Commercial Real Estate Lending for Small Businesses

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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.

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
Cash Flow – Example
Assume $200,000 purchase, $160,000 mortgage

<table>
<thead>
<tr>
<th>Project Income &amp; Expenses</th>
<th>Unit</th>
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<tbody>
<tr>
<td>Rental Income Type</td>
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<tr>
<td>Unit 1</td>
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<td>Unit 2</td>
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<td>Unit 3</td>
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<td></td>
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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?
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.

Ideas for Funding and Structuring Commercial Real Estate Loans

- SBA 504
  - 50% 1st 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
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

Due Diligence

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

- Surveys
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?

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?
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.

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%)
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 2nd mortgages on commercial real estate.

- Construction projects (even relatively minor ones) require specialized monitoring.

QUESTIONS?

- Jim, Jane and Dan