Berman Fink Van Horn
"What's hot in Metro Atlanta Real Estate and How to Take Advantage of It"

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5 C's of Credit Underwriting

- **Character (Ethics, Management, etc.):** *Character* covers the "people" aspect of business lending. Lending institutions will assess the business owner's management ability, experience in the industry, business references, and personal credit and integrity. Lending institutions want to feel confident that the business owner will stand by the business obligations in times of crisis.

- **Capacity (Cash flow):** *Capacity* represents the business's ability to repay debt. For most lenders, this is a top underwriting priority. Lending institutions will review historical and projected financial performance to determine whether or not the business can repay the requested loan. The business's cash flow must meet a ratio above the proposed debt repayment to ensure repayment even if there is a decline in performance.

- **Capital (Balance Sheet/Equity)**. *Capital* represents the equity invested in the business by the owners. Capital provides a cushion for a business to rely on during periods when cash flow is tight. Also, Lending institutions will ensure that the owners have sufficient personal investment to remain dedicated to the business should difficult times arise.

- **Condition (Economics).** *Conditions* speak to the economy in which the business operates. Lending institutions will attempt to identify the main risks for the business, industry, and local and national economy. Once these risks are identified, lending institutions will determine if the business is prepared to mitigate these risks as much as possible.

- **Collateral (Assets available for Secondary Repayment).** *Collateral* is security for the loan as a secondary source of repayment. In most instances, collateral consists of business assets acquired with the requested loan. Lending institutions will always discount the current value of the collateral to a more realistic liquidation value. As a result, lending institutions will not lend "dollar-for-dollar" when assets are being acquired. At times, lending institutions may require additional collateral.

Types of Loans

Owner Occupied (51% or more occupied by owner/operator) and Investor (<51% or more occupied by owner/operator)

- **Traditional Commercial Mortgage**
  - Equity: 15-25% down (although higher equity could be required if cashflow not supportive of request)
  - Term: 5 – 10 Year Balloon with up to 20 year amortization (in rare instances, 25 years). In some instances, fully amortizing options up to 15 year term.
  - Rates: Fixed and Variable Rate including Interest Rate Derivative options on larger loans
  - Costs: up to 1% origination plus vendor costs (i.e. appraisal, legal, etc.). Prepayment penalties apply on some fixed rate products.

- **SBA 7(a) loan for commercial real estate**
  - Equity: 10% down
  - Term: Fully Amortizing up to 25 years.
  - Rates: Fixed and Variable Rate (6.25 % to 8.75 %).
  - Costs: 3-3.50% plus vendor costs. Prepayment penalties apply.

- **CDC/SBA 504 loan for commercial real estate**
  - Equity: 10-15% down. Typical structure is 50% 1st Mortgage with a Bank, 40% 2nd Mortgage through SBA/CDC, and 10% equity from Borrower.
  - Term: Fully Amortizing up to 20 Years on SBA 2nd Mortgage/Debenture. Bank 1st Mortgage must have minimum 10 year balloon payment and generally amortized over 20.
  - Rates: Fixed or Variable on Bank 1st Mortgage and Fixed on SBA/CDC 2nd Mortgage (i.e. 4.54% over 20 years)
  - Costs: Bank fees are similar to above for traditional commercial mortgage. SBA fees quoted by CDC (generally similar to 7a).

- **Secondary Market Lending Vehicles (i.e. conduit financing, life insurance, mezzanine, private equity, hard money etc.)**

Borrowing Tips

- Provide a complete financial package to Bank/Lender.
  - Articulation of the request including project description, desired financing terms, and reasons behind pursuing project (i.e. new location will increase production capacity vs. current constrained capacity). It never hurts to be upfront about hot buttons in what you desire of your financing partner from a terms and ongoing servicing capacity.
  - LOI/Purchase Contract. If a construction project, construction documentation should be provided including GC contract/resume', budget for improvements, plans/specs, etc.
  - A Business Plan can be relevant with some ventures. Business Plans should be concise vs. elaborate.
  - 2-3 Corporate Financial Statements (Profit & Loss/Balance Sheet). Financial Statement Quality matters with strong preference towards CPA Prepared financials (i.e., Compilation, Review, Audit) vs. Management Prepared Financials. Banks may require 2-3 Years Corporate Tax Returns in conjunction with financials.
  - If tenants involved, a rent roll and copies of leases along with some details on tenants (including financials if available) if not credit rated.
  - Listing of all Direct and Contingent Liability Information for Corporation and Sponsors including Lienholders, Balances, Payments, and Corresponding Collateral.
  - Resume's of sponsors can be helpful including experience in the industry, with the type of property to be purchased, etc.
  - 2-3 Years Personal Tax Returns of Sponsors with a detailed Personal Financial Statement. Some Banks require PFS on their form.
  - Liquidity Verification (Corporate/Personal) to document equity and financial flexibility.

- Highlight your strengths (financially/operationally) and don't be afraid to highlight your opportunities for improvement (financially/operationally). There are risks within every operation and proactively articulating those to your lender along with your strategies to mitigate them are both signs of good character and management depth. You don't want your lender to identify those on their own and jump to conclusions.
- Interview 2-3 Lenders that are recommended by your trusted advisors (any more will be confusing and time consuming). Don't make financing terms the sole focus of interviews. Many banks will be unable to provide you their best terms without fully underwriting your request and determining the depth of your potential relationship. Look for a cultural fit including servicing model (local vs. centralized underwriting and relationship management), lender's appetite for certain borrower profiles, industries, project types, etc., ability to grow with you and your firm, and ability to provide additional depth including broad scope of products/services, market intelligence, relevant industry data, connections to grow your business, etc. Always be thinking ahead vs. the transaction at hand as a strong financial partner is critical to long term success.