

Improving the Seismic Resilience of California Buildings

Presents Opportunities and Challenges for Lenders

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For those of us fortunate to live and work in California, we have all probably felt a tremor or two. We live every day with the threat of a future, damaging earthquake centered in our backyard. Many wonder how such an event might impact our lives, and most certainly, the buildings that we occupy on a daily basis. Lenders too should be mindful of the seismic vulnerability of buildings in their portfolio and those under consideration for future transactions.

Now, San Francisco's recent adoption of a Mandatory Soft Story Retrofit ordinance is highlighting in a new way that these assets in seismically active areas present challenges and also opportunities for lenders.

Historic Earthquakes Shake Up Building Codes

Numerous destructive earthquakes have shaped the way engineers design and construct buildings, with the ever-evolving performance objective of protecting life safety and creating a

seismically resilient building inventory. Since the first Uniform Building Code was published in the late 1920's, building codes have become more comprehensive and have incorporated lessons learned from past earthquakes. Most notable for California are the 1906 San Francisco, 1971 San Fernando, 1989 Loma Prieta, and 1994 Northridge Earthquakes. These dates loosely correlate with the "cut-off" dates that lenders may be familiar with from engineering due diligence policies – for example, Fannie Mae may require a seismic risk assessment for buildings with tuck under parking constructed prior to 1988, after which tuck under parking was recognized to present a significant risk.

Unfortunately, many buildings built before these code changes have not been retrofitted. Of specific concern to engineers, policy makers and lenders alike is the older multifamily building inventory in very populous cities like San Francisco and Los Angeles.

San Francisco's Soft Story Retrofit Ordinance

In 2013, on the anniversary of the 1906 San Francisco Earthquake, the City passed a Mandatory Soft / Weak Story Seismic Retrofit Ordinance. The City passed a similar retrofit ordinance

in the 1990's for highly damageable and unsafe unreinforced masonry buildings. The City's focus now is to provide safer housing for the residents.

This most recent Soft Story Retrofit ordinance is focused on the multi-family housing inventory and specifically targets the following vulnerable structures:

- Wood frame structures (Type V fire rating);
- Five or more residential units;
- Three or more stories above grade (two stories over basement or under-floor area);
- Permitted for construction prior to 1978; and
- Having a "target story" (associated with a weak or soft condition).

Notices were sent out in September of 2013 to owners of buildings meeting the first four criteria above – these owners must complete a screening form to determine whether their building will be subject to the ordinance. The fifth criteria, whether the building has a "target story" or not, must be assessed by a licensed engineer or architect and is the determining factor of whether a retrofit is required. Owners are now under pressure to make this determination by

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September 2014. Current estimates indicate that about 3,000 of the 6,000 noticed buildings may require some form of seismic retrofit.

What Does San Francisco's Ordinance Mean for Lenders?

Many of these building owners will be seeking financing for the construction of retrofits. Whether lenders have an existing loan on a noticed building, or if they are considering lending on a noticed building, a policy should be in place to manage this going forward.

It is noteworthy that prior financing and associated due diligence on a property may have not revealed a soft story condition. Many lenders do not have a seismic policy requiring

a seismic risk assessment (known as a Probable Maximum Loss or "PML" report). For those that did require seismic risk assessment, all too often the assessment did not properly address building stability and the potential for localized collapse due to a soft story or other alarming seismic deficiency.

A lender with an existing note on a property on the City's soft story list may choose to assist the owner with retrofit financing, either through the issuance of a second loan or a refinance of the entire asset. However, the borrower may not have sufficient equity for a second. The expense of the retrofit may increase the risk of default and foreclosure.

For lenders who wish to place financing on a property that is on

the list but hasn't been retrofitted there are a number of approaches to consider. The loan can be funded with the stipulation that the borrower retrofit within a specified time frame, with funds for the retrofit held back and paid out through construction. Alternatively, the loan may be funded and require the borrower to obtain a second to pay for the retrofit. The more conservative approach would require the borrower to perform the retrofit before funding the loan and the proceeds of the loan wouldn't be used for the retrofit. In any case, earthquake insurance can be a short-term mitigant until the retrofit is performed, but placing insurance on

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a soft story building may be costly or infeasible.

As the lending community reacts to the ordinance, one considers the timeline presented. Step one is completion of the screening forms that have been sent to approximately 6,000 building owners. Building owners have until September 15, 2014 to complete the forms. Buildings subject to the ordinance will be entered into one of four compliance tiers with staggered deadlines for completing work; completion dates start September 15, 2017 and continue each subsequent year until September 15, 2020. This timeline means that lenders have time to develop specific programs and guidance for borrowers, as well as solidifying lending approaches and portfolio reviews on noticed buildings.

After attending a few workshops and fairs presented by the City it is clear to us that building owners are asking a lot of questions and seem to get conflicting information from various sources, whether the information is from city officials, engineers and architects, or contractors. Lenders that are financing a retrofit should keep in mind that many contractors do not have the structural and seismic design background necessary to select an appropriate retrofit. It is important for building owners to choose a knowledgeable consultant that understands the ordinance requirements and the fundamentals of seismic retrofitting, and will also stick with them throughout the process to ensure a cohesive approach and effective solution.

What Locales Are Next?

San Francisco is paving the way on this issue and several other California communities are sitting back, watching and learning. Many already have plans to implement their own mandatory or voluntary programs. Cities already engaged in this include Berkeley, Fremont, San Jose, Oakland, San Leandro, Campbell, Burbank, Los Angeles, and Santa Monica – and the list is likely to continue to grow.

The City of Los Angeles has been in the news recently after the release of a list of nearly 1,500 older “non-ductile” concrete buildings that researchers have indicated are particularly vulnerable to strong seismic ground shaking. Assessing the risk of collapse and ultimately repairing these buildings will present a significant challenge as more than 220,000 people live or work in these buildings.

Questions about how these building will be inspected and retrofitted, and who will foot the bill, are being evaluated and will get us another step closer to improving the safety of our older buildings.



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