

HIRC

The High-Risers Club

6.25.2024 – Financing

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Welcome

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Does anyone have anything great to share personally or professionally?



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Podcast

Tune in wherever you get your podcasts!

- **Last Week: Things to Know about a Commercial Real Estate Letter of Intent (LOI) for a Purchase**
- **This Week: Deal Making Strategies Are Crucial Whether You Represent a Seller or Buyer of Commercial Real Estate**

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Financing

Commercial Lenders

- a. National, Regional and Local Banks
- b. Credit unions
- c. SBA Lenders
- d. Pension funds
- e. Insurance companies
- f. Real estate investment trusts (REITs)
- g. Agency: Freddie Mac, Fannie Mae, HUD

Financing

Commercial Lenders Loan Types

- a. Small Business Administration (SBA)
- b. U.S. Government loan
- c. Loan – Fixed-rate up to (10) years
- d. Construction loan
- e. Bridge loan
- f. Hard money loan
- g. Mezzanine loan

Financing

Timing: commercial loan approvals and closings can take two to three times longer than residential.

Financing

Differences in qualification for commercial loan vs. residential loan

- a. Commercial real estate loans are underwritten based on property cash flow. Borrower's income is considered secondarily. Properties income/expenses are the primary consideration rather than the borrower's personal financial statement.
- b. Borrower's liquidity is important.
- c. Debt Service Coverage Ratio (DSCR)
- d. Residential loans underwritten based on borrower income and debt
- e. Loan-to-Value (LTV) must be at or below the maximum requirement. Multi-family is usually 75-80%. Retail and Office are usually 65-75%.

Financing

Typical down payment requirements are higher for commercial vs. residential loans

a. 20-25%. Conservative lenders require 30%. Property type dependent.

Financing

How to underwrite a commercial loan – calculation of NOI based on actual “in place” income and expenses:

- a. Based on current income & expenses. Does not consider future rent projections.
- b. Break down operating expenses (taxes, utilities, repairs, and maintenance).
- c. Apply market vacancy rate and management fee.
- d. Debt Service Coverage Ratio (DSCR): ratio of net operating income to the mortgage payment. This is calculated as NOI divided by Annual Debt Service. A building with an NOI of \$224,000 and an Annual Debt Service of \$170,000 has a DSCR of 1.32x. DSCR is one of the underwriting standards a commercial lender uses to determine if they will offer a purchaser financing. Different types of real estate have different minimum debt service coverage ratio standards.
- e. Required Debt Service Coverage Ratios (DSCR): minimum 1.25x for multi-family. More conservative for other asset types 1.30-1.35x. Hotels can be 1.50x.
- f. Lenders also insist on cushion in property cash in case the owner experiences higher than normal vacancies or expenses. The more uncertain the property’s net income, the larger the cushion required by a commercial lender.

Financing

Loans are analyzed based on the specifics of the transaction, not on a standard lending program. There are many moving parts.

- a. The property's income
- b. Debt Service Coverage Ratio
- c. Loan-to-value ratio
- d. Owner's experience
- e. Property performance history
- f. Location
- g. Strength of the lease agreement
- h. Lease expirations, rollover, rental concessions, etc.
- i. Strength of the tenants
- j. Physical condition of the property
- k. Property vacancy rate
- l. Market vacancy rate
- m. Historical vacancy rate
- n. Desirability of property class

Financing

What's appealing to a lender

- a. A history of good cash flow
- b. Occupancy and vacancy
- c. An asset in good condition
- d. Strong leases
- e. Lease expirations
- f. Borrower experience owning investment real estate

Financing

What's not appealing to a lender

- a. Inconsistent cash flow
- b. Deferred maintenance
- c. A challenging asset class

Financing

Borrower is assessed based on:

- a. Real estate investing experience
- b. Net worth
- c. Credit score
- d. Cash reserves

Financing

Amortization: ranges from 15-35 years.

Most amortizations are 25 years.

Financing

Term: 5-10 years fixed

Below is a real-life example of a 5-year term, 25-year amortization for a \$2.8M mortgage

Loan Date	Interest Rate	Payment	Payment Change
11.6.2007	6.625%	\$19,125.08	
11.6.2012	3.760%	\$14,406.88	↓ \$4,781.20
11.6.2017	4.410%	\$15,424.03	↑ \$1,017.10
11.6.2022	5.500%	\$16,340.82	↑ \$ 916.79

Financing

Timetable for closing

60-90 days from request to closing. Can be accelerated if Purchase & Sale Agreement (PSA) requires earlier closing date. Borrower must have all documentation available.

Financing

Commercial closing costs

a. These costs are more expensive than in residential real estate. The high end of the fee ranges depends on the complexity of the transaction and the sales price. The ranges listed below are examples of fees.

- Appraisal: \$1,500-\$10,000
- Lender Commitment Fee: \$1,500-\$10,000 (% of loan amount)
- Inspections: \$500-\$5,000
- Legal Services: \$2,000-\$25,000
- Document Preparation: \$500-\$2,000

Financing

Loan application sequence

- a. Prepare financing package
- b. Submit to potential lenders
- c. Lender issues Term Sheet/Letter of Intent (non-binding)
- d. Review with borrower to select a lender based on loan terms.
- e. Borrower signs term sheet and gives the lender a good faith deposit to order third party reports (appraisal and environmental).
- f. Banker submits to in-house underwriter to prepare internal presentation.
- g. Banker/underwriter obtains approval from the loan committee and issues a commitment letter. This is subject to the receipt of favorable third-party reports.
- h. Borrower/owner signs commitment letter.
- i. Process moves to closing. Lender's attorney issues closing checklist to borrower's attorney.
- j. Closing scheduled after receipt of all documentation.

Financing

Loan Submission Checklist

a. Property

- Description of building
- Land area
- Parking
- Pictures, include the property and immediate surrounding area

b. Borrowing Entity

- Name of the entity that will own the property
- Partners with ownership of 20% or more provide:
 - Personal financial statement
 - Borrower schedule of their real estate portfolio
 - 2-3 years of personal tax returns
 - Background of each partner describing business and real estate experience

Financing

Loan Submission Checklist

c. Property Financial Information

- Rent roll
- Operating expenses for the property
 - Real estate taxes
 - Insurance
 - Utilities, detailed breakdown
 - Repairs and maintenance
 - Trash Removal
 - Snow Removal/landscaping
 - Other Expenses

d. Owner-Occupied Property

- 2-3 years of business tax returns

e. Legal

- Purchase and Sale Contract

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<https://www.facebook.com/groups/commercialrealestateforresidentialrealtors>



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Next Session

Negotiating/Deal Making Part 2

**Tuesday, July 2, 2024
@ Noon Eastern**

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