State of Construction Finance

2023

Insights, data, and trends for commercial
real estate lenders and developers

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INTRODUCTION

Each year Rabbet surveys construction lenders and commercial real estate developers to uncover trends and benchmarks in construction finance. This year's report found that developers and lenders still face challenges surrounding communication and collaboration. Future-proofing operations is top of mind for both lenders and developers, including both rethinking legacy processes and implementing new technology.

The last several years, the State of Construction Finance report has tracked and documented the ever-changing landscape of the construction industry during a global pandemic, labor shortages, material pricing spikes, and a fundamental change in the way the world executes business. In 2020, the pandemic introduced the need for cloud-based technology to support remote work. In 2021, construction volumes and high prices forced the industry to look towards new technologies and acknowledge that existing processes could not keep up. In 2022, inflation climbed followed by interest rates, but project starts did not slow, pushing developers and lenders to question if there would be a return to "normal." **There is a case to be made that volumes in 2023 are simply a recalibration back to pre-pandemic norms.**

Rabbet surveyed over 90 qualified professionals across lending and development with active construction portfolios ranging from less than $20 million to more than $1 billion. Respondents were sourced via Rabbet's own network of lenders and real estate developers, which includes but is not limited to Rabbet's customers.

The 2023 State of Construction Finance Report seeks to dig deeper into understanding the "why" behind many of the challenges and shifts that have occurred in the last year. **This report takes a closer look at how lenders and developers are addressing and perceiving construction finance in 2023.**

SURVEY SNAPSHOT

64% of respondents claim that software has helped their team gain efficiency and productivity

58% of lenders are investing in process improvements to stay ahead and combat the current macroeconomic climate

46% of lenders say risk on projects has increased over the last year

68% of developers have invested in process improvements to improve upon legacy processes in the last year

39% of draws get sent back to developers for additional documentation by the lender

46% of lenders say they would automate the identification of at risk projects

TOP CHALLENGES

Based on the results of this year's report, lenders and developers have been more willing to evaluate and enhance their processes internally and externally with the ultimate goal being efficient tracking of and access to relevant data. They are now acting on many of the lessons they've learned.

Real estate development and construction loan management each come with its own set of challenges. This year, collaborating externally remains a challenge for lenders; however, there is a new and clear emphasis on real-time data tracking and management that has emerged as the biggest challenge for developers. In previous reports, real estate developers felt challenged by internal collaboration and reporting project statuses externally. The industry as a whole is suffering from data inefficiency.

Which activities are most challenging for lenders?

1. External Collaboration with Borrowers and Third Parties
2. Reporting and Analyzing Data Across Projects
3. Managing Risk
4. Processing Draw Requests
5. Internal Collaboration

Lender Challenges

External communication followed by reporting and analyzing data across projects have emerged as the major challenges for lenders for the third year in a row. Lenders also noted that managing risk was a major challenge they are facing.

Which activities are the most challenging for developers?

1	Knowing exactly where project finances stand at all times
2	Managing your construction budget
3	Tracking everything about projects in one place
4	Collaborating with internal teams
5	Reporting on project status to external parties
6	Preparing and submitting draw requests

Developer Challenges

In 2022, tracking all project data in one central place was the most challenging activity for developers followed closely by both managing the budget and knowing exactly where all project finances stand at all times.

This year, knowing exactly where all project finances stand at all times prevailed as the biggest challenge, budgement management held its second spot, and tracking all project data in one central place fell to the third spot.

Though there was a slight shift in the order, these three challenges won by significant margins in comparison to the other challenges outlined. This continues to suggest that developers need accurate, real-time, and easy-to-access project finance data.

Legacy Software

This year, developers and lenders still have a strong reliance on spreadsheets yet many respondents touted typical spreadsheet softwares as their least favorite tool. Many accounting systems were also mentioned as an unfavorable tool for developers specifically.

Spreadsheets have been the most widely used program for both lenders and developers for the last 3 years. This survey sought to understand what the "correct" amount of usage for this legacy process is and how much of the process can be automated to reduce manual entry and other associated laborious tasks.

38% of lenders claim that "too much" of their process relies on spreadsheets and developers claim that 65% of their processes still rely on spreadsheets. Despite this dependence, the majority of respondents also required multiple systems to manage the construction finance process - an average of 2.6 systems.

Developers were aligned and used an average of 2.5 systems. Over half of developers are using 3 or more systems or tools to track draws requests, pay applications, budgets, and more across all projects.

As processes become more automated and technology continues to play a larger role in construction finance processes, the risk of losing efficiency increases when manual spreadsheets are utilized in abundance. This risk leaves more room for error and ultimately increases the complexity of all components of the process. Both lenders and developers will have to move away from manual input and towards tailored technology in order maintain security and increase process efficiency.

More than 68% of developers have improved upon their legacy processes in the last year via operational tweaks or software implementation. When asked about change management and the difficulty it poses, 48% of developers said the changes were easy to implement. 66% of developers said these changes brought them a competitive advantage. 52% of developers noted the changes, though difficult to implement, were worth it because of the competitive advantages they were able to gain.

Manual Risk

Human error associated with manual processes and data entry still have industry stakeholders concerned about errors and data security. Both lenders and developers recognize the positive impact of digital processes on project risk.

According to both lenders and developers, human error is still an added risk to an already risky process. 100% of lenders felt that human error was a risk to their process and over 46% of those lenders viewed the risk as substantial. Last year, only 28% of lenders saw this risk as substantial which indicates that lenders are now understanding the potential repercussions of manual work.

46% of lenders say that risk on projects has increased over the last year while another 43% claim that their risk stayed the same. This is a significant change from last year when 64% of lenders claimed that risk remained the same as the year before. They also claim that almost 52% of their current construction loan management process could be automated to save time or reduce errors.

We asked lenders what they do to manage risk in their process. Last year, around half of the lenders involved in this survey claim that introducing technology to minimize data entry and automated compliance checks are the two most prevalent ways they manage risk in their processes. This year, manual compliance checks and reviews from multiple departments lead as the top two ways to manage risk on projects.

What do lenders do to manage risk in their process?

Category	Value
TECHNOLOGY TO MINIMIZE DATA ENTRY	14%
AUTOMATED COMPLIANCE CHECK	17%
MANUAL COMPLIANCE CHECKS	22%
REVIEW FROM MULTIPLE DEPT	18%
INVOLVE A CONSTRUCTION LOAN MONITOR	12%
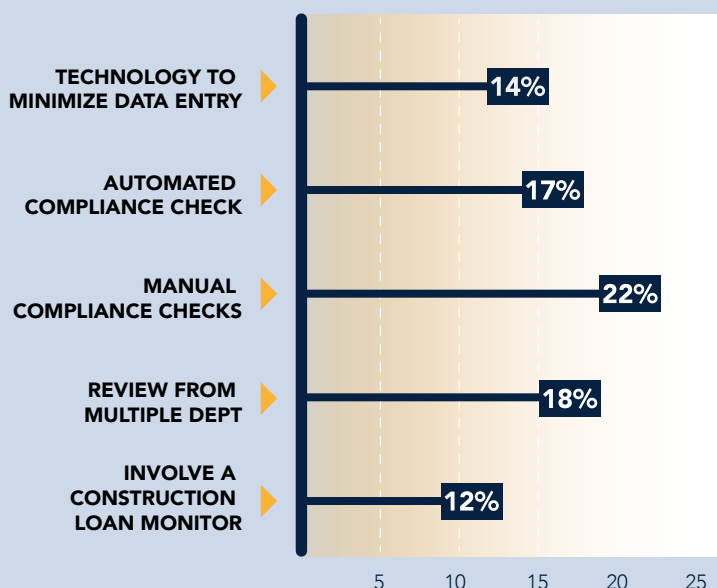
WIN, LOSE, & DRAW
The Complex Draw Process

Only 71% of draws are completed without errors according to lenders, whereas developers report that close to 61% of draw packages submitted are approved without additional documentation and change requests. The time spent on the construction finance process is heavily tied to the complexity of the draw process.

This process continues to be arduous, time-consuming, and inefficient for both lenders and developers. As construction starts slow down due to macro-environmental shifts, time is of the essence for both lenders and developers to focus on the inefficiencies of their current draw processes and correct the areas where bottlenecks and errors may occur. The complicated nature of the current draw process leaves many opportunities to lose information and time. In future years, when teams are winning new business at an accelerated rate again, operational efficiency will be even more important.

Developers claim that it takes an average of 5 to 6 days for their lender to fund their draws. This is an improvement from last year's report that found developers claiming it took 6 to 7 days for a lender to fund their draw. Over 40% of respondents said it takes 7 or more days to get their draw funded.

Developer Draw Process	
On average, how many days does it take for your lender to fund your draws?	**5.8 days**
How many hours do you or your team spend reporting on project finances or budgets each month (preparing and/or reviewing reports)?	**13.5 hours**
Outside of the standard draw, how long does it take you to prepare a project report for equity partners or owners every month?	**4.9 hours**

When developers were asked how streamlined or efficient they would say their lender's process is today, 68% said it was efficient to some degree. 85% of lenders perceive their current draw process as efficient. Lenders were also asked how efficient their processes were from their borrowers' perspective, and 85% of lenders thought that their borrowers felt their process was efficient.

Next, lenders were asked about their processes in order to understand which parts of their current draw workflows take the most time.

| Lender Draw Process	
On average, how many days does it take to review and process a new draw request from a borrower?	5.4 days
On average, when processing each draw request, how much time do you or your team spend searching for documents, invoices, etc.?	3.9 days
On average, when processing each draw request, how much time do you spend waiting for approvals?	3.9 hours
While processing each individual draw request, how much time does your team typically use to find and solve draw errors?	4.3 hours
How many hours do you or your team spend reporting on construction loans or draws each month (preparing and/or reviewing reports)?	18.4 hours

Where does the time go?

There is a consistent belief by both lenders and developers that some of the construction finance process could be automated to increase efficiency. This report sought to understand where time is currently spent in this process in order to identify areas where automation would have the biggest impact.

Lenders' Perceptions of Time and Efficiency in Loan Management
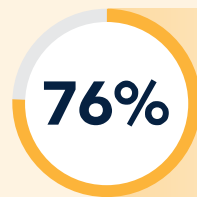
76% of lenders feel that they **spend too much time double checking correcting, or auditing** the work of others to make sure it's accurate
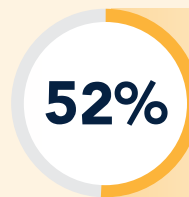
52% of lenders claim thet **their current construction loan management process could be automated** to save time or reduce errors.

When asked how much of their current process could be advanced by technology, developers responded that 55% of their current process could be automated for time and error reduction and 78% of developers felt they spend too much time double checking, correcting, or auditing the work of others to make sure it's accurate.

Time is a valuable resource that can be better prioritized when technology is introduced to automate tasks that do not require fully manual processes. This study aimed to understand where lenders and developers felt their processes could be optimized via technology as well as the impact of technology that has recently been implemented. The construction finance processes for both lenders and developers are involved and time consuming. One element of these processes that this report dove into is the timespend surrounding reporting. Lenders and developers were asked if they could automate or streamline one aspect of reporting for their construction finance process what it would be.

Lenders' Use of Their Time

Lenders would automate the identification of at risk projects more than any other activity. This comes as no surprise when considering the added risk inflation, rising interest rates, and labor shortages can add to a project. Lenders also mentioned they would automate "borrowers preparation of draw materials" and would value "more automated & comprehensive management level reporting."

This report asked lenders which aspects of the draw process are the most time consuming.
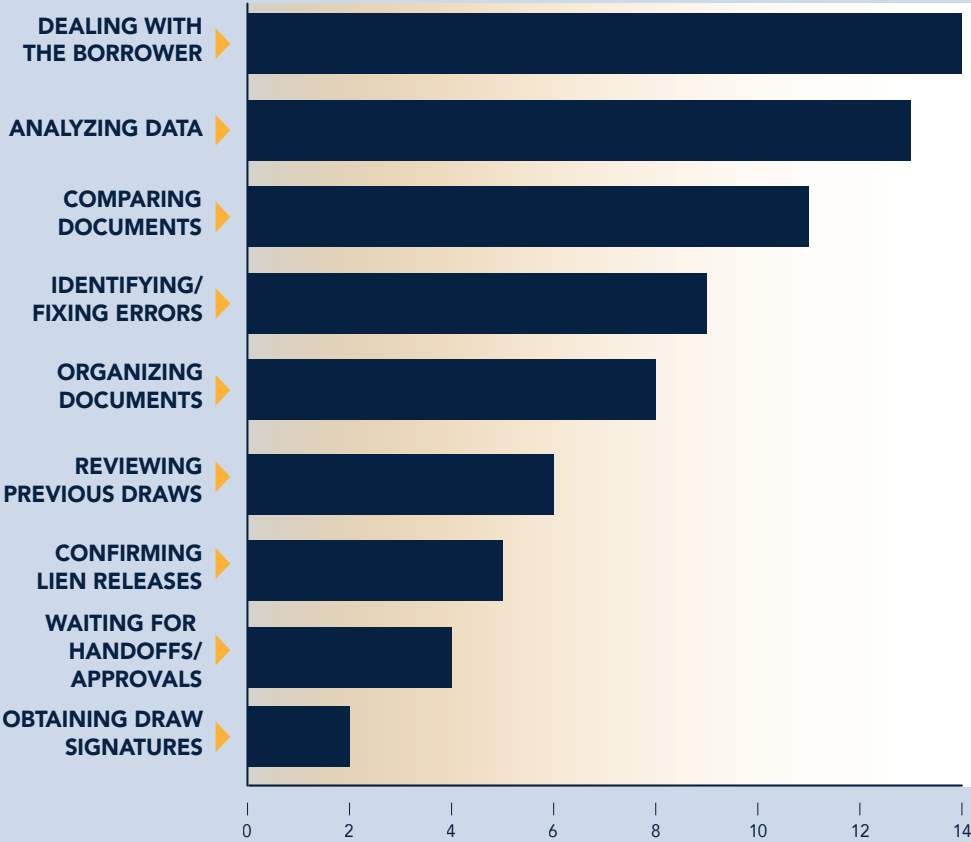
Lenders claim that analyzing data and dealing with the borrower are the two most time consuming activities related to the draw process. Comparing documents came in as the third most time consuming activity.

Dealing with the borrower was the most time consuming aspect for lenders. This report sought to understand where the perceptions of both lenders and developers were aligned, where there was misalignment, and how much time was spent on draws on average.

Aspects that developers would streamline or automate if they could include:
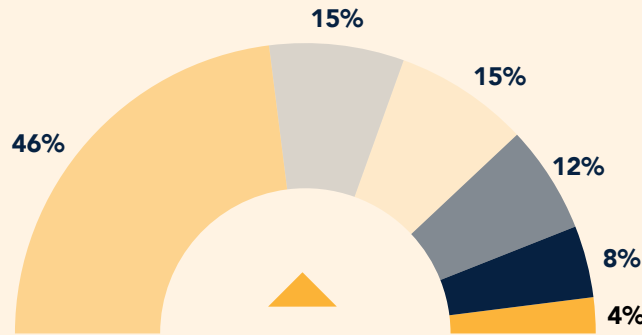
If you could automate or streamline one aspect of reporting for your construction loan management process what would it be?

46%	Identifying At-Risk Projects
15%	Comparing Trends Across Projects and Portfolios
15%	Alerting Users to Human Error on Spreadsheets or Documentation
12%	Identifying Loan Covenant Violations
8%	Other
4%	Cash Flows / Forecasting
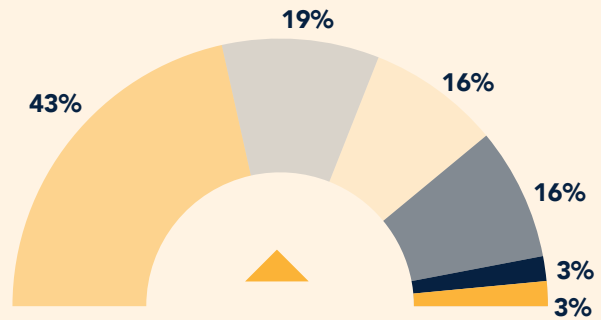
If you could automate or streamline one aspect of reporting for your project finances what would it be?

43%	Month-by-month cash projections and forecasting
19%	Project cost trends
16%	Contingency usage
16%	Vendor cost performance
3%	Schedule risk
3%	Other

We asked developers what aspect of reporting for their project finances they would streamline or automate if they could.

43% of developers claim that they would automate month-by-month cash projections and forecasting over all other tasks related to reporting if they could.

INVESTING IN THE FUTURE

The current macroeconomic environment is undoubtedly a concern for both lenders and developers. Both parties are reevaluating legacy processes while deal volume may be down in order to ensure that their operations have the stability and agility to navigate any of the uncertainties that lie ahead. Both parties are enlisting the help of software and digitization in order to "future-proof" their processes as much as possible.

A digital transformation brought on largely by the necessary process changes which stemmed from the pandemic has opened the industry up to modernization. The ever-changing economy's impact to the industry is illuminating the imperativeness of leveraging technology in order to stay competitive. This report dives into the impact of new technology in processes that were seemingly unchanged for decades and where the most valuable changes are being pursued.

Over time, this report has followed the industry's perception of technology as it went from resisting technology to an acceptance that technology would enhance processes and reduce risk. Now, there is widespread adoption of technology and we are finally seeing the results.
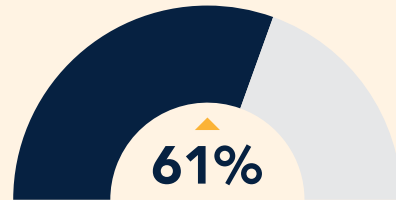
Software's impact on efficiency and productivity

64% of respondents have adopted construction finance software to gain efficiency and productivity.

Software implementation among lenders and developers

68%
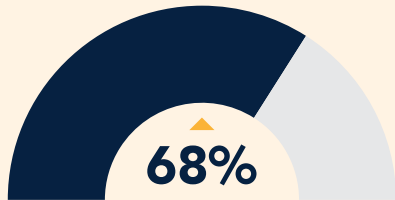
Lenders who have adopted construction loan administration

61%

Developers who have adopted development management software

This year, this report has identified that 61% of developers have adopted development management software to help their team gain efficiency and productivity. 68% of lenders surveyed make the same claim of construction loan administration software.

In order to dig deeper into what lenders want from their borrowers and what developers want from their lenders, we asked what one thing they would change about working with the other.

Lender Perceptions
When it comes to **working with your borrowers**, if you could wave a magic wand and change one thing, what would it be?

- Correct information/Data accuracy
- Standardization
- Trust with the borrower
- Better documentation

Developer Perceptions
When it comes to **working with your lenders or equity partners**, if you could wave a magic wand and change one thing, what would it be?

- Process simplicity
- Standardized reporting and documentation
- More professional borrower experience/communications
- Free flowing data and metrics that are tracked and accessible by both parties

The pursuit of all of these wants can be accomplished via investments in and successful implementation of technology. Implementation is key because technology is only valuable when it is being used to its full potential.

TRENDS AND TAKEAWAYS

Trend	▶ Takeaway
Lenders and Borrowers Want Reliable Data Management Alignment	**Desire for More Standardized and Transparent Data**

Lenders and Borrowers Want Reliable Data Management Alignment

Effective collaboration and alignment is paramount to the entire draw process. Both lenders and their borrowers want reliable data management and would like access to their data at any time.

Both sides would like insight into the process for the other side and would like data that readily flows both ways.

This report has found that lenders want the draw process to be standardized, organized, timely and simple. Lenders hope for data that is accurate and streamlined. Developers also crave a process that is standardized, organized, timely, and easier.

Human error, combined with remote work, manual spreadsheets, and new processes have industry stakeholders concerned about errors and data security. Process efficiency is key in mitigating these risks.

Both collaborators still suffer from processes that are antiquated and require documents to be shuttled back and forth; however, are seeking software solutions to enhance their processes.

Desire for More Standardized and Transparent Data

Implementation of technology often results in trackable data. Now, companies are starting to gather and track data that previously was not.

As processes continue to be modernized for both lenders and developers, they should think through how to enhance data management and access for the other.

Frustration from revisions, corrections, and unmet expectations from both the lender and the borrower can be diminished to some degree if there is insight into the process from each side and information can flow two ways.

In order to satisfy the needs of both lenders and developers, processes must be more transparent, streamlined, and standardized. Process optimization must be prioritized to ensure that a lender and their borrower can operate efficiently and communicate effectively with the other. Data transparency can also work to eliminate risk brought on by unknowns.

Technology can be deployed for lenders and developers to not only encourage standardization and accuracy, but also to aid in the translation of information between parties. Both stakeholders must invest in a process that is timely, familiar, and accurate.

Trend	▶ Takeaway

Reliance on Technology to "Future-Proof" Operations

Lenders and developers understand that they must optimize operations as much as possible to account for the uncertainty of the future. This year has made it clear that change is inevitable and the companies that will overcome the obstacles ahead are the ones that have strong processes that will continuously enable faster and better decision making.

Error and risk reduction have been prioritized and helped by technology.

Respondents call for automation and the integration of technology into their processes indicates that industry stakeholders are continuing the trend towards making communication channels future-proof.

Lenders and developers identified areas where their processes could be automated, and both noted parts of their process that are critical to the future of their projects such as identifying risk and project forecasting. Ever changing interest rates, material and labor costs, and other macroenvironmental circumstances highlight the need for process excellence. Automation is a huge component of establishing this excellence for the future.

The focus has shifted from implementation of technology to leveraging technology to enhance current processes. The goal is to take relatively unchanged practices and make them streamlined, faster, and standardized.

Tech-Enabled Operations Are More Sustainable

Software can mitigate unwanted surprises for lenders and their borrowers.

It is critical for both lenders and developers to continue to audit and edit how they are storing and sharing information in order to make sure their operations will function regardless of the circumstances to come.

Technology enables operations when leveraged correctly and used to its full advantage. Lenders and developers should implement technology that gives them foresight into the future and allows them to make decisions earlier and with better data.

Oftentimes, technology automates tasks so that teams can focus on tasks that require more attention. This allows team members to free up bandwidth for future-facing initiatives and due diligence. The sooner you see a potential change or problem arise, the more time you have to think through potential options and choose a solution that is aligned with company-wide business goals.

When problems are new, the hope is that teams can continue to orient to sustainable processes to navigate these problems. The problems may vary but well founded processes can greatly improve the odds of overcoming new challenges.

Trend	▶	Takeaway

Technology Unlocks Competitive Advantages

A goal of any organization should be to have processes in place that promote business goals and empower team members to do their best work.

Technology can add bandwidth to existing workers by automating time-consuming yet simple tasks. Tech-enabled operations could also be attractive to top talent. When team members are equipped with the tools necessary to perform at their best, they are empowered to bring their best work to an organization.

Software implementation does not necessarily replace skilled workers. The hope is that the right technology gives skilled team members all of the tools necessary to be as productive, efficient, and effective as possible.

Top talent with top performance helps build a culture and expectation of excellence and forward-thinking. This skillset and mentality will be a huge advantage for both lenders and developers as the circumstances of the future continue to surprise this industry.

68% of developers have improved upon their legacy processes over the last year and invested in process improvements. This leaves less than a third of the industry adherent to antiquated processes. 65% of developers noted that the change gave them more of a competitive advantage. Though change can be difficult to navigate, the cost of change is worth it when considering the true cost of loyalty systems that are behind the times.

Change is inevitable. Technology is how teams can ensure that they can continue to do more and do it better.

Additionally, technology can create a sense of confidence and security when attracting potential clients.

Change Now is Worth it for Stability Later

Change management within an organization, especially organizations with longstanding legacy processes, can be difficult. This change, however, can be worth it. Choosing to integrate software into business processes can often be easier than creating buy-in with existing team members. It is crucial to involve potential users into the implementation process and ensure the potential benefits are understood.

Now is a great time to focus on operations, evaluate current structures and workflows, and implement systems that give your team the ability to pivot, grow, and adapt whenever necessary.

A teachable, replicable, and worthwhile process can:

1. Enable existing team members by reducing tedious and manual tasks. Empower existing team members to prioritize elements of their jobs that can enhance business goals

2. Attract top talent that can help both lenders and developers stay competitive

3. Help existing team members efficiently transfer knowledge and data to new team members

4. Highlight business "knobs" that can be turned to propel business goals

Technology alone cannot empower an organization. People must buy into the change and leverage the technology to its full potential. Find the right technology for your team and for your current and future business goals. The right technology will leave your team better prepared to navigate more unknowns ahead and will bridge the gap between what is currently working and what could work better.

About Rabbet

Rabbet is transforming the construction finance industry with tailored solutions that provide a complete picture of real estate development portfolios. Designed for real-time workflows and comprehensive insights, Rabbet enables real estate developers, lenders, investors and related service providers to lower operational costs, make more informed decisions, and earn trust with other financial stakeholders. Founded in Austin, TX in 2017, Rabbet has improved visibility and efficiency for over $50B in opportunistic and value-add projects.

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