

How to Create and Executive Summary & Commercial Loan Guide

IN ORDER TO INITIALLY EVALUATE YOUR REQUEST, WE MUST RECEIVE THE FOLLOWING INFORMATION

1. Executive Summary

- a. This should be a complete, extensive overview of the project that includes:

2. Description of Property:

- a. Address, project name, estimated value, number of units, occupancy, etc.

3. Legal Owner:

- a. Entity and individuals which own the property or to be created.

4. Loan Amount & Use of Funds:

- a. Debt owed, other liens on the property, uses of cash.

5. Date of Purchase & Price:

- a. How much cash does the borrower have invested?

6. Debt Service:

- a. Current debt on property (including terms and if current), current NOI, 3-yr pro forma NOI and any stabilization notes or key events.

7. Sources & Uses:

- a. Explain how and where the funds will be used, including source of your investment funds and funds already invested in the project.

8. The Story:

- a. Give us a clear picture of what is going on. What is the situation, and why should we finance the project?

9. Color Photos:

- a. Provide pictures of the current condition of the property to give us a better idea of the nature of the project that we are financing.

10. Sponsor Resume and Bios

- a. We need to know about each and every Principal in the transaction. We want to know about their background, level of experience, position and connection relative to this project.

Documents Required by Lender

After vetting your lender, send them all documentation as the Underwriter's job is to mitigate risk and quantitative documentation is 100% necessary.

Property Documents

- Purchase Contract
- Payoff Statement (if Refinance)
- Plans & Permits
- Sources & Uses of Funds
- Scope of Work
- Appraisal & Feasibility Report

Personal Documents

- Investor Experience (HUD statements, current properties with financials)
- General Contractor Resume (for SPEC Home Loans or Fix N Flip Guarantor)
- Last 3 Months of Bank Statements (to show source of funds for down payment, closing costs & reserves)
- Driver's License (Front & Back)
- Passport/Visa (if Foreign National)
- Bank Statements 2 months (Source of down payment & reserves)

Business Documents (if closing in LLC)

- Articles of Incorporation
- Operating Agreement (LLC) or Bylaws (Corp.)
- EIN Letter

Underwriting Commercial Loans

FICO scores are a Make or Break It Criteria for Commercial Loans? True or False

False, The deal, how it will generate a profit and borrower's assets are more important.

The Basics that are evaluated:

- Demonstrate how the deal will generate a profit
- Who is involved and what roles will each partner partake
- Your experience managing the subject project
- Your assets and cash (ability to maintain and sustain the project) after deposit
- FICO 620 Min, 680-730 Good Pricing, 730+ Great Pricing

Understand in Commercial Lending there are No set loan programs.

You must sell the idea and concept to the lenders, this is why choosing Bartling Lending Partners as your commercial loan broker is beneficial as we have access to 100s of lending institutions.

The first step in underwriting a commercial property is to calculate the property's cash flow, which is commonly referred to as net operating income, or NOI.

A commercial real estate lender needs to examine certified copies of the property's rent roll, current and historical income and expense statements (also referred to as the profit-and loss statements, or P&Ls), leases, real estate tax bills, insurance, utility bills, and expense reimbursement records.

NOI Analysis

A typical apartment rent roll includes at minimum the following information:

- Suite or unit number
- Tenant name
- Unit type (i.e., one-bedroom/one-bath unit)
- Unit or suite size (in square feet)
- Market rental rate
- Contract rental rate
- Lease start date or move-in date
- Lease expiration date
- Security deposit

Typical retail or office rent roll will include at minimum the following details:

- Suite or unit number
- Tenant name
- Suite size (in square feet)
- Monthly base rent
- Annual base per square feet (PSF)
- Monthly CAM reimbursements
- Monthly real estate tax reimbursements
- Monthly insurance reimbursements
- Move-in date and lease expiration date

- Expense stops
- Security deposit

The total monthly or annual rental income, referred to as gross potential income (GPI). After calculating the GPI, we apply a vacancy factor of at least 5 percent or higher.

For example, if a 200-unit apartment complex has 20 vacant units, then the vacancy ratio or factor is 10 percent ($20 \div 200 = 0.10$ or 10%).

GPI less the vacancy factor results in a net rental income, referred to as effective gross income, or EGI.

The next process in analyzing the property's NOI is to verify all operating expenses. Verifying operating expenses involves reviewing financial statements, often referred to as profit and loss statements, or P&Ls. Typical operating expenses include real estate taxes, insurance, utilities, repairs and maintenance, cleaning, supplies, landscaping and lawn care, legal and professional services, administrative services, management fees, marketing fees, and capital improvements. These recurring operating expenses are subtracted from the EGI, resulting in the property's NOI.

Now it's time to capitalize the NOI in order to calculate the property's capitalized value. We do this by dividing the NOI by a market capitalization rate, which is a process referred to as capitalization. "Capitalized value" in one sense is just another way of saying "market value."

The term "rate of return" refers to the percentage rate that investors expect to receive on their money. For example, a 10 percent annual rate of return means that the investor expects to receive \$10,000 in return for investing \$100,000. Annual rates of returns for commercial investment properties can range from a low of 5 percent to as high as 25 percent. However, for the average apartment investor, the standard rate of return or capitalization rate is about 10 percent.

	Annual
Purchase Price	\$1,000,000
Gross Potential Rent (GPI)	\$250,000
LESS: Vacancy	10% (\$25,000)
Effective Gross Income (EGI)	\$225,000
<u>OPERATING EXPENSES</u>	
Real Estate Taxes	\$40,000
Insurance	\$15,000
Repairs & Maintenance	\$5,000
Landscaping & Lawn Care	\$5,000
Cleaning	\$25,000
Pool	\$6,000
Utilities	\$4,000
Management Fee	\$10,000
G&A	\$5,000
Replacement Reserves	<u>\$10,000</u>
TOTAL EXPENSES	\$125,000
Net Operating Income (NOI)	<u>\$100,000</u>
LESS:	
Annual Debt Service or Annual P&I Payment*	\$80,000
Debt Service Coverage Ratio (DCR)	1.25
Cash Flow Available After Debt Service	\$20,000

* The Annual Debt Service is the monthly P&I payment multiplied by twelve months. The monthly P&I payment is based on an \$800,000 loan amortized 30 years at an interest rate of 9.40%.

Debt Service Coverage Ratio

The debt service coverage ratio, or DCR, is simply a percentage of the property's net operating income (NOI) that exceeds the property's annual debt service. For example, if the DCR is 1.25, it signals to the lender that the annual NOI or annual cash flow effectively exceeds the annual debt service by 25 percent.

Annual debt service is calculated by multiplying monthly principal and interest payments by twelve. The phrase "annual debt service" is lender slang for twelve months of P&I payments.

Calculating the DCR is quite easy; all you have to do is divide the property's NOI by the annual debt service.

As illustrated in Figure 1-1, dividing the property's annual NOI of \$100,000 by the annual debt service of \$80,000 results in a DCR of 1.25 ($\$100,000 \div \$80,000 = 1.25$).

The property's annual cash flow in this example is 1.25 times greater than the annual debt service. This ratio illustrated in Figure 1-1 is essentially telling the lender that for every dollar of debt service there is \$1.25 of net operating income.

Sell The Lender Your Concept

A loan request package is similar to a business plan and highlights the salient facts of the loan transaction. A standard commercial loan request package is divided into six sections with the following headings:

- 1. Executive Summary**
- 2. Property Description**
- 3. Location and Demographics**
- 4. Property Economics**
- 5. Market & Submarket Data**
- 6. Sponsorship**

The outline or layout of an executive summary is composed of five parts in the following order:

- 1. Purpose of Loan Request**
- 2. Sources and Uses**
- 3. Property Description and Location**
- 4. Financial Summary**
- 5. Borrower**

1. Executive Summary

What is included in your Executive Summary?

Apartments

- Name of the project
- Physical address
- Brief description of location (e.g., located in west Houston near Beltway & I-10)
- Number of units and net rentable area
- Occupancy
- Year built/year renovated
- Construction type: walk-up garden, midrise, high-rise
- Type of parking: covered, multilevel garage, subterranean
- Utilities paid by landlord
- Utilities paid by tenant

Retail

- Name of the project
- Physical address
- Brief description of location (e.g., located in north Houston near The Woodlands)

- Type of retail: strip center, grocery-anchored center, neighborhood center, mall
- Net rentable square feet (NRA)
- Number of tenants
- Occupancy
- Year built/year renovated
- List of anchor tenants, including national and regional tenants
- Type of leases (e.g., triple net or modified gross)

Office

- Name of the project
- Physical address
- Brief description of location (e.g., located in south Houston)
- Type of office (downtown or suburban; high-rise, suburban midrise, medical)
- Net rentable square feet (NRA)
- List of tenants occupying more than 20% of the building
- Occupancy
- Year built/year renovated
- List of major tenants, including national and regional or publicly traded companies
- Type of leases (e.g., full service or gross, modified gross, or triple net-NNN)

Industrial

- Name of the project
- Physical address
- Brief description of location (e.g., located in east Houston)
- Type of industrial (e.g., office/warehouse, R&D, light industrial, bulk distribution)
- Net rentable square feet (NRA)
- Number of tenants
- Occupancy
- Year built/year renovated
- List of major tenants, including national and regional or publicly traded companies
- Type of leases (e.g., full service or gross, modified gross, or triplenet-NNN)
- Number of truck bays, type of rail service area
- Ceiling height
- Parking spaces
- Percentage of office finish-out to warehouse space
- Percentage of air-conditioned warehouse space

The Purpose of Loan Request section, including questions a lender may ask.

What is the Loan Type and Purpose?

Purchase loans

- Purchase price
- Loan amount

- Loan-to-value ratio
- Loan term (3, 5, 7, or 10 years)
- Amortization (20, 25, or 30 years)
- Anticipated interest rate
- Payment type: P&I or interest-only
- Secondary financing
- Purpose of acquisition: Long-term hold or to flip
- Rehab needed?
- Any repairs or deferred maintenance to cure?
- Will the property be renovated and repositioned to create value?
- Will the property be converted from an apartment to a condominium?
- Will the loan include an earn-out? An earn out is NOT a new loan or a refinancing of an existing loan; it is simply an increase of an existing loan.

Refinance loans

Purpose of refinance

- Is it to lower the interest rate?
- Cash out?
- Is it to lengthen the amortization period?
- Replace a maturing existing loan?
- Buy out existing partners?
- Date of purchase
- Original purchase price
- Cost of any capital improvements or renovations
- Existing loan amount
- Current value
- Purpose of the cash-out dollars
- Amount of existing equity
- Amount of original equity
- Loan payment history

Bridge loans

Purpose of bridge

- Reposition the property and create value?
- Remodel, repair, or renovate?
- Convert the use or add more square feet or units?
- Raise rents and stabilize occupancy?
- Pay for tenant improvements and leasing commissions?
- Replace old tenants with new tenants?
- Provide more time to sell the property?
- Provide for interest reserves?
- Will the bridge loan need to convert into a mini-perm?
- Is the borrower requesting an earn-out?
- What is the exit strategy?

Construction loans

- Purchase price or cost of the land
- Is the land owned free and clear?
- Date of land purchase
- Zoning
- Entitlements
- Capital (construction) budget
- Loan-to-cost (LTC)
- As-completed stabilized value
- Name of the general contractor
- Name of the architect
- Does the developer have city permits?
- Are the Plans approved by the city?
- Is the site platted or engineered?
- Is the developer planning to sell or to hold as a long-term investment?
- Is the project preleased?
- How will the construction loan be paid off?

Property Description and Location

Key Financial data most often highlighted in an Executive Summary:

- Purchase price
- Purchase price per unit (apartments) or per SF (commercial)
- Average rent per SF per year (commercial)
- Average rent per month per unit (apartments)
- Gross Potential Rental Income (GPI)
- Triple net recoveries or utility expense reimbursements
- Other or miscellaneous income
- Actual vacancy rate
- Market vacancy rate
- Effective gross income (EGI)
- Operating expenses (both fixed and variable)
- Net operating income (NOI)
- Monthly or annual proposed P&I payment
- Debt service coverage ratio (DCR)
- Combined debt service coverage ratio (CDCR)
- Loan-to-value ratio (LTV)
- Loan-to-cost ratio (LTC)

Property and Site Details

- Property name and physical address
- Property type (e.g., apartments, retail, office, self-storage mini warehouse)
- Number of units or total net rentable SF
- Occupancy

- Year built/year renovated, expanded, remodeled
- Number of tenants
- Average apartment unit size in SF or average tenant space size in SF
- List of anchor tenants (e.g., the grocer anchor in a retail shopping center)
- List of tenants occupying more than 20% of the total space

Site/land details

- Purchase price
- Total SF or acreage
- Shape, layout, and general dimensions
- Zoning
- Ingress and egress
- Visibility and signage
- Utilities
- Easements or deed restrictions
- Roads and shared driveways
- Excess land

Construction details

- Configuration, design features, functional utility
- Number of buildings
- Building height (number of stories)
- Type of roof (flat, pitched)
- Foundation
- Mechanical and electrical systems
- Type of heating and air-conditioning systems
- Public utilities
- Number of elevators
- Number of bay doors (grade level, dock high)
- Ceiling height
- Type of exterior wall (e.g., brick, concrete tilt-up wall, wood siding)
- Type of parking (garage, open lot, number of spaces)
- Parking ratio per 1,000 SF or per unit (apartments)
- Deferred maintenance or needed repairs

Visual Aids

- Photographs of the property and site
- Photographs of adjacent properties and bordering streets and neighborhood
- Site plan, survey, or recorded plat
- Floor plans
- Stacking plan (office buildings only)
- Aerial photographs
- Construction elevations/drawings
- Local map (Google Maps, for a scale of approx 1 inch for every 1,000 feet)

- Area map (about a three-mile radius from the center of the subject property)
- Regional map (usually a city map)

Market & Submarket Data

Demographic Statistical Information for a one-, three-, and five-mile radius of the subject property. Such statistical information can be found on U.S. Census Web sites

- Population
- Per capita income
- Median income
- Average household income
- Average household size
- Average home value
- Percentage of owner-occupied household-s
- Percentage of non-owner-occupied households (renters)
- Employment statistics
- Vehicular traffic counts
- Population density
- Schools, colleges, and universities

Financial Summary

- Purchase price
- Purchase price per unit (apartments) or per SF (commercial)
- Average rent per SF per year (commercial)
- Average rent per month per unit (apartments)
- Gross Potential Rental Income (GPI)
- Triple net recoveries or utility expense reimbursements
- Other or miscellaneous income
- Actual vacancy rate
- Market vacancy rate
- Preparing the Loan Request Package
- Effective gross income (EGI)
- Operating expenses (both fixed and variable)
- Net operating income (NOI)
- Monthly or annual proposed P&I payment
- Debt service coverage ratio (DCR)
- Combined debt service coverage ratio (CDCR)
- Loan-to-value ratio (LTV)
- Loan-to-cost ratio (LTC)

Financial Analysis

The property economic section, no matter how complicated the loan transaction may be,

should generally be organized in the following order:

- Schedule of Income (1st page)
- Historical Cash Flow (2nd page)
- Loan Analysis (3rd page)
- Supporting documents (rent roll, property financial statements)

Unit Mix and Rent Schedule							
Unit Type	No. of Units	SF	Total SF	Unit Rent	Rent Per SF	Monthly Rent	Annual Rent
1BR, 1 Bth	24	813	19,500	\$700	\$0.86	\$16,800	\$201,600
2BR, 1 Bth	20	925	18,500	\$750	\$0.81	\$15,000	\$180,000
2 BR, 1.5 Bth	88	1,000	88,000	\$825	\$0.83	\$72,600	\$871,200
2BR, 2 Bth	32	1,125	36,000	\$900	\$0.80	\$28,800	\$345,600
3 BR, 2 Bth	56	1,250	70,000	\$975	\$0.78	\$54,600	\$655,200
3 BR, 2.5 Bth	20	1,400	28,000	\$1,050	\$0.75	\$21,000	\$252,000
Total/Average	240	1,083	260,000	\$870	\$0.80	\$208,800	\$2,505,600

Financial Supporting Documents

Be sure to include in the property economics section, if at all possible, the following list of supporting documents:

- Rent roll
- Property income and expense statements
- A trailing twelve-month income and expense statement (if available)
- Occupancy history
- Lease rollover schedule (if available)
- Construction budget (for brand new ground-up construction loans)
- Renovation budget
- Capital repair budget

Rent / Sales Comparables

- Name of property
- Photo
- Address
- Distance from subject property
- Size (square feet, number of units)
- Year built
- Occupancy
- Rental rates / Total sales price
- Type of lease (e.g., NNN, full service) / Sales price per unit or per SF

- Number of tenants / Date of sale
- Rent specials or concessions, if any
- Operating expenses
- Base year or expense stop

Sponsorship

The Sponsorship section of the loan request package is where the lender can find information about the financial strength and experience of the sponsorship. The word “sponsorship” is really industry jargon for borrowers, key principals, and guarantors. The origin of this word is not known, but it refers to the person or persons who will be ultimately responsible for the care and operation of the property and for the repayment of the loan

Following is a list of resumés, financial statements, and personal documents commonly found in the Sponsorship section:

- Borrower’s personal resumé
- Borrower’s company resumé
- Balance sheet
- Income statement
- Cash flow statement
- REO schedule
- Copy of credit report

Net Worth and Liquidity

Qualifying for a commercial loan there is great emphasis on the borrowers net worth and liquidity as we all understand many business are cyclical, seasonal, and the borrower has to be in good financial health to maintain the subject property. Understand we the lender is not the IRS please report all assets, income to improve your position on obtaining a loan.

An audited financial statement, or, specifically, the balance sheet, prepared and audited by an accountant or a certified public accountant (CPA), is usually preferred by lenders to a balance sheet prepared by the borrower. A set of compiled financial statements prepared by a CPA, though not yet audited, is also acceptable by lenders.

Following is a list of non real estate assets, which are separated into those assets excluded and those that are included in the calculation of a borrower’s net worth:

Assets that are excluded:

- Trusts
- Noncontrolling ownership interests
- Stocks in private corporations

- Unsecured notes receivable
- Life insurance policies
- Business equipment and inventory
- Personal loans
- Equity in net assets of a partnership
- Company stock options
- Automobiles, personal property, jewelry, guns
- Oil and gas interests
- Accounts receivable
- Time shares
- Nonpublicly traded securities
- Goodwill, patents, trademarks

Assets that are included:

- Cash (checking, savings, and money market accounts)
- Certificates of Deposit (CDs)
- Stocks
- Bonds
- Mutual funds
- Notes receivable supported by real estate
- Lender escrow reserve accounts
- IRAs, 401(k)s, pension
- Earnest money escrowed at title company

Standard liquidity ratios usually equal 10 percent or 20 percent of the borrower's net worth. Examples of liquid assets:

- Cash assets
- Checking and savings accounts
- Money market accounts
- Certificates of deposits (CDs)
- Earnest money held in escrow
- Trust accounts (only if the trust is a guarantor and if it is a family trust; restricted and charitable trusts cannot guarantee debt)
- Capital replacement reserves
- Marketable securities (non cash assets)
- Stocks
- Bonds
- Mutual funds

Examples of different sources of income include the following:

- Wages and salaries (W-2)
- Bonuses and commissions
- Interest and dividends

- Business income (self-employment)
- Capital gains
- Rental income
- Partnerships and joint ventures
- Trusts
- Oil and gas royalties
- Alimony and child support
- Annuities and retirement distributions
- Social Security

Commercial Loan Guidelines

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