Beginning Investment :	400.0	286.3	302.5	318.8	335.0	351.3	367.5	383.8
Development Costs Site / Land :	(130.0)	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Development Costs House :	(270.0)	(270.0)	(270.0)	(270.0)	(270.0)	(270.0)	(270.0)	(270.0)
Sale of Home:	286.3	286.3	286.3	286.3	286.3	286.3	286.3	286.3
Ending Investment :	286.3	302.5	318.8	335.0	351.3	367.5	383.8	400.0
Investor Cash Flow :	(400.0)	0	0	0	0	0.0	0.0	400.0
IRR :	0.0%							

# Overview – here is one way it can be done

## Variations:

House prices could be sold at market value – hopefully at a profit .

Investors do not need to be the ultimate home buyer.

## Challenges:

Housing market could decline during this process. Cost of House may exceed market value and ability to get a big enough mortgage.

Cost of development could increase over time requiring increased investment.

If investors are also the buyer – then their cash investment is tied up until the final house is completed so they need to plan for this – possible solution would be to find a mortgage lender who would allow “credit” to the investor of their initial investment equity as the down payment ( $50/400 = 12.5\%$  down payment) – this may or may not be possible.

## East Side Bluff - Actual Numbers

Site = just under 1 city block = 72,00SF = 1.652 acres – typical lot = 55' x 150'

Initial House = 3BR / 3Bth 2,100SF – 1<sup>st</sup> floor = 2BR / 2Bth 1,400SF 2<sup>nd</sup> floor = 1BR / 1Bth 700 SF apartment / big room

East Side Bluff - Sulphur Oklahoma		
Development Costs		
	(000s)	
Acquisition :	48.6	< 72,000 SF = 1.652 acre
Site Development :	73.3	< Clear & Grade, Sewer, Electrical
Plans :	6.3	
Total Site :	128.2	< 8 Lots
Total Site :	128.2	
720 E. 4th Construction :	259.6	
Total Investment :	387.8	
Per Lot :	16.0	< 8 lots
720 E. 4th Construction :	259.6	< \$124/SF development cost
Total Cost 1 house :	275.6	< 3BR / 3Bth 2,100SF = \$131/SF

Compared to other locations costs are lower in rural areas – trade off is speed – everything happens at 1/5 speed. At the current rate it would take 15 years to build 8 homes.

Possibly solution would be to get more builders involved but this would eliminate opportunity to “rotate” equity as each home is completed requiring more up-front investment.

	Acquisition & Plan		Site Prep			Construction Begins - 2 years + to complete house									
<u>East Side Bluff</u>	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	
	2018	2018	2018	2019	2019	2019	2019	2020	2020	2020	2020	2021	2021	2021	
	(000s)	(000s)	(000s)	(000s)	(000s)	(000s)	(000s)	(000s)	(000s)	(000s)	(000s)	(000s)	(000s)	(000s)	Total
Investment :	2.0	60.0	20.3	7.1	17.5	26.4	46.9	46.5	55.4	67.2	32.0	4.6	0.7	0.7	387.3
Cumulative Investment :	2.0	62.0	82.3	89.4	106.9	133.3	180.2	226.7	282.1	349.3	381.3	385.9	386.6	387.3	

<b>East Side Bluff - Sulphur OK</b>	
<b>Affordability Model - rent out apartment to off-set mortgage cost</b>	
	<b>Sulphur OK</b>
	<b>(000s)</b>
Example home cost :	300.00
5% Down :	15.00
95% Mortgage :	285.00
Annual Mortgage PMI 3.3% APR / 30yr / 95% LTV :	9.41
Annual RE Tax :	2.93
Annual Home Insurance :	<u>1.20</u>
Annual total home cost :	13.54
Rent From Apartment (\$600/mth x 10 mths) :	<u>(6.00)</u>
Net Annual home cost :	7.54
cost / mth :	0.63

A home with an apartment that is rented out can:

- Reduce expense by about 44%
- Provide lower cost housing to more people.
- Help with “age in place” strategies.
- Net Cost for 2BR / 2Bth 1,400SF home = \$630/mth

**Note: Some municipalities will not allow this.**

# Goals

- Build a Community Neighborhood.
- Use Equity only – no debt – avoid transaction costs.
- Give-back to the local community by sourcing local talent and buying from local suppliers.

## Overall Take-Aways

- A Covid Pandemic messes up your opportunity to market and attract participants.
- People are reluctant to be the first homeowner – they want to wait to see success before committing.
- Rural People want land / acreage – are uncertain about being too close to neighbors. Wealthy out-of-towners want lots of cheap land.
- “Poor” people want the lowest cost / lowest monthly payment. Understanding the merits of a well built / low cost to operate home with a mortgage cost off-set strategy is elusive.
- The market (including the mortgage appraisal industry) does not value quality construction.

## Ty's Strategy for lower cost homes

- Build in rural locations – costs lower.
- Use traditional construction – source labor / skill / material locally – lenders will loan, city will approve, workers can be found.
- Partner with a local builder – incentivize with shared profits.
- Use all equity – build then sell one unit at a time. Avoid transaction and finance costs.
- Use home and site design, along with Deed Restrictions and Access Easements to foster “Build it and they will come community development”.
- Build 2 story homes – design the home so the 2<sup>nd</sup> level can be rented out as an apartment to offset ownership cost. Use design that meets multiple living needs (Single, Family, Age-in-place).

# Home Affordability Challenge:

The majority of people can not afford housing.

Demographic data			
	USA (000s)	Portland OR (000s)	Sulphur OK (000s)
Median Net Worth Typical USA Family :	97		
Median Net Worth (age 55-64) :	187		
Median Home Price :	200	454	75
% USA with net worth < \$200K :	80%		
Annual Mortgage PMI 4% / 30yr / 80% LTV :	9.2	20.8	3.4
Annual Median RE Tax :	2.3	5.1	0.7
Annual Median Home Insurance :	1.1	1.1	0.5
Annual Median total home cost :	12.6	27.0	4.6
Annual Median rent 1BR/1Bth:	14.6	16.1	7.0
Median Family annual income :	59	53	46
Median annual Income before tax (age 55-64) :	68		
Median annual Social Security Income :	16		
% who live off Social Security only :	45%		
Data varies by source (not a lot) - data per Survey of Consumer Finances (SCF) - Federal Reserve - 2016, U.S. Census 2015, and other believed reliable sources			

## It costs less to live in rural locations

Most people (80%) face retirement with a net worth less than the cost of a house – they failed to buy a home and pay off the mortgage after 30 years of work. 45% of retired rely upon social security only.



# Partner with a local builder – incentivize with shared profits.

Find people who know how to make things with their hands.



**The Builder – George – with one of his crew James.**

Builder gets paid as he goes – but has incentive to: 1). Be fast. 2). “build it right” so we keep expense waste down, and have a home that can sell for a market price.

## Profit Waterfall

**Net Sale Proceeds are paid:**

- **Repay Developer actual cost of development.**
- **Pay Developer 8% preferred, compounded, accrued return.**
- **Split 50 / 50**

# Sulphur Oklahoma – South Central Oklahoma



**Chickasaw National Recreation Area**



**Artesian Hotel Casino and Spa**



**Lake of the Arbuckles**

## East Side Bluff

### First Floor 2 BR / 2 Bth

32' x 46' foot print = 1,472sf

Porch = 8' x 20'

2 car Carport = 20' x 20'

Bed Rooms = 12' x 15' =  
180sf

Baths = 7.3' x 11.7' = 85sf

Great Room (kitchen, dining,  
living) = 15.4' x 46' = 708sf

Laundry = 8' x 15'

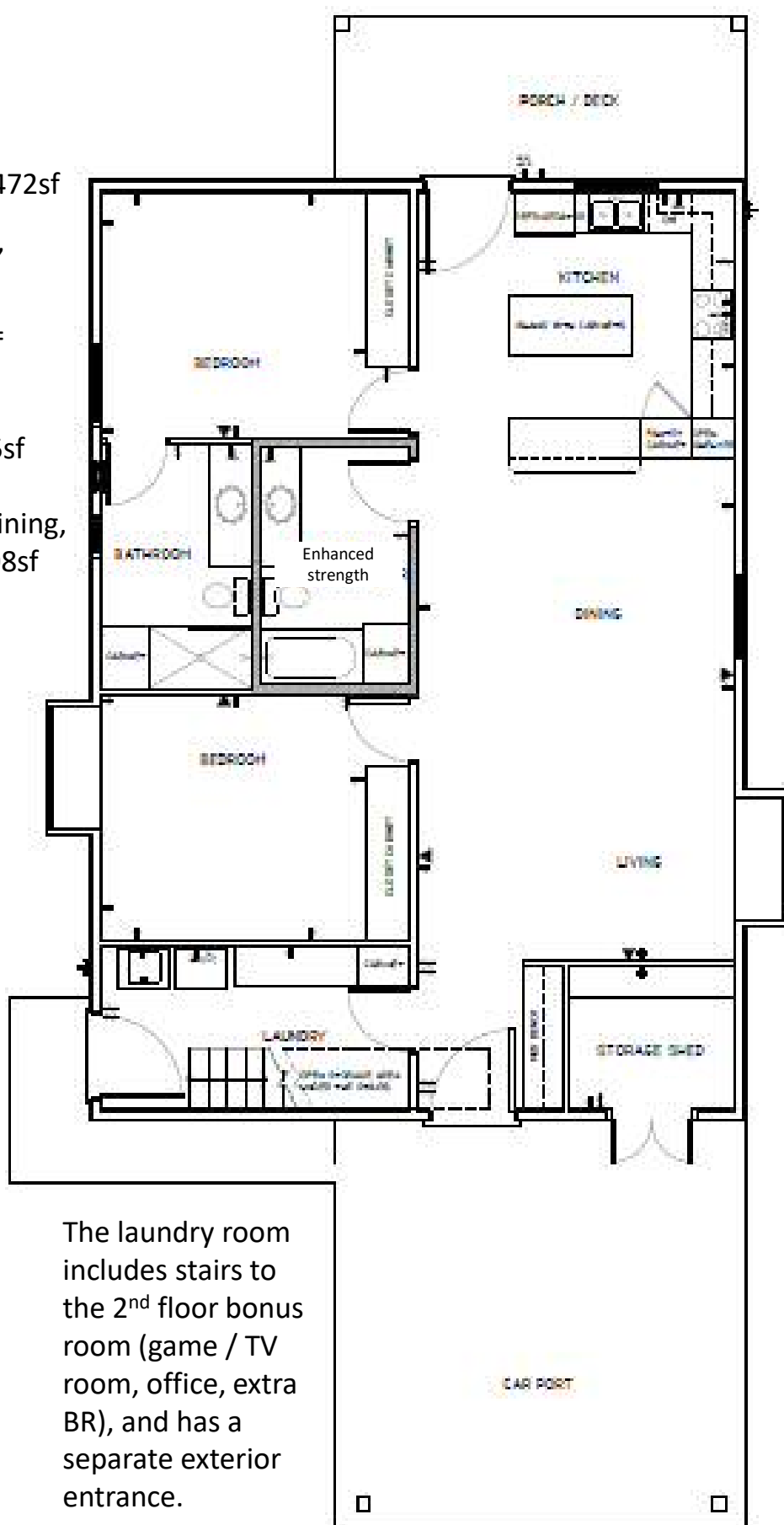
Storage = 7' x 8'

Doors are extra wide  
to accommodate  
mobility (4' exterior  
doors, 3' BR and Bth  
doors).

The bedrooms and  
baths are the same  
size to be equally  
desirable.

The interior bathroom  
is reinforced for  
enhanced strength; 2"  
x 6" studs with  
plywood sided walls  
and ceiling and solid  
door.

The laundry room  
includes stairs to  
the 2<sup>nd</sup> floor bonus  
room (game / TV  
room, office, extra  
BR), and has a  
separate exterior  
entrance.



## East Side Bluff

2nd Floor Bonus Room with 1  
Bth

700sf +/- total.

The great room center is 14.5'  
x 38.4' = 556sf

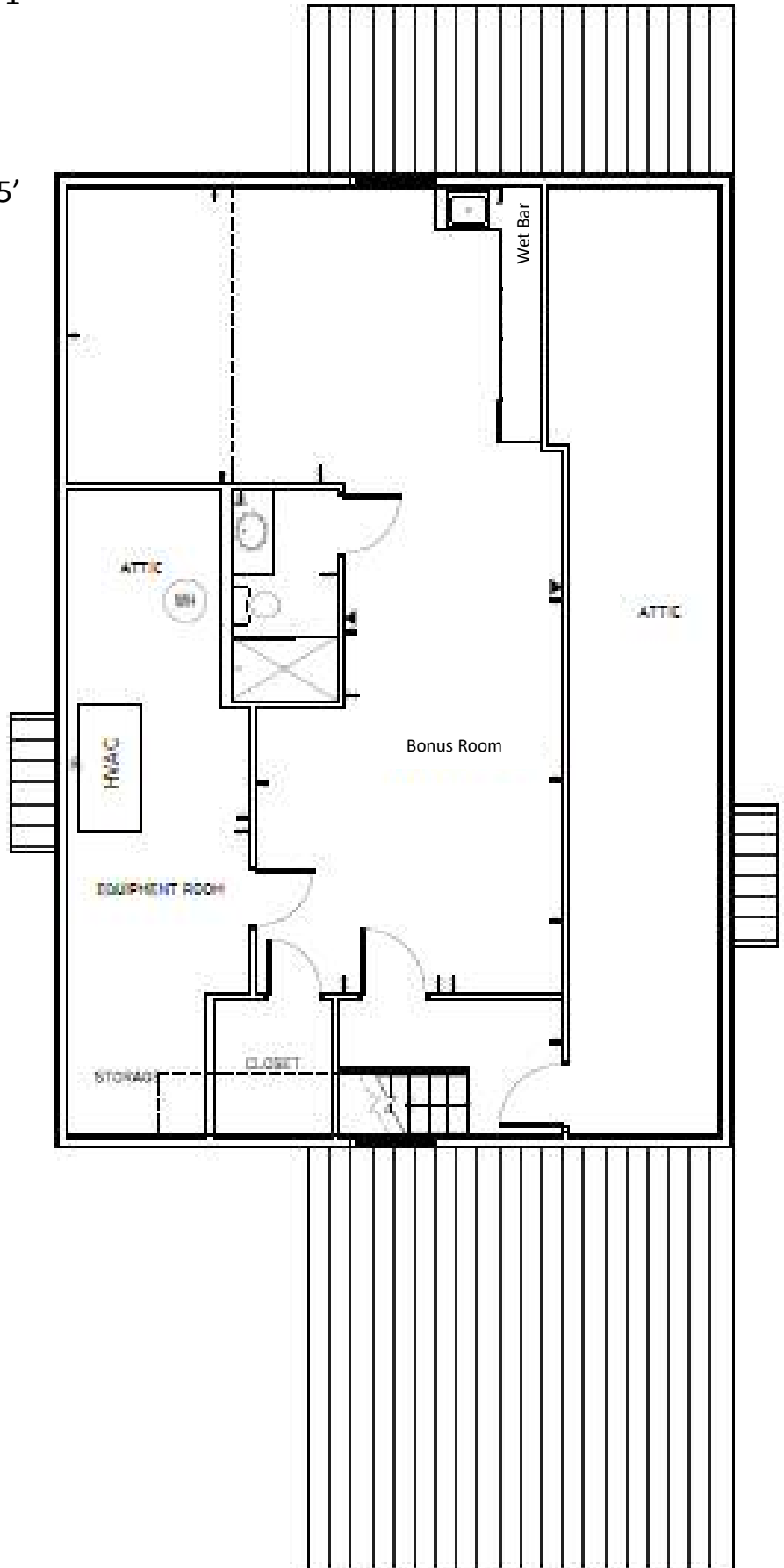
Bath = 5' x 10'

Walk-in closet.

Equipment room and attic  
storage is also available.

The 2<sup>nd</sup> floor Bonus room  
provides versatility to meet  
multiple needs:

- Game room for kids.
- Man cave / TV room / Art  
Studio / Office.
- Guest room / extra bed  
room.
- Care taker quarters.
- Storage.
- Has a separate entrance  
door at the top of the stair  
landing and can be shut-off  
and not used.



## House Design for flexibility and cost effectiveness

8 home pocket neighborhood. 3BR / 3Bth homes 2,100 SF

2 story house with ability to lease out the 2<sup>nd</sup> floor as an apartment. There is a separate entrance with a shared laundry room and ability to shut-off area from the 1<sup>st</sup> floor.

2 stories = lower cost (one foundation / one roof)

Car port with Storage = lower cost vs. full garage

Designed to foster community – Front Porch with kitchen window looking out over common space.

Enhanced construction for low cost maintenance and utility / operating costs.

### Meets multiple needs

1<sup>st</sup> Floor – 2BR / 2 Bth (1,472 SF)

Room Mates: Equal sized rooms.

Family with children.

Single with office.

Elderly with care taker quarters.

2<sup>nd</sup> Floor – 1BR / 1Bth loft apartment (700 SF)

Bonus room – man cave – bed room - studio

Care taker quarters

Separate apartment



## Legal Ownership of each lot

1/2" rebar stake  
aluminum cap

WYANDOTTE AVE.

THIRD STREET EAST

FOURTH STREET EAST

721 E. 3<sup>rd</sup> St.  
60' x 150'

720 E. 4<sup>th</sup> St.  
60' x 150'

719 E. 3<sup>rd</sup> St.  
55' x 150'

718 E. 4<sup>th</sup> St.  
55' x 150'

717 E. 3<sup>rd</sup> St.  
55' x 150'

716 E. 4<sup>th</sup> St.  
55' x 150'

715 E. 3<sup>rd</sup> St.  
80' x 150'

714 E. 4<sup>th</sup> St.  
60' x 150'

50.00'  
Set mag nail with  
aluminum washer

140.00'

Found 3/8" rebar  
with plastic cap

power pole is on  
property corner

found 3/8" rebar  
with plastic cap

140.00'

found 1/2" rebar stake

Street addresses indicated assigned by the City of Sulphur  
Site = 72,000 SF Land = 1.652 acres

Monte I  
ade a sur  
me and that this plat was p  
ractice of Land Surveying.

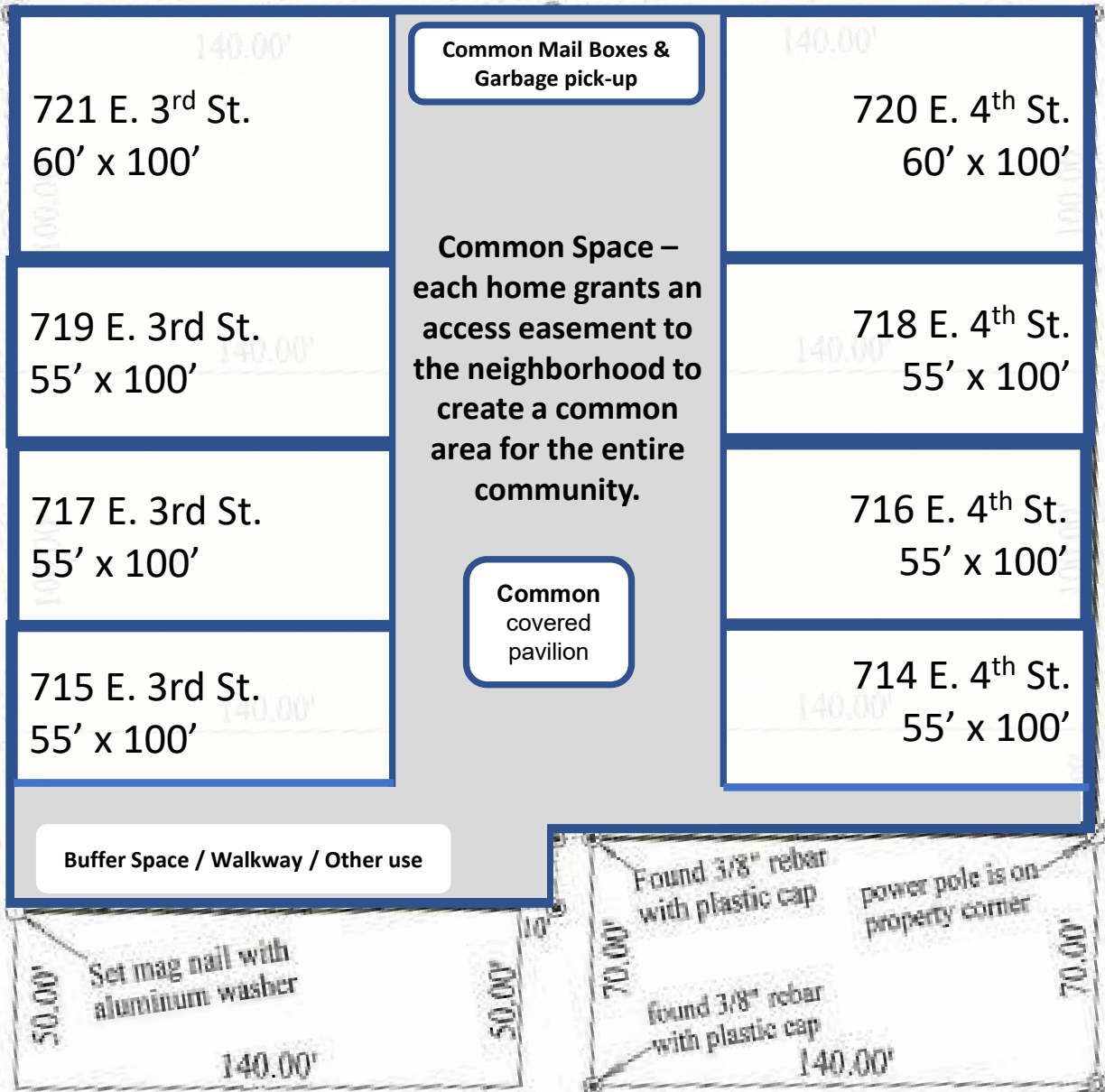
## Area available for improvements vs. Common Area space

1/2" rebar stake  
aluminum cap

WYANDOTTE AVE.

THIRD STREET EAST

FOURTH STREET EAST



Common Space – each home grants an access easement to the neighborhood for the center 50' of each lot; creating a 100' wide x 230'+ common area for the entire community – including a 25' wide easement on south side of 715 E. 3<sup>rd</sup> St. for underground power line easement and a buffer space / walkway / other use, and including a 5' wide easement to the south side of 714 E. 4<sup>th</sup> St. for a buffer space / walkway.