TOP 10 WAYS TO FINANCE ANY CRE ASSET

AN AVENUE FINANCIAL PUBLICATION

AVENUE Financial
Real Estate Solutions

TABLE OF CONTENTS

It is often said that, “Short cuts are not worth it.”

Avenue Financial put together this Top 10 checklist in order to reduce lender push back and simplify your commercial financing application process. Whether it’s a bank loan, bridge loan, commercial mortgage backed security (CMBS) loan, hard money loan, pension funds or Life Co loan, etc. – this checklist should cover all the basics. It takes a lot of time and effort to structure a commercial real estate loan application. Many factors and risks that if left unchecked could turn a great commercial real estate loan transaction into a bad one. This list goes over the fundamentals essential to every loan proposal. More importantly, it will help you realize which loan terms and lending platforms may work best for your needs.

#10

Structural and Environmental Integrity:

Nearly every lender will require a baseline property condition assessment (a BPCA report) and at minimum, a Phase 1 environmental assessment, which is why you should be upfront concerning the condition of your property right from the beginning. Trained, experienced engineers and scientists will conduct a thorough inspection looking for major issues like asbestos, lead paint, cracks in the façade, potholes, fire sprinkler systems, etc. and minor issues like historical database reviews, hazardous material generators, roof leaks and any historical and current environmental concerns.

More importantly, the engineers will prepare a summary of anticipated expenditures and replacement reserve costs. This enables you to properly budget for necessary improvements. In a commercial property acquisition, the lenders will typically hold back any non-recoverable items within the summary that occur within the term of the requested mortgage. It's always best to keep great environmental compliance records, have a realistic capital expenditure budget or property improvement plan and have a detailed history of capital expenditures and large repair items made over the years.

#9

Debt Yield Ratio:

Determining LTVs and DCRs is a vital step in the process and why Debt Yield is invaluable to determine. It made a strong comeback after the debt bubble in 06' and 07' serving as a crucial measurement of risk while remaining uninfluenced by cap rates, amortization and interest rates. Debt Yield is the percent of NOI in comparison to the debt. Debt Yield=NOI/Loan Amount.

During our current economic environment, this risk measurement is playing a critical role during the qualifying process.

The important part about debt yield, aside from how to calculate it, is knowing that it represents the downside risk to the lender if and when they have to take back the collateral.

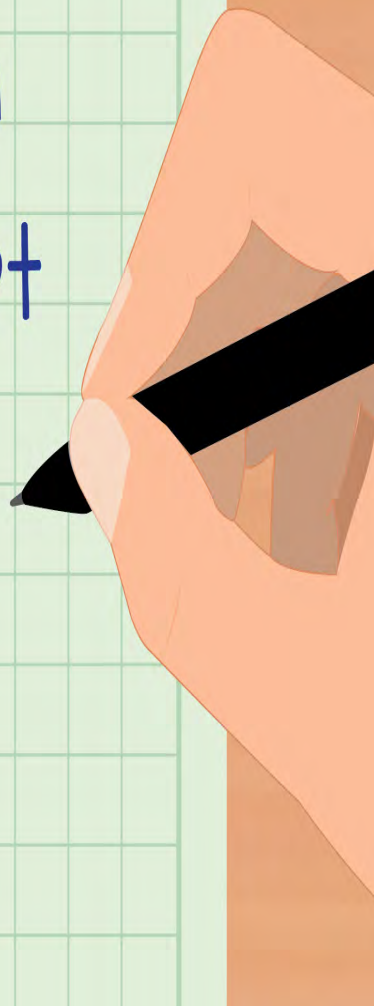
#8

Debt Service Coverage Ratio:

DCR, DSCR or just debt coverage is the amount of times a property's cash flow covers its annual debt service or ADS. A typical loan will require a minimum DCR of 1.25. This ensures the property can sustain mortgage payments AND have some cash leftover for any unforeseen, or totally predictable, expenses or loss of income. DCR=NOI/ Debt Service.

DSCR < 1

= no sufficient cash to service the debt



However, knowing what income and expenses your lender will include may not be the same for every case and may be subject to negotiation. Routine (monthly) capital expenditures are added to operating expenses. Larger and less common expenses, like tenant improvements and renovations are considered "one-time expenses" and aren't included as an operating expense.

#7

Property Management:

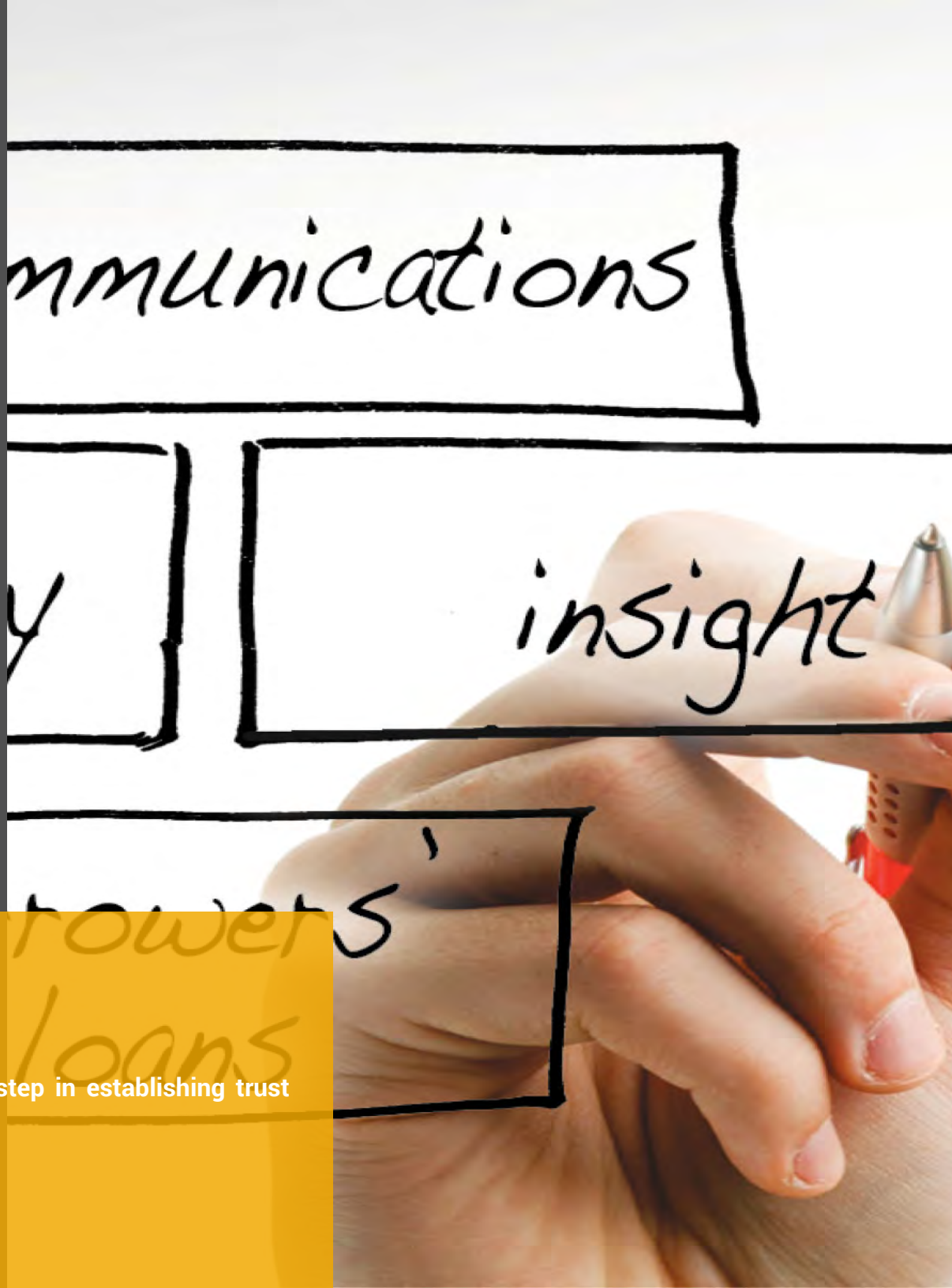
The lender will want to see a legitimate property management “PM” agreement prior to closing. The lender usually wants to make sure the PM agreement is to a third party (related or unrelated), cancellable within 30 to 90 days and that the fee is fair. Bearing in mind, the more management intensive a property or project is, the more important it is to know who is going to be in charge of the day-to-day operations.

Additional information like office location, units/assets under management, relevant experience and key principals will be really helpful.

#6

Borrower/Sponsor Information:

Know Your Customer (KYC) isn't just a phrase, it's a lending guideline. It's more than just credit scores, background checks and credibility. It is also to protect all parties from anti-money laundering risks and mortgage fraud. The number one funding source of terrorism is related to real estate.



"Knowing your client" is the first VERY important step in establishing trust between the broker, the borrower and the lender.

#5

Occupancy (%):

Occupancy comes in varying forms. Physical Occupancy = square feet leased/total leaseable square feet. Economic Occupancy focuses on actual revenue vs. potential revenue. Physical Occupancy is just a percentage at any given moment in time.

Stabilized Occupancy will be determined based primarily on current, past and future occupancy trends told in the rent roll, occupancy reports, and rollover schedule. Having a good handle on the market conditions, forecasts, a leasing report and a solid manager with well-defined, realistic goals and strategies will increase your ability to assess a true stabilized occupancy.

#4

Net Operating Income (NOI):

NOI (Net Operating Income) is your true revenue picture. Determining what goes above or beneath that bottom line can be quite a task. Getting other parties, such as a lender, appraiser, borrower or investor to agree to the appropriate NOI to underwrite often requires a more skillful approach. Typically, the credit departments will deduct anywhere from 6-8% of your NOI to account for structural, management and vacancy. The best way to get another party to agree to underwrite at your preferred NOI is to provide strong supporting evidence.

The most common forms are:

Income Statement - 3 years (at minimum) notice to reader (NTR) accountant prepared financial statements and trailing twelve-month statements.

Pro-forma - an estimate of what the future income will look like. It should be backed by the property's prior and current financial performance, future plans and strategies for management and supported by the market.

#3

Age, Quality & Condition:

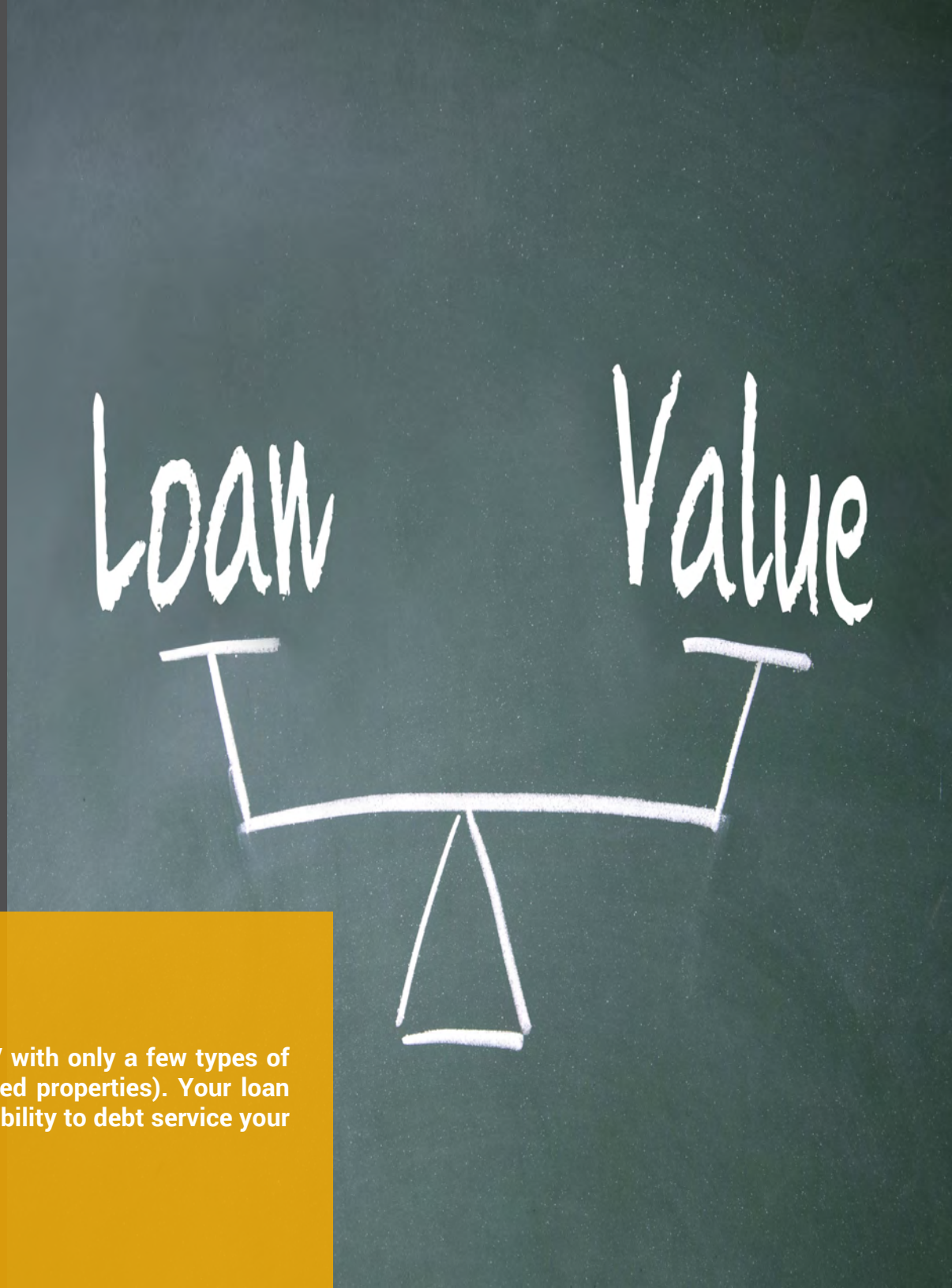
Overall age, quality, condition and remaining economic life of a property are part of the appraisal and Baseline Property Condition Assessment (BPCA). Part of the BPCA will include a summary of anticipated expenditures to help our clients develop long-term capital budget planning of expenditures for major repairs or replacements of building components and equipment.

There's no excuse for not being upfront with information regarding vacant units or units where tenants will not be renewing. It's to your best interest to be upfront and honest.

#2

Loan-to Value (LTV):

Loan to Value (LTV) is typically the first question a lender needs answered. The true intention of LTV is to efficiently describe the amount of debt and equity represented in a property. The LTV is determined by taking your requested loan compared to the appraised value of your property.



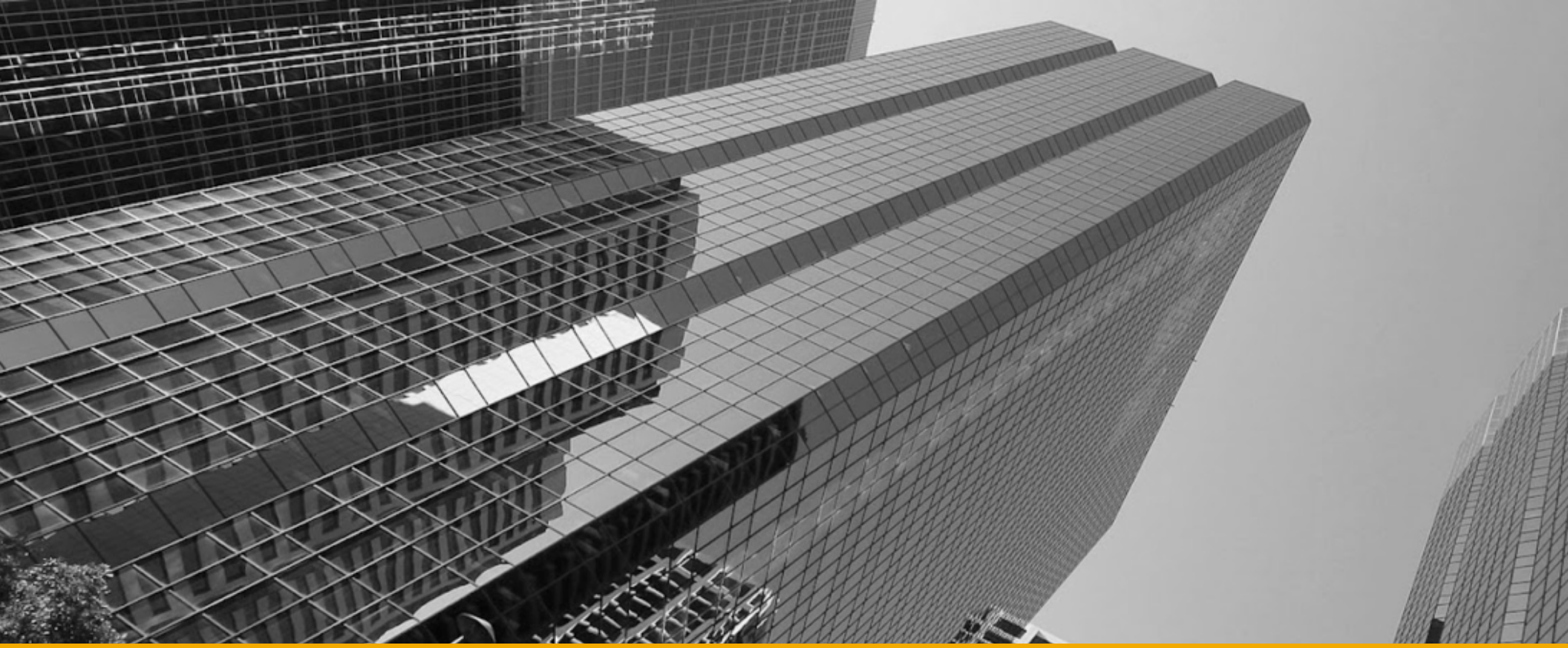
Most loans fall within the range of 65% to 75% LTV with only a few types of properties obtaining higher leverage (owner occupied properties). Your loan threshold will be determined by both LTV and your ability to debt service your loan.

#1

A Loan Package:

This is how we put it all together. There are a lot of people trying to fund loans with random emails, incomplete information and unknowns that often lead to their loan request being rejected. The more complete a loan request is presented, the more likely and quicker it will be approved.

A well-executed loan package can take some time to put together, but it really does make all the difference for everyone involved in the transaction. If your loan package contains everything discussed on this list, then expect to get the right answers, results and the funding your deal deserves when it closes.



Whether you need a mortgage loan intermediary or simply a top-notch loan package, Avenue Financial is here to help you. For more information contact us:

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ABOUT US

Vic Cotton - Vice-President / Broker

Vic Cotton is recognized as a commercial and residential mortgage specialist who holds his Accredited Mortgage Professional Designation.

He is also a member of:

- Canadian Association of Accredited Mortgage Professionals
- Mortgage Professionals Canada
- Alberta Mortgage Brokers Association

Vic Cotton has over 30 years in business development and has been involved in the financing of over half a billion dollars in commercial real estate.

Vic is recipient of:

- ***Calgary Mortgage Professionals Commercial Mortgage Broker of The Year Finalist***
- The ***Calgary Award for Commerce*** presented by the **Mayor of Calgary**
- The ***Premiers Award for Marketing*** presented by the **Premier of Alberta**
- The ***Most Ethical Business*** presented by the **Better Business Bureau**
- A finalist in the ***Ernst and Young Entrepreneur of the Year award for the Prairie region***

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