



SMALL BALANCE COMMERCIAL LENDING: QUALIFYING OPPORTUNITIES

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April 18th, 2017

blustream
— L E N D I N G —

Agenda

- How is qualifying commercial loans different from residential?
- How to calculate and evaluate commercial loan ratios
- How to choose the right loan program for your client
 - Complete Doc
 - Lite Doc
 - Bank Statement
- How to package a loan for highest chance of approval
- Resources & contact information

Differences between Commercial & Residential Mortgages

Residential Mortgages

- Underwriting the Borrower
 - Debt to Income Ratio
 - Credit Scores
 - Employment Stability
- Loan Structure
 - Low Down Payment (5%)
 - Lower Interest Rate
 - Longer Terms
 - Lower Fees
 - No Prepayment Penalties

Commercial Mortgages

- Underwriting RE Cash Flow
 - Debt Service Coverage Ratio
 - Loan to Value
 - Credit Score
- Loan Structure
 - Higher Down Payment (15-30%)
 - Higher Interest rate
 - Shorter Terms
 - Higher Fees
 - Prepayment penalties

Differences between Commercial & Residential Mortgages

Residential Mortgages

- Closing
 - Average 45 days
- Industry Difference
 - High transaction volume
 - Immediate response time
 - Listings easily accessible (MLS)

Commercial Mortgages

- Closing
 - 30 to 60 days
- Industry Difference
 - Low transaction volume
 - Slower response time
 - Listings not as easily accessible

Types of Properties

Investment

- Zoned commercial or mixed use
- More than 60% of revenue (rent) comes from businesses who do NOT own the building
- Underwritten based on rental income and building expenses
 - Common term used:
Net Operating Income

Owner Occupied

- Zoned commercial or mixed use
- More than 50% of the revenue (rent) comes from building owner
- Underwritten based on cash flow from underlying owner's business and/or the owner themselves
 - Common term used:
Global Cash Flow

Important Ratios and Calculations

- **Net Operating Income (NOI)**: Net cash generated before mortgage payments and taxes. NOI is calculated by adding the property's gross rental income to any other income (such as late fees or parking income), and then subtracting vacancies and rental expenses.
- **Vacancy Rate/Occupancy Rate**: The **vacancy rate** is the percentage of all available units in a rental property, such as a hotel or apartment complex, that are vacant or unoccupied at a particular time. It is the opposite of the **occupancy rate**, which is the percentage of units in a rental property that are occupied.
- **Debt Service Coverage Ratio (DSCR)**: Measures borrower's ability to pay the property's monthly mortgage payments from the cash generated by the rental property.
- **Capitalization Rate (Cap Rate)**: Places a value on a property based on the NOI it generates, allowing for comparison of properties with different Fair Market Values (FMVs). The Cap Rate is computed by dividing NOI by the property's FMV. The higher the Cap Rate, the better the property is said to be performing.
- **Loan to Value (LTV)**: The amount of a secured loan or mortgage divided by the fair market value of the property.

Sample Property with Ratios and Calculations

- Scenario:
 - 5-unit commercial office property
 - Needs to Refinance a \$1,008,000 loan
 - 5-year term with 30 year amortization at 7%

Sample Operating Statement



Property Operating Statement

Date: 03/31/17

Property Address: 123 Main St

	20 15	20 16	Trailing 12 Months 03/31/17	YTD 03/31/17
Annual Gross Rent	\$129,800.00	\$129,800.00	\$129,800.00	\$32,400.00
Vacancy and Collection (Minimum 5%)	5%	5%	5%	5%
Adjusted Gross Income (AGI)	\$123,120.00	\$123,120.00	\$123,120.00	\$30,780.00
Expenses:				
• Real Estate Taxes	\$1,000.00	\$1,000.00	\$1,000.00	\$84.00
• Insurance Premium(s)	\$1,000.00	\$1,000.00	\$1,000.00	\$84.00
• Management Fee (Minimum 5%)	5%	5%	5%	5%
• Management Fee	\$6,156.00	\$6,156.00	\$6,156.00	\$1,539.00
• Utilities	\$3,000.00	\$3,000.00	\$3,000.00	\$3,000.00
• Garbage Collection				
• Replacement Reserves (3%)	3%	3%	3%	3%
• Replacement Reserves	\$3,693.60	\$3,693.60	\$3,693.60	\$923.40
• Maintenance & Repairs	\$2,000.00	\$2,000.00	\$2,000.00	\$2,000.00
• Supplies	\$500.00	\$500.00	\$500.00	\$500.00
• Legal and Professional Fees				
• Other	\$5,000.00	\$5,000.00	\$5,000.00	\$5,000.00
Total Annual Expenses	\$22,349.60	\$22,349.60	\$22,349.60	\$13,130.40
Net Operating Income (NOI) (AGI - Total Annual Expenses)	\$100,770.40	\$100,770.40	\$100,770.40	\$22,649.60

Signature _____

Date _____

Sample Rent Roll



Rent Roll – Commercial
(Self Storage, Office, Light Industrial, Retail, Warehouse, Mixed Use)

Rent Roll as of: (required)

PLEASE COMPLETE ALL COLUMNS AND SECTIONS

PROPERTY ADDRESS						CITY			STATE	ZIP CODE	
123 Main Street						Emeryville			CA	94608	
SUITE #	TENANTS NAME <small>(Write vacant for vacant suites.)</small>	SQ. FEET <small>(approx)</small>	CURRENT MONTH RENT IN PLACE	ORIGINAL OCCUPANCY DATE <small>(MM/DD/YYYY)</small>	LEASE START DATE <small>(MM/DD/YYYY)</small>	CURRENT LEASE EXPIRATION OR MTM	LEASE TYPE <small>(NET, MOD. GROSS, GROSS)</small>	MONTHLY C.A.M. CHARGES	NEXT RENT INCREASE <small>(MO / YR)</small>	NEXT RENT INCREASE <small>(\$ / MO)</small>	EXTENSION OPTIONS? <small>(Y / N)</small>
A	Smith	1,000	\$2,000.00		01/31/2015	01/31/2018	NNN	\$100.00	01/18	\$100.00	y
B	Jones	1,000	\$2,000.00		01/31/2016	01/31/2019	NNN	\$100.00	01/18	\$100.00	y
C	Black	1,000	\$2,500.00		01/31/2015	01/31/2018	GROSS		01/18	\$100.00	n
D	White	1,000	\$1,800.00		01/31/2016	01/31/2019	GROSS		01/18	\$100.00	y
E	Johnson	1,000	\$2,200.00		01/31/2015	01/31/2018	NNN	\$100.00	01/18	\$100.00	y
							Choose One				
							Choose One				
							Choose One				
							Choose One				
							Choose One				
							Choose One				
							Choose One				
							Choose One				
TOTALS		5,000	\$10,500.00					\$300.00			
NOTES ON TENANTS											

I (we) certify under penalty of perjury that the foregoing information herein is true and accurate.

Net Operating Income

- **Net Operating Income (NOI)** is the net cash generated before mortgage payments and taxes. NOI is calculated by adding the property's gross rental income to any other income (such as late fees or parking income) and then subtracting vacancies and rental expenses.
- Documents needed: Rent Roll & Operating /Profit and Loss Statement (P&L)
- How to Calculate: $\text{NOI} = \text{Annual Rents, less vacancies, less total rent expenses}$:

\$129,600	Annual Gross Rents
<u>(\$ 6,480)</u>	Less Vacancy
\$123,120	Adjusted Gross Income
<u>(\$22,349)</u>	Less Total Rent Expenses
\$100,770	Net Operating Income (NOI)

Total expenses will not include income taxes or interest

Debt Service Coverage Ratio (DSCR)

Debt Service Coverage (DSCR) – Calculated as NOI divided by debt payments. Measures your ability to pay the property's monthly mortgage payments from cash generated by the rental property.

- Documents needed: Rent Roll; tax returns or operating statement; approximate mortgage payment
- Example: \$100,770 NOI and debt payments of \$80,475. The DSCR is 1.25 ($\$100,770 \div \$80,475 = 1.25$).
 - DSCR of less than 1.00 (e.g. 0.75) indicates a lack of cash flow to cover the property's operating rental expenses and have enough money left over to pay the mortgage payments.
 - This means that the borrower has negative cash flow and will have to subsidize the difference in order to pay the lender.
 - Obviously, a lender will not be willing to loan a borrower money to purchase a property that does not generate enough cash to pay the lender back.
 - DSCR greater than 1.00 means there is enough cash to make all mortgage payments
 - In the above example, the DSCR of 1.25 means that the property will generate 1.25 times more cash required than what is required to pay the mortgage.

Capitalization Rate (Cap Rate)

Capitalization Rate (Cap Rate): Values a property based on the NOI it generates, allowing for comparison of properties with different Fair Market Values (FMV).

- The Cap Rate is computed by dividing the rental NOI by the property's FMV.
 - The higher the Cap Rate, the better the property is said to be performing.
- Example:
 - NOI = 100,770
 - Appraised Value = 1,440,000
 - Cap Rate = $100,770 / 1,440,000 = 6.9\%$

Loan to Value Ratio (LTV)

Loan to Value (LTV): The amount of a secured loan or mortgage divided by the fair market value of the property.

Example:

- Loan amount: \$1,008,000
- Appraised Value: \$1,440,000
- $LTV = \$1,008,000 / \$1,440,000 = 70\%$

Global Debt Service Ratio

- Only used for Owner Occupied properties
- All lenders calculate this differently
 - Usually: Add together the cash flow from the owner's business and the owner's personal cash flow, and then divide by debt payments on all personal- and business-related debt (including the subject property)
 - This ratio should be at least 1.25
- **We will focus on this in a special webinar this May**

Choosing a Lender

SBA Lender

- Types 7A or 504
 - 7A Loan: 85 – 90% LTV, Variable Rates 5.25% to 8.75%, 25 Year Term, \$5M limit
 - 504 Loan: 85 – 90% LTV, 3.5% to 6% fixed on SBA portion, 5-6% bank portion is variable, 20 Year Term
- Underwriting is strict
- Prepayment is incredibly difficult and expensive
- Must be at least 51% Owner Occupied

Conventional (Bank) Loan

- LTV 80% max , but 70 to 75% is preferred
- Rates 5% to 7%
- Up to 30 year Amortization (3, 5, 7 & 10 year loans)
- Loan amounts over \$250K
- Underwriting is strict; based on personal credit and the property
- Owner Occupied or Investor

Choosing a Lender

Blustream & Non-Bank Lenders

- Priced higher than conventional bank loans BUT offer longer terms and better rates than online lenders and hard money lenders
 - LTV: 50 to 80%
 - Terms: 10, 15, 20, 25, or 30 year amortizations with loan terms of 3, 5, or 7 years
 - LOI within 48 hours
 - Approval after return of LOI and fees in another 48 hours
 - Underwriting based on credit score, cash flow, type of property

Online Marketplaces (OLM) & Hard Money Lenders

- OLMs: Up to 80% LTV, 8-12% fixed or variable, 6 months to 5 year loans
- Hard Money Lenders: 50 to 55% LTV, 10 to 18% variable or fixed, 6 months to 3 year terms
- Smaller loan amounts
- Easy underwriting
- Quick funding: often no appraisal needed

Choosing a Loan Program

Complete Doc (Blustream, SBA Lenders, or Conventional Lenders)

- Credit worthy investors and/or owner occupiers
- Restrictive underwriting
- Requires full package of financial information, including tax returns, financial statements, etc.

Lite Doc (Blustream or Finance Companies)

- ONLY for investment properties
- Better for borrowers who may be showing a loss on property tax returns
- Operating statement and rent rolls are essential to underwrite this product
- Max LTV is 70%

Bank Statement (Blustream or Hard Money Lenders)

- ONLY for owner occupiers
- Better for borrowers whose underlying business is showing a loss
- 12 months of operating account bank statements essential to underwrite this product
- Max LTV is 65%

Packaging a Commercial Loan: Complete Doc Program

Investor

- Commercial Loan Application
- Tri-Merge Credit Report
- Operating Statement - for Property
- Rent Roll
- Purchase Contract, if applicable
- 2 years of tax returns for property if owned by an entity
- 2 years of tax returns for the guarantor (and owner of property over 25%)
- Personal Financial Statement
- Vesting Map
- CAP EX Schedule
- Deferred Maintenance Schedule

Owner Occupier

- Commercial Loan Application
- Tri-Merge Credit Report
- Profit and Loss Statement for underlying business
- Balance Sheet for the underlying business
- Purchase contract if Applicable
- 2 years Tax returns for Underlying Business
- 2 years of tax returns for the guarantor (and owner of business over 25%)
- Personal Financial Statement
- Vesting Map
- Debt Schedule
- CAP EX Schedule – if applicable
- Deferred Maintenance Schedule – if applicable

Packaging a Commercial Loan: Lite Doc Program

- For Investment Properties Only
- Documents Needed:
 - Commercial Loan Application
 - Tri-Merge Credit Report
 - Operating Statement
 - Rent Roll
 - Personal Financial Statement (may be required)
 - Vesting Map
 - Debt Schedule
 - CAP EX Schedule
 - Deferred Maintenance Schedule

Packaging a Commercial Loan: Bank Statement Program

- For Owner Occupied Only
- Documents Needed:
 - Commercial Loan Application
 - Tri-Merge Credit Report
 - 12 months bank statements from main operating account
 - Personal Financial Statement
 - Vesting Map
 - Debt Schedule
 - CAP EX Schedule – if applicable
 - Deferred Maintenance Schedule – if applicable

Contact Us

- Approved Brokers:
 - Please contact your Regional Account Manager
 - See next slide for listing
- NON-approved Brokers:
 - Please call 888-415-1620

Contact Us: Account Managers

Account Manager	Region	Telephone
David Johnston	So Cal - southern portion	949-466-3993
Jeff Garcia	So Cal - northern portion	818-270-0020
Ryan Melideo	So Cal - northern portion	818-644-7661
Scott Wise	Bay Area	510-461-2891
Jeff Portnoff	Bay Area	925-890-2963
Greg Vaughn	Bay Area-South Bay	415-694-9405
Eric Nowak	Sacramento	415-672-1025
Jesse Tannlund	OR and In House Acct Mgr	415-690-9471
Tom MacArthur	WA	206-550-3185
Sheila Long	AZ	808-268-1708
Brendan Berry	PA and NJ	610-637-1994
Steve Duran	Florida - West Palm Beach	954-483-5213
John Farrell	Florida - Orlando	561-901-9027
Debbie Koehler	Florida	561-512-1212
Jeff Grebe	Colorado	303-798-6200

Important Links

Blustream

<http://blustream.com>

SBC Forms

<http://blustream.com/resources>

SBC Guidelines & Flyers (under “Commercial”)

<http://blustream.com/wholesale-loan-programs>



QUESTIONS?

Terms

- **Operating Statement** - an earnings report, or a profit and loss statement (P&L), starts with revenues and then subtracts costs and expenses to calculate net operating income.
- **Rent Roll**- a register of lands and buildings owned by a person, company, etc., showing the rent due and total amount received from each tenant.
- **CAM** – Common Area Maintenance Charges - things like landscaping , garbage, lobby upkeep and bathroom maintenance.
- **LTV** - Is a financial term used by lenders to express the ratio of a loan to the value of an asset purchased. The term is commonly used by banks and building societies to represent the ratio of the first mortgage line as a percentage of the total appraised value of real property.
- **Purchase and Sale Agreement** - a contract that outlines the obligations of both parties entering an agreement to buy/sell/transfer a property. This is the main difference between a contract of sale and purchase of real estate and deed; the latter represents the actual transfer of a property from one party to another, or the closing step of a transaction.
- **Capitalization Rate** - The rate of return on a real estate investment property based on the income that the property is expected to generate. The capitalization rate is used to estimate the investor's potential return on his or her investment. ...**Capitalization Rate = Net Operating Income / Current Market Value**. Higher the Cap Rate the better the property is performing.
- **Occupancy/Vacancy Rate** - the ratio of rented or used space compared to the total amount of available space.
- **Tenant Improvements** - Preparation of leased premises prior to or during a tenant's occupancy, which may be paid for by either the landlord, the tenant, or both. These can be written in the lease or the purchase contract.

More Terms

- **Lessee** – The person renting or leasing the property. Also known as a tenant.
- **Lessor** - The person who rents or leases a property to another. Also known as a landlord.
- **Metropolitan Statistical Area (MSA)** Generally, the area in and around a major city. The Office of Management and Budget (OMB) defines an MSA as having one of the following characteristics: a city with a population of at least 50,000, or an urbanized area with a population of at least 50,000 with a total metropolitan population of 100,000.
- **Sale leaseback** - A leasing and financing strategy in which a property owner sells its property to an investor, then leases it back. This strategy frees capital that otherwise would be frozen in equity.
- **Zoning** The designation of specific areas by a local planning authority within a given jurisdiction for the purpose of legally defining land use or land use categories.
- **Cap Ex** – Capital expenditures is an expense where the benefit continues over a long period, rather than being exhausted in a short period. Such expenditure is of a non-recurring nature and results in acquisition of permanent assets. It is thus distinct from a recurring expense.
- **Deferred Maintenance** - is the practice of postponing maintenance activities such as repairs on both real property (i.e. infrastructure) and personal property (i.e. machinery) in order to save costs, meet budget funding levels, or realign available budget monies.