2019

State of Construction Finance

Rabbet

Introduction

What's top-of-mind for real estate lenders and developers in 2019? What are their priorities, pain points, and overall sentiment toward the construction finance process? And has the digital transformation finally arrived in the construction industry?

Rabbet decided to find out.

For this year's State of Construction Finance report, Rabbet surveyed qualified commercial lending executives and real estate developers. Conducted in April 2019, the survey was distributed using the Real Estate Daily Beat, CrowdStreet, and Rabbet's own network.

The portfolios of the 55 respondents range from less than $10 million to more than $1 billion under construction and span all major asset classes including multifamily, retail, industrial, office, hospitality, healthcare, and single-family. The lenders surveyed include both traditional banks and alternative lenders. Of the developers surveyed, more than half also perform as an equity partner and nearly a third also perform as a lender.

While some respondents report using a system like Rabbet to manage their construction finances, the majority of respondents did not.

Digital Readiness

Over half of construction finance data is trapped in spreadsheets and pdfs.

It's no secret that the construction industry has been slow to adopt new technology. However, it *is* surprising that in the era of the fintech revolution, construction finance is still largely dominated by a technology that's four decades old: spreadsheets. Only 48% of construction finance data is in a system, leaving the remaining half trapped in spreadsheets, pdfs, and emails. It's also not uncommon for this rich, complex data to be stored in manila folders.

Construction loans are widely regarded as the riskiest component of a lender's portfolio. In last year's report, lenders reported that their number one concern is whether or not there are enough funds for project completion. The slowness of the industry to embrace digital transformation has serious impacts. In 2019, only a quarter of lenders report portfolio-level reports for cash flows and capital requirements.

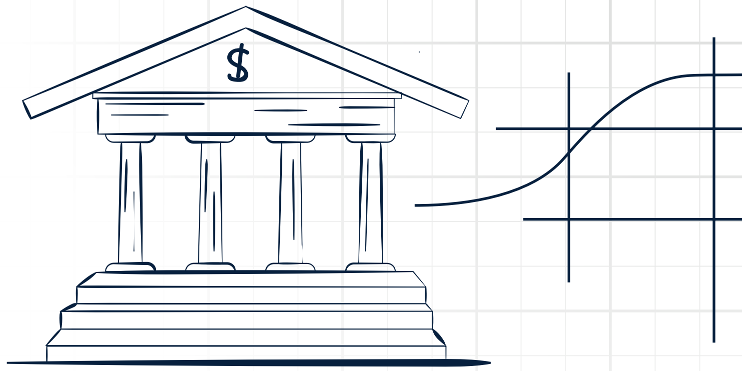
Despite the crawling rate of adoption, there is evidence of digital readiness. Although developers are twice as likely to report that they trust artificial intelligence in the construction finance process, both lenders and developers think automation would have a positive impact. 71% of lenders agree that certain aspects of the draw process can be automated, and 67% of developers think automation will expedite the process.

> "We now have an organized, centralized system with all of our construction finances. I'm a big data guy. Any collection of organized information is something I can learn from and is a value-add to my business."
>
> Eli Weiss, Joy Construction Principal

State of Loan Administration

Lenders and developers hold very different perceptions of the state of construction finance. While the gap in the reported time to fund has narrowed since our [2018 report](), developers are still twice as likely to report that the process is frustrating, slow, or painful.

Both parties are transparent about a lack of confidence in the process: nearly a third of lenders don't have portfolio-level reports, and nearly half of borrowers aren't confident they submit draw requests with all the required information.



LENDERS

29%

don't have portfolio-level reports

71%

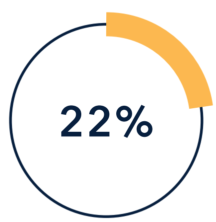
say certain aspects of the draw process can be automated

38%

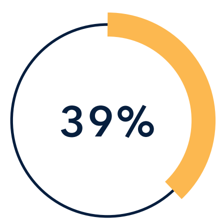
trust artificial intelligence to help with the draw review process

6.6 days on average to approve a draw

LENDERS SAY DEVELOPERS THINK:

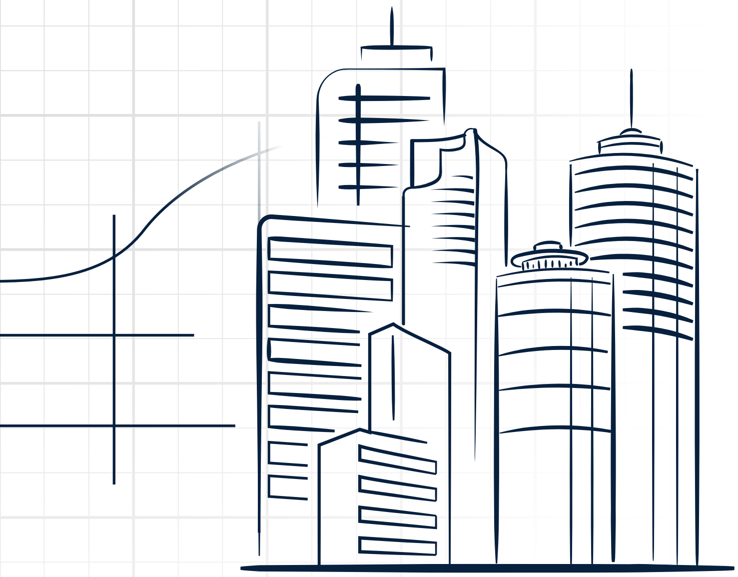


Think the lender's process is frustrating, slow, or painful



Think the lender's process is streamlined or efficient

The hardest part of the process? Lenders say it's **the inspection process (52%)** followed by **reviewing invoices (33%)**



While the experience varies, the two parties share plenty in common. Both think automation would have a positive impact on the process, which aligns with their mutual acknowledgement that organizing and reviewing invoices is one of the hardest parts of the construction finance process. There's also an opportunity to share information to achieve mutual goals: developers report a strong interest in paying contractors on time, and lenders report a strong desire to know which contractors they are exposed to on each project.

DEVELOPERS

7.7 days on average to approve a draw

DEVELOPERS ACTUALLY THINK:

42%
Think their lender's process is frustrating, slow, or painful

0%
Think their lender's process is streamlined or efficient

The hardest part of the process? Nearly half of developers say it's **collecting invoices** and **the back-and-forth with the bank to get approval**

42%
aren't confident they submit draw requests with all the required information

2/3
think automation would expedite the process

58%
trust artificial intelligence to help with the draw review process

Emerging Trends

Rising Prevalence of Developer-Lenders

Real estate developers are rarely pure-play. Vertical integration into investing, construction, and property management has long been the strategy for developers to capture more value. So what *is* new? The rise of real estate developers-turned-lenders.

In Mortgage Bankers Association's 2019 CREF Outlook Survey, respondents mark alternative lenders as the area of fastest growth. This growth is most concentrated in the riskiest areas of real estate finance: bridge and construction loans.

2019 developer-lender entrants include Catalyst Asset Management and Scale Lender, a joint venture between Carlyle Group and Slate Property Group. Given their experience on the other side of the transaction, developer-lenders are uniquely positioned to navigate construction financing, even offering LTCs up to 80%—a figure far out of range of traditional lender's 60-70% peak.

Traditional lenders tend to welcome the expertise of the new financing partners as a bellwether for project success. We expect strong growth in debt fund originations throughout the year, especially among positions that typically fall just out of favor for traditional lenders.

The Alternative to Alternative Financing

Seven years after the JOBS Act, CRE crowdfunding is still in its infancy relative to the traditional loan process. CrowdStreet, a commercial real estate crowdfunding platform, reported a record-setting $75 million invested in the first quarter of 2019 and a total of over $11.9 billion in projects transacted on their platform since inception. The Buccini/Pollin Group's first-quarter $6.7 million equity raise for their Virgin Hotel Nashville project shows this space is maturing and growing more institutional in nature.

Crowdfinancing is still largely an equity play, but CrowdStreet reports growth in debt deals for projects in development. This alternative to alternative lending has yet to cross into construction financing because the process to coordinate multiple draws from a wide pool of investors is time-consuming, inefficient, and costly. As construction finance management technology takes hold in 2019, take notice. This new source of capital may be knocking at the door.

Welcoming the Connected Construction Economy

The real estate industry is entering the advent of the connected construction economy: a state where information is effortlessly accessed in real-time and decisions are made with full confidence. For the first time, industry participants are starting to operate with the same current and historical project information.

Real estate has always been a relationship business, and 2019 has ushered in the digital infrastructure for strengthening the relationships among lenders, developers, and other real estate stakeholders. New tools ensure that no one shuffles through old emails, endlessly scrolls through pdfs, or traces formulas in spreadsheets to get the confirmation they need. Even more, no one waits in the dark while someone else looks for the answer.

Our 2019 State of Construction Finance survey respondents show a cautious but optimistic view of the role artificial intelligence will play in the construction finance process. 71% of lenders say certain aspects of the draw process can be automated, and 58% of developers trust AI to help with the draw review process. These results signal that both parties are readying themselves to adopt the technologies necessary to improve the draw process and ultimately achieve a connected construction economy.

Rabbet

About Rabbet

Rabbet is bringing efficiency, accuracy, and transparency to the complex connected construction economy. The intelligent construction finance platform uses machine learning to parse documents and connect information for reduced administrative burden, verifiable compliance, and faster decision-making for real estate lenders and developers. Based in Austin, Texas, Rabbet is venture-backed by QED Investors, Camber Creek, and Goldman Sachs.

Rabbet

For more information, please visit www.rabbet.com

Connect with us