

## Commercial Real Estate Lending for Small Businesses

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Lead Sponsor



### Intro to Commercial Real Estate Lending

- Who are we?
  - Dan Betancourt
  - Jim Buerger
  - Jane Bittcher
  
- Why should your CDFI get involved in commercial real estate lending?

## Underwriting 101 Owner Occupied Real Estate

- Financial Analysis
  - DCR is calculated in similar fashion as for any term obligation – add back rent when buying property.
- Term 15-20 years max (5-year balloon?)
- Loan to Value
  - Generally 75-80% is desirable, may consider higher based on other mitigating factors.
- Property Analysis
  - Fair market value and fair market rent should be analyzed and special purpose buildings.

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## Underwriting 101 Multi-use/Tenant Real Estate

- Financial Analysis
  - Need to analyze property cash flows
  - Borrower reputation and experience
- Terms
  - Generally 15-20 years (5 year balloon?)
- Loan to Value
  - Generally more conservative towards 75% loan to value
- Property Analysis
  - Mix of commercial/retail – pre-leased
  - Market conditions

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## Cash Flow – Example

Assume \$200,000 purchase, \$160,000 mortgage

Project Cashflow					
Project Income & Expenses					
	Unit				
Rental Income	Type	Num	Sq Ft.	Rent	Annual
Unit 1	1BR	2	800	\$700.00	\$16,800.00
Unit 2	2BR	1	1000	\$900.00	\$10,800.00
Unit 3	Comm	1	1500	\$1,900.00	\$22,800.00
<b>Total Apartment Rent</b>		<b>4</b>			<b>\$27,600.00</b>
<b>Total Commercial Rent</b>					<b>\$22,800.00</b>
Vacancy	5% Apt				-\$1,380.00
	10% Comm				-\$2,280.00
<b>Net Rent</b>					<b>\$46,740.00</b>
<b>Expenses</b>					
Mgmt Fee				3%	\$ 1,402.20
Insurance					\$3,000.00
Taxes					\$6,000.00
Utilities					\$6,000.00
Water/Sewer					\$3,000.00
Permits/License					\$500.00
Maint.				3%	\$1,402.20
Repair Allow				2%	\$934.80
<b>Total Expenses</b>					<b>\$21,239.20</b>
<b>Operating Income</b>					<b>\$25,500.80</b>
Debt Service					\$19,500
NOI					\$6,001
DOC					1.31

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## Underwriting Extras for Commercial Real Estate

- How does the new loan payment compare to the current lease payment?
- If the location is changing, what, if any effect will it have on business operations?
- Is there a construction component or is it a finished building?
- Are renovations necessary, or is it in move-in condition?
- Will the business occupy 100%, or will there be tenants?

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## How should a CDFI prepare to be a commercial real estate lender?

- Hire an underwriter/analyst who knows the industry.
- Find reliable, knowledgeable resources to perform due diligence.
- Use outside resources to close the loans if staff is not experienced in real estate.

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## Ideas for Funding and Structuring Commercial Real Estate Loans

- SBA 504
  - 50% 1<sup>st</sup> mortgage, 40% 504 Mortgage, 10% equity injection
- State & Local Sources
  - In PA – PIDA, Small Business First, State Hospitality Guaranty
- Federal SSBCI Funds
- Federal Home Loan Bank
  - Banking on Business in PA
- New Markets Tax Credits

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# Due Diligence

## ■ Commercial Appraisals

- Lower of Cost or Market
- 3 Valuations – market, cost, income
- “As Is” vs. “As Improved” valuation
- Flood Certifications
- On-line Services

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# Due Diligence

## ■ Environmental Concerns

- Preliminary Questionnaires/Detailed Questionnaires
- Phase 1 Assessments
- Testing/Remediation – Phase 2 & 3
- Online Services – Electronic Data Resources

## ■ Surveys

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## What other concerns exist?

- If construction or rehab, who is monitoring and inspecting the project?
- Have necessary permits been received?
- If funding through draws, who is approving payments?

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## Considerations for the Borrower

- Who will own the building (individuals, separate entity)?
- Are there enough resources in reserve to cover an emergency?
- Who will manage day to day operations of the building – will it distract from the operations of the business?

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## Case Study

- \$600,000 total project of a \$400,000 purchase of a mixed used commercial property with proposed renovation budget of \$200,000.
- See handout and NOI Worksheet.

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## Case Study

- Leo Iron and Metal Inc.
  - Total project cost: \$962,000
  - Bank financing: \$481,000 (50%)
  - SBA 504: \$349,000 (36%)
  - Owner's equity: \$144,300 (14%)

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## Pitfalls to Funding Commercial Real Estate Projects and the Lessons We've Learned

- Make sure you have analysts and backroom employees who understand commercial real estate, or engage outside resources.
- These projects can take a long time from application to closing, especially when rehab is involved.
- Avoid 2<sup>nd</sup> mortgages on commercial real estate.
- Construction projects (even relatively minor ones) require specialized monitoring.

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## QUESTIONS?

- Jim, Jane and Dan

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