NorthBrook

Solutions for Commercial Real Estate Financing

What Makes a First Class Commercial Mortgage Funding Submission

For many borrowers who do not have a lot of experience sourcing financing for their commercial properties, they are often surprised at what is asked of them.

Unfortunately, all too frequently, there is someone out there who assures them its not all that hard, and the borrower can get their money with far less effort.

When that happens, one of three things can happen:

- The borrower ends up with a loan carrying expensive and/or difficult loan conditions that don't fit the property or what the borrower is trying to achieve.

- After a few short efforts this advisor can't find a lender and gives up, leaving the borrower with no funding to complete their plan.

- The advisor finds an interested lender who then starts what turns out to be a difficult application process because the borrower doesn't have an experienced advisor to help them. The loan, if it gets done, starts an uneasy relationship neither the lender nor the borrower are particularly happy with.

Today we are going to walk through the steps needed to compile a complete, successful commercial funding request. One that carries the right terms to meet the borrower/owner's objectives, achieves the right pricing for the loan, and launches a favorable relationship with the lender the borrower can build on in the future.

To get started there are some fundamental truths you should know about commercial mortgage applications.

1. There are significant differences between a commercial mortgage application and a residential application. The reality is a house is easier to sell than a warehouse or small retail plaza. That makes residential properties less risky and therefore the lender can extend their loans with less documentation and a less stringent review.

2. Commercial mortgages rely almost entirely on the property's ability to generate sufficient funds to pay for the loan and on-going property maintenance. If you are relying on outside funds to make these payments the loan will be extremely difficult to place, which is often the case with residential properties where the borrower is generally the only source of for debt repayment.

3. Commercial mortgage applications require far more documentation and expertise than an application for a residential property.

With these key points in mind let's look at what is needed to get your loan request funded.

Purpose Plan

The purpose plan is simply setting out a logical plan for what the loan proceeds will be used for and what the operating plans are going forward. This is a perfect example of the difference between a residential application and a commercial application. For the residential property the plan is straight forward – someone (you or a renter) is using the house to live in. No purpose plan is really needed.

For a commercial property there are many alternatives. Yes, you are requesting a mortgage, but what specifically are you going to do with the funds? Are you using the money to:

- purchase the property,
- take money out to acquire new properties,
- will you be renovating –
    - will the renovations be major or minor,
    - will the renovations be used to change the use of the building,
    - will the renovations be used to attract or keep tenants,
    - will the renovations be used to prep the property for sale.

Each option above will impact how a potential lender will assess the funding submission. Your advisor should know the key issues of each different assessment point and provide you with a specific plan as to how best present them to maximize the benefits coming out of that lender's financing offer.

A poorly presented purpose plan can cost you money either in terms of rate, maximum funds accessible or restrictive loan covenants. Worst case is your lender looks at the plan and early in their assessment rejects an otherwise good submission outright.

Leases and Rent Rolls

Leases are the most common documentation for commercial properties. You should have a valid and enforceable lease with clear terms and conditions for every tenant in the building. Even if you are using the property for your own use, but own it through a separate holdco, you need a lease between you and the holdco.

You must also have a valid rent roll. A rent roll is a summary document that sets out all current leases detailing the rental amounts, any additional rents such as parking, sq. footage per unit, start date of lease, end date, and number of renewals if applicable.

Coming out of COVID the rent rolls should reflect all rental deferrals or rental exemptions granted during the lockdown periods.

The rent roll must reconcile back to the individual leases, the property operating statements, and the future cash flow analysis. One of the most common errors that we see in failed applications is having discrepancies between the rent roll and one or more of the other items mentioned.

Discrepancies here are easy to identify and fix. Your advisor should have no trouble helping you get these key documents in line.

3rd party Assessments

Third party assessments typically refer to appraisals and Phase 1 Environmental assessments. Both are documents you will be required to get. However, we strongly recommend not ordering those assessments until you are in direct negotiations with a lender. Most lenders have their own list of approved assessors and its best to use one of those.

What we do recommend is, if you have a previous environmental assessment from when you originally purchased the property, use that in the initial submission. If you are purchasing the property, see if the seller has their old copies.

For purchases, the Agreement of Purchase and Sale can act as a temporary stand in for the appraisal.

For refinancing an existing building, a market valuation from a reputable realtor or automated valuation service is a cheaper alternative that can be used as a temporary stand in.

Preparing an acceptable funding submission that includes upfront costs such as property assessments and advisory fees cannot be avoided. Trying to push them off makes you look like something less than a serious borrower in the lenders' eyes.

There are many other potential assessments you may have to get depending on the building and the surrounding circumstances. The one I do want to mention is a cost consultant's report. If you are building new or doing any sort of material renovation work, these reports are becoming mandatory in the industry.

While you may not be familiar with cost consultant reports now, you will be asked to get them.

Operating Statements

Operating statements are not your normal company financial statements (which you will need as well). Operating statements just report the revenues and operating costs of each individual building.

They are the statements we referred to earlier that need to reconcile back to the rent roll(s).

You will need separate operating statements for each property you are financing or offering as additional collateral.

To the extent you have quarterly operating statements, all the better. However, you must have at least the last 1 or 2 year annual statements.

If you don't have up to date operating statements, an experienced advisor can help you and/or your accountant put them together quickly and for less cost.

Cash Flow Analysis

A cash flow analysis is another critical component of your overall submission. We honestly believe no application is worth submitting if this analysis is not included.

The cash flow analysis includes revenue and cost projections as well as a loan repayment schedule. It ties your rent roll information, your operating costs and any renovation costs together and is the key backup support for your Purpose Plans.

It should show how you will stay within your loan covenants and will include analysis of future costs and cashflow available for debt servicing.

The analysis should go out until the end of the requested mortgage term

It shows you are a serious property owner who is thinking well past the day after you get your funding.

All serious commercial advisors should have the skills and be willing to prepare the cash flow analysis as part of their submission preparation work.

Debt Servicing

As stated at the beginning of this presentation, commercial mortgages rely almost entirely on the property's ability to generate sufficient funds to pay for the loan and its own maintenance. That means it must deliver positive debt service. To secure your loan the property must debt service at the minimum levels plus a cushion mandated by the prospective lender(s).

As debt service is a must, if you are going to successfully attract your funding, all submissions should demonstrate the property debt services at acceptable levels. The submission should also detail, not only how the property debt services today, but also, using the cash flow analysis, how it will for the duration of the loan term.

We believe it is important enough that we also like to include a short written subsection on how the Purpose Plan and tenant strategies support the debt service throughout the term of the loan.

Addressing Outstanding Issues

No property and/or borrower is perfect. Somewhere within the submission there should be an open discussion of problem areas and how they could, or are already being~~,~~ addressed.

Hoping a lender will somehow miss these areas is wishful thinking. These lenders are professionals.

Frankly we typically set aside a full standalone section within the submission to deal with any outstanding issues. We find being upfront and visible on the issues provides the lender with some comfort they are dealing with professionals.

Exit Plan

Every approved loan application states in it how the loan will be repaid.

Even if the answer is simply "at end of term the borrower expects to renew with the lender at similar terms" this is sufficient and worth mentioning. So long as the cash flow analysis supports this position the lender will typically accept it.

It is a simple but noteworthy way to end any submission.

Other Matters

Commercial loan requests are as unique and diverse as the many unique and diverse types of properties they support. Coming out of all these alternatives there can be requirements for a wide range of information requests and documentation ranging from building permits to considerations for special lease extensions.

An experienced advisor can help you work through all of these special requests and get them incorporated into your submissions in ways that only make your request stronger.

To put things in perspective, a professional submission could save you ½ of 1% on your rate which is $13,500 on a 3 year $900,000 mortgage and $105,000 on a $7 million mortgage.

Alternatively, it could increase your LTV. With a 5% increase you reduce your required down payment by $115,000 on a $900,000 mortgage and approximately $895,000 on the $7 million mortgage

Open For Business

These advisory services have the potential to make a material change to your acquisition strategies and are available now for all who wish to take advantage of them.

To get started, or to simply get more information on the services, please go to http://northbrookcapital.com/contact/, provide the initial information, and we will connect with you as quickly as possible.

The right loans and the right lender relationships can change your investment strategies for years to come.

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