ADU Financing Alternatives

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Rental Market Stats

- Demand demographic – Oregon #1 in-bound state for those moving here 2013 & 2014*
- Portland rents rising on average 7% per year since 2010
- According to the city of Portland, PDX has seen one of the highest increases in rent in the nation last 12 months – close to 15% and has one of the lowest vacancy rates in the country
- Per the US census bureau Portland is the 3rd most competitive rental market in the country
- In 2010 around 7,000 people moved to Oregon.

By 2014 that number had jumped to 32,000 people*

*source United Van Lines

*source: Jason Jurevich Portland State University as reported by KGW Sept 3rd, 2015

Personal Funding Sources

- Personal Savings, liquid funds, stock/bonds
  - Consider opportunity cost of self-funding relative to other options
- Family loans & gifts
- Loans from 401K
- Business Loan

First Mortgage Cash out

PROS:

- Potentially lower long term cost of financing relative to 2nd mortgage or rehab options.
- Can be less restrictive then formal renovation and/or construction financing
- Can allow borrowers to capitalize cost instead of using liquid savings
- Less restrictions on how funds are used compared to a formal renovation loan

CONS:

- 80% maximum cash out loan to value (85% FHA)*
- Based on current value only (does not take into consideration value of addition of ADU/Rehab)
- Requires refinance of existing mortgage – could be disadvantageous depending on existing mortgage terms
- Could present higher fees than self-funding or other financing options

*Maximum loan to value more restrictive with investment properties verse owner occupied

2nd Mortgage Cash out – fixed vs. line of credit

PROS:
- Less fees and more streamline qualifying than first mortgage
- Does not require refinance of existing first mortgage
- Less restrictions on how funds are used compared to a formal renovation loan

CONS:
- Typically maximum loan to value is 90% or less (most capped at 80%)*
- Based on current value only (does not take into consideration value of addition of ADU/ Rehab)
- In most cases higher interest rate than first mortgage or interest rate risk with a line of credit

*Maximum loan to value more restrictive with investment properties verse owner occupied

Renovation Financing – Purchase or Refinance

PROS:

- Unique loan type that allows borrowers to finance all renovations into one fixed loan amount
- Loan to value considerations based on “After Rehab Value”, not existing value
- In addition to considering “after rehab value”, equity requirements are much less than first or second mortgage cash-out requirements

CONS:

- Interest rates can be higher than non-renovation first mortgage financing
- Restrictions on how funds are used
- Higher fees relative to other options

Renovation Financing cont. Homestyle & 203K

- 203K is an FHA based renovation loan
  - Requires only 3.5% down payment on purchase price + renovation
  - Can be more attractive for lower credit score borrowers
  - Limited to maximum loan amount of $362,250 in surrounding Counties
  - Attached ADUs only (no detached ADUs)
  - Investment properties not allows
  - Has a 1.75% funding fee of the loan amount & permanent mortgage insurance

- Homestyle is a Conventional based renovation loan
  - Requires only 5% down payment based on purchase price + renovation amount
  - Limited to $417K maximum loan amount in Oregon
  - Can be more appropriate for higher credit score borrowers
  - Allows for detached ADUs
  - Allows investment properties to be financed

Jumbo Renovation & Construction Financing

- Jumbo renovation needed when loan amounts exceed loan amount limitations of Conventional & FHA programs
- Construction Financing needed when existing home is being demolished and new construction to take place
- Down payment and/or equity requirements typically higher than Conventional or FHA loan.

Case Study

- 203K Renovation purchase with basement ADU Feb 2015 – N. Portland
  - $292K purchase price
  - $66,500 renovation

    Purchase + renovation = $358,500 with 3.5% down payment of $12,547
  - After rehab value $405K

    Provided $46,500 in immediate equity

  - Refi value August 2015 $428K – almost $70K of equity
  - Basement ADU rents for $1300/month 2bd/1bath
  - Total mortgage payment after Refi $2220

Personal Case Study – return on investment considerations

- Converting existing garage into ADU – N. Mississippi Ave.
  - $50,000 build cost
  - $1000-$1200 potential rental income – 2 bd/1 bath
  - Projected tax increase of 100% or approximately $200 additional per month
  - Anticipated property equity gain with legal ADU approximately $50,000

  - $1100 rental income minus projected tax increase of $200/month = $900 net

Net after tax cash flow of approximately $900/month or $10,800/year.

Even dismissing the equity gain of the ADU & future rent appreciation, this still provides a cash on cash return of approximately 22%* per year on upfront investment or a 4.63 year payback period. Arguably the pay back period is immediate given there is anticipated dollar for dollar value increase of the property value verse build cost

*$10,800 annual net rental income divided by $50,000 initial investment = 21.6% simple annual return