

# “Small” Deal Financing

*Heritage Ohio  
October 6, 2015*



# *Commercial Real Estate Lending Underwriting Considerations*

- Evaluate market demand and cash flow
- Underwrite pro forma cash flow with adequate vacancy, reserves, and operating expenses
- Developer experience
- Loan sized to DSC, ranging from 1.20-1.35x
- Loan-to-Value (LTV): 70-80%
  - Means equity (cash, seller note, tax credit equity) of 20-30%
- Vacancy factor-varies based on product, market
- Evaluate historical operating expense to establish pro forma
- Construction Loans: -  
Preleasing level: target is close to break even

# *Evaluating Historic Projects*

- Assess the team
  - Developer
  - Accountant
  - Preservation Consultant
  - Attorney
  - Contractor
  - Architect
- Closely Review the Plan
  - Budget-adequate contingency?
  - Sources and Uses
    - Timing of equity, investor funds?
  - Key: When and who will “bridge” credit equity?
  - Developer cash equity always invested first and no less than ~10% of TPC
  - Developer Fee?

# *Assessing Mixed Use: Multi-story with Storefront*

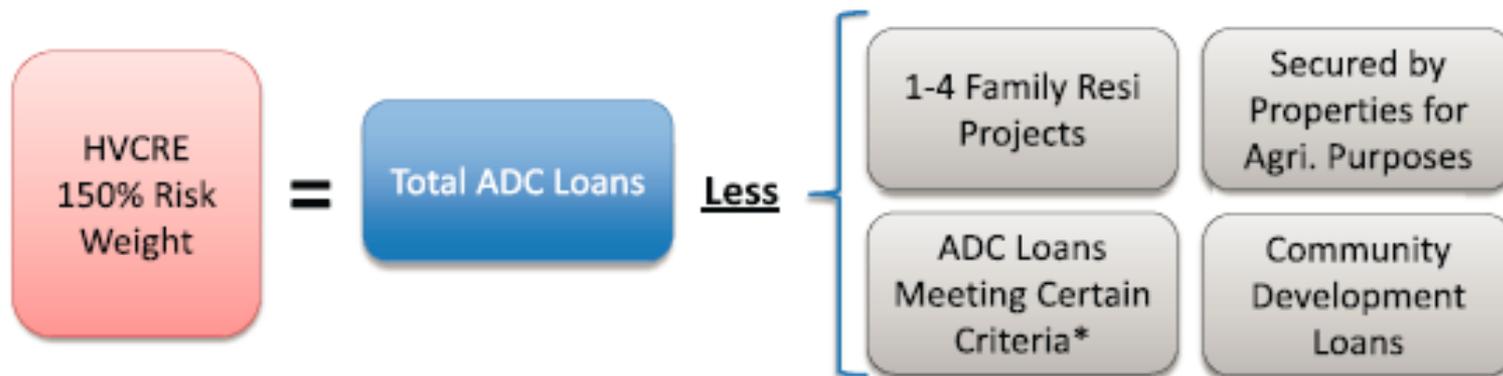
- Compatibility of uses
- Parking to support-separate to avoid conflicts
- Emphasis on historical performance: has this worked here before?
- How are expenses, e.g. utilities handled?
- Can 2<sup>nd</sup> level space support debt service by itself?

PERIOD	2013	
	Proforma	\$/Unit
<b>INCOME:</b>		
<b>Base Rent</b>	\$ 2,359,540	\$19.45
<b>Tenant Reimbursements</b>	\$ 12,000	\$0.10
<b>Other Income</b>		\$0.00
<b>Total Gross Potential Income</b>	\$ 2,371,540	\$19.55
<b>Less Vacancies/Concessions</b>	-\$237,154	-\$1.95
<b>EFFECTIVE GROSS INCOME (EGI)</b>	\$ 2,134,386	\$17.59
<b>OPERATING EXPENSES:</b>		
<b>Management Fee</b>	\$ 85,375	\$0.70
<b>Operating Expenses (R E Taxes)</b>	\$ 175,000	\$1.44
<b>Operating Expenses (Utilities)</b>	\$ 300,339	\$2.48
<b>Operating Exps (Repairs &amp; Maint)</b>	\$ 271,297	\$2.24
<b>Insurance</b>	\$ 199,165	\$1.64
<b>Operating Expenses (Other)</b>	\$ 150,000	\$1.24
<b>TOTAL EXPENSES</b>	\$ 1,181,176	\$9.74
Expense Ratio (% EGI)		55.3%
<b>NET OPERATING INCOME (NOI)</b>	\$ 953,210	7.86
Non Operating Expenses	\$ -	
Replacement Reserve	\$ -	
Cash Available for Debt Service	\$ 953,210	
Proposed Debt Service	\$ 761,244	
<b>Annual Debt Service</b>	\$ 761,244	
<b>NET CASH FLOW AFTER DS</b>	\$ 191,966	
<b>Annual Debt Service Coverage</b>	<b>1.25</b>	

# High Volatility Commercial Real Estate (“HVCRE”)

*Its Impact on  
Construction Lending*

## High Volatility CRE (HVCRE)

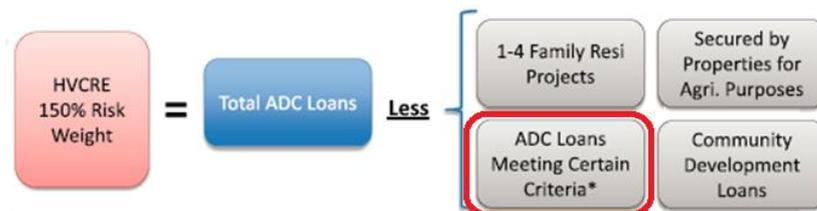


\*ADC loans meeting certain criteria are **not HVCRE**:

- LTV is at or below maximum supervisory LTV; **and**
- Borrower has contributed at least 15% of “as completed” appraised value in cash or unencumbered readily marketable assets; **and**
- Borrower contributed capital is contractually required to remain throughout the project life

Source: FDIC

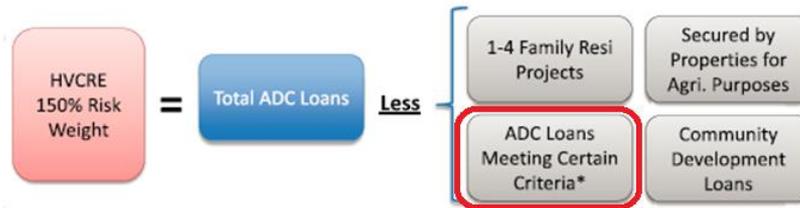
# Equity Requirements



In order to achieve the ADC exclusion, the Borrower must contribute at least 15% of “as completed” appraised value in cash or unencumbered readily marketable assets.

- The 15% must be cash contributed or spent on out-of-pocket development costs prior to any loan advances. Additional pledged collateral (other than marketables) does not count toward this test.
- The cash cost used to purchase land (regardless of the date purchased) is included, rather than the land value.

# Equity Requirements



In order to achieve the ADC Exclusion, the Borrower contributed capital is *contractually required* to remain throughout the Project life. “Contractually required” means that

- The 15% equity requirement **must be stipulated within the loan documents** (ie. no distributions to the Borrower from the Project) until permanent loan conversion, payoff, or sale.
- Guidance has been provided in the Underwriting Manual, page 11-17, to define permanent loan conversion: Bank considers conversion to mean i) no further loan advances, ii) property meets the as-complete appraised value qualifications, and iii) qualifies for the permanent loan extension option, or in the event of no permanent loan option is offered, it qualifies for a permanent loan under the Bank’s normal underwriting criteria .

# QUESTIONS?



Senior Vice President

Manager of Commercial Real Estate Lending