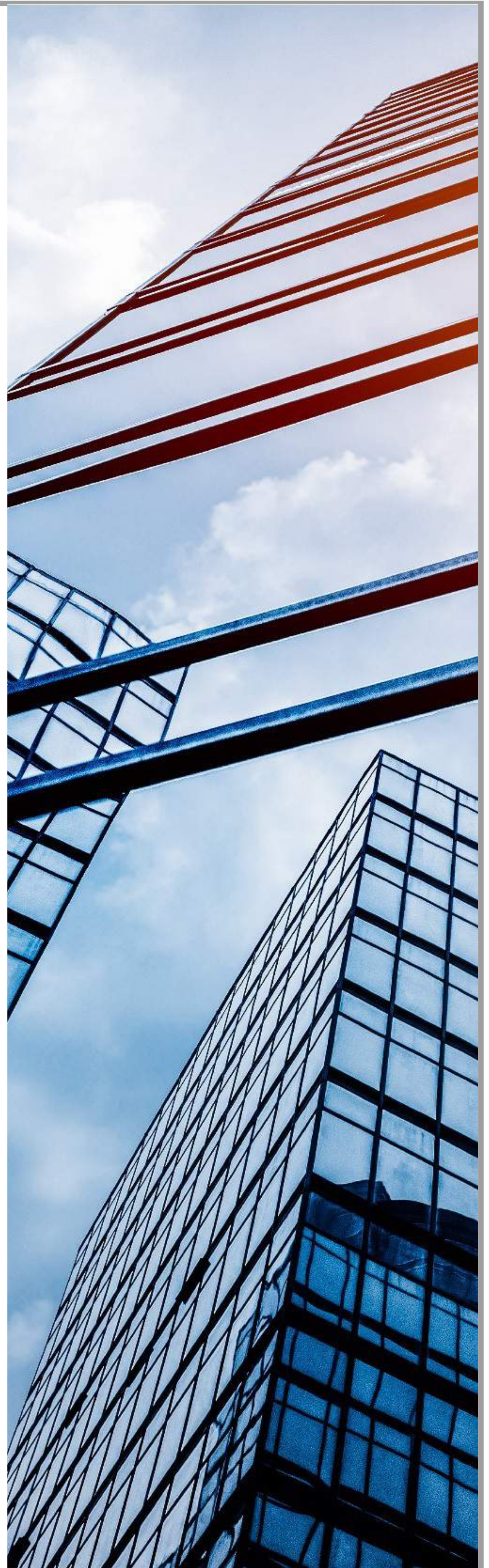
COMMERCIAL MORTGAGE GUIDEBOOK



CONTACT OUR TEAM:

WWW.HWCLENDING.COM

Thank you for downloading our eBook!

Commercial real estate financing can be a complicated process. Do not be concerned if you feel confused or overwhelmed. Investment property banking is a specialized industry which has all its own proficiencies and nuances, as with any other business. An investment property may also likely be one of the largest purchases you will make in your lifetime. Meaning that particular property and your real estate portfolio is going to be an important factor when considering your assets, liabilities and overall income. And we would argue that financing is the most crucial component of your investment property. So wanting to understand the basic concepts, strategies and risks of commercial real estate financing – well that just makes you a good investor.

Capital advisory companies like HarborWest specialize in partnering with investors to quarterback the commercial financing process. Our goal is to provide access to the top market capital sources and negotiate the most competitive loan terms for our clients, all while making that process as seamless as possible and minimizing overall liability for them.

Prior to starting HarborWest, what we found over the years is that much of the commercial mortgage market caters to the largest commercial transactions, leaving middle-market investors with scattered options. HarborWest has become known for using our big company access and experience to specialize in providing those middle-market investors with the same resources, quality work and attention that they also deserve.

We look forward to reviewing your financing needs with you, but in the meantime -- we hope we can help new clients understand the basics of commercial real estate lending and that our guidebook will be insightful for you.

Enjoy!

Colin Dubel, President
HarborWest Commercial Lending

Commercial Lender Types

Banking Institutions
Life Insurance Companies
Conduit Lenders (CMBS)
Government Sponsored Entities (GSEs)
Debt Funds
Private Lenders

Commercial Mortgage Types

By Loan Stage:
Acquisition
Refinance
Construction
Bridge Financing
Rescue Financing

By Property Type:
Multifamily Buildings
Office Buildings
Industrial Property
Owner-User
Retail Property
NNN Leased
Mobile Home Parks
Self-Storage Facilities
Hospitality
Special Purpose
Raw Land

Commercial Key Concepts

Amortization Period
Fixed Rate Period
Loan-to-Value (LTV)
Recourse vs. Non-Recourse
Debt Service Coverage Ratio (DSCR)
Debt Yield Ratio (DY)
Prepayment Penalty
Rate Lock
Single-Asset Entity
Impound Accounts
Assumability
Loan Conditions
Commercial Loan Costs
Post-Close Requirements

Commercial Loan Qualification

Borrower Qualification:
Recourse vs. Non-Recourse
Personal Financials
Business Financials
Business Outlook
Credit & Character
Sponsor Experience

Property Qualification:
Property Type
Property Location
Quality & Condition
Appraised Value
NOI & Cash Flow Ratios
Overall Tenancy
Legal Considerations

Commercial Loan Process

Identify Mortgage Brokerage
Scenario Assessment
Review and Analysis
Broker Packaging
Lender Negotiations
Loan Option Selection
Lender Due Diligence
Lender Approval
Condition Satisfaction
Post-Closing & Servicing

About the Author

About Colin Dubel
About HarborWest

Glossary of Terms

Full Glossary of A-Z Terms

Commercial real estate properties are financed by a variety of mortgage lenders. Each lender type has their own general box for the types of deals where they are usually a proper fit, and within each lender type – each individual lender has their own unique program parameters, requirements, and appetite. As the market changes, so do the lending programs for each individual lender and is something that is constantly in flux. HarborWest maintains close relationships with the most competitive individual lenders and consistently tracks changes to their programs as well as new lenders entering the market. Navigating this terrain can be difficult for a variety of reasons – but there are some general rules of thumb a borrower should be informed of when discussing their best route with HarborWest.

Banking Institutions

The most well-known commercial lenders fall under this category and include banks, credit unions, and savings & loan institutions. These institutions source capital from their customer deposit base to make available for commercial lending purposes. Most banks have a specialty commercial real estate loan department to handle these requests that are separate from the consumer lending departments available to the general public for such things as credit cards, personal loans, or home mortgages. HarborWest will provide preferred access to these specialty departments, and in the case of a pre-existing relationship, help you leverage your relationship for better rates and terms. Banks usually pursue aggregate client relationships and can usually offer rate discounts and underwriting exceptions on a commercial mortgage request in exchange for deposits or additional business. The size of the bank can also be beneficial to a borrower. Larger banks that have national reach can service a client with properties in different states, while community banks that are limited in their lending footprint can make loan offers for deals that might not gather interest elsewhere.

Banks are also a primary source for construction lending being mostly footprint lenders as they allocate funds for communities they serve and are also best setup for the construction draw and reimbursement process to developers since they have local contacts to monitor the project. Banking institutions typically have the lowest processing fees and a variety of flexible programs to meet client needs. Each bank typically has their own “box” to fit their lending strategy and goals. They also however are recourse lenders for the most part and can be conservative, more paperwork heavy, and scrutinize a borrower's personal cash flow and credit more than other lender types. Banks are also more regulated, so it’s important to work with HarborWest to identify and tackle any potential audit or regulation issues with your request before moving forward.

Life Insurance Companies

Many life insurance companies have dedicated departments to invest their customer premiums and one of the largest asset classes for that is commercial real estate debt. While many life companies have an equity investment division whereas the life company is a commercial real estate investor, the larger focus is on the debt side where they can better control their risk. Life companies rely on the origination and servicing of commercial mortgage companies to execute this and are very rarely available to borrowers directly. You must be an approved correspondent lender or brokerage with a track record and meet professional requirements to originate new commercial real estate loans for life insurance companies. HarborWest is an approved correspondent lender for a variety of life insurance companies to provide direct access to these private programs to our clients.

Due to the nature of life insurance, their debt investments need to be more conservative than other lender types. Life insurance companies for the most part tend to target low leverage (low LTV) opportunities in more populated areas. They typically require experienced real estate investors and a good liquidity position on the borrower's side to qualify for their top programs. Sponsor and property requirements tend to be fairly strict in order to be a low-risk and predictable investment return to the life insurance company, but qualified borrowers can benefit with low, long-term fixed rates and commonly can be offered non-recourse loans.

Conduit Lenders (CMBS)

Conduit lenders finance loans under a Commercial Mortgage-Backed Security (CMBS) execution platform. Commercial mortgage-backed securities are bonds that are collateralized by a pool of commercial real estate properties. The bonds are divided up into "tranches" which offers bond investors different risk and return profiles to choose from. New securitizations are rated and then monitored by independent rating agencies and available to the public. CMBS loans are securitized, so originators pursue loan requests that will be locked in for the long-term. To attract borrowers to this, they can typically offer higher leverage, longer amortizations, full-term interest-only options and attractive rates.

CMBS loans are always non-recourse as well since the collateralization is primarily based on the property which can be a huge draw for many borrowers. However, CMBS loans can be somewhat complex at times. Loan structures can become incredibly involved with multiple conditions and restrictions not found with other loan types. Rates are not locked until right before closing, which can make a stark difference for larger loan amounts if the transaction occurs during a volatile market. Required legal fees for CMBS financing can be cumbersome and excessive compared to other loan types. CMBS loans also require defeasance as their prepayment penalty, which can be extremely costly if you want to sell or refinance the property (defeasance is explained in a different section of this e-Book).

Given these implications, CMBS loans are usually a better fit for long-term hold properties and larger loan amounts that justify the higher fees to execute. HarborWest can provide CMBS cost comparisons and defeasance scenarios to help clients better understand this option, as well as our experience and back office legal contacts to help negotiate loan documents for larger transactions.

Government Sponsored Entities (GSEs)

Government agencies or government-sponsored entities (GSEs) among others include SBA (Small Business Administration), HUD (Dept. of Housing & Urban Development), FNMA (Fannie Mae) and Freddie Mac (FHLMC). GSEs do not directly originate loans, but instead have approved correspondent lenders and brokerage companies like HarborWest originate new loans for them that meet specific criteria and assume the loan from the correspondent. The government agencies are primarily strong candidates only for multifamily financing (FNMA, FHLMC, HUD) and small-cap owner-user business real estate for companies (SBA).

Government agencies account for almost half of all multifamily loans and small business real estate loans financed in the US, as their programs can reach more rural areas where other lenders may not be willing to lend. Paperwork and processing times can be more demanding than with other lenders which needs to be considered for purchase transactions with strict escrow deadlines. The agencies providing multifamily loans are typically competitively priced and always non-recourse which can be very attractive to investors, and especially attractive to syndicated entities or foreign investors that likely would run into issues with recourse lenders like banks.

SBA real estate loans can offer up to 90% (LTV) financing to small businesses which many times is the only option for companies with minimal equity to expand their operations or purchase instead of leasing their space. While the SBA may be the funding source for these owner-user transactions, it is actually the bank or approved correspondent that determines the interest rate they can offer. HarborWest tracks the market lenders with the most competitive SBA program rates and can also help negotiate discounts by establishing business banking relationships with that specific lender.

Debt Funds

A commercial real estate debt fund is a private equity backed fund that pools individual investor capital and deploys that capital into commercial real estate debt opportunities. These funds have always existed but became more prominent after the most recent major 2008 recession, as banking regulations and scrutiny became tighter. Debt funds usually specialize in a specific asset type, location or strategy and pool money from investors looking to allocate a portion of their savings into commercial real estate. Debt funds are less regulated so they all have better flexibility to work with buyers and landlords, which can be beneficial to negotiate more favorable rates and terms for your new mortgage. Many funds specialize to go head-to-head with the most aggressive banks and institutions with more flexibility, while others may specialize in bridge loan products for example offering tailored and flexible loan terms with competitive market pricing.

This category also includes the online marketplace or “crowdfunding” which started to gain traction after the recession but has lost its spark in recent years. Crowdfunding platforms allow easier entry into debt funds with a much lower investment requirement for the debt pool and diversification by splitting that investment into both debt for mortgages and equity for crowdfund principals to use in acquisition opportunities. Debt funds are a preferred capital source for HarborWest as they tend to be more “investor friendly” - more strategic, flexible and negotiable compared to other lender types. HarborWest maintains relationships with very select debt funds that specialize in certain situations or asset classes in order to bring the most fitting product to our clients.

Private Lenders

Private lenders are a fantastic source of capital when other lender types cannot perform, or the loan request requires the execution to be extremely strategic. Private lenders are usually individuals or family office lenders that are lending their own funds. Seller financing would technically fall under this category. Private lenders are lightly regulated, so they are able to provide very flexible terms, loan structure and most importantly – make decisions based on pro-forma numbers and mitigating factors if the property or borrower does not currently qualify for stabilized property programs with other lender types. Expedited closings are usually also available as there is usually no “red tape” to go through for a decision if the private lender is ready to commit based on his or her own level of due

diligence. Private loans usually cannot offer high leverage and require a fair amount of equity and are comparatively expensive on both rate and fees than other lender types.

Many private loans are short term which can be an issue if the loan is coming due and the property or borrower still does not qualify. If the borrower is not able to refinance or pay off the private lender at maturity, they could be at risk of default. However, if the potential opportunity of the property is too attractive to pass up, many times a private loan in the long-term can be well worth the short-term pain of high rates and fees. The private lending arena is in general very scattered and can lack a sense of organization that makes a client feel confident in their abilities. HarborWest has refined our private money capital sources through the years to only include private lenders and investors that have built a proven track record with our team, repeatedly performed for our clients, and that we can personally recommend.

Commercial real estate loans are primarily classified by either their stage or their asset class. The stage refers to the financing need of the property and usually falls into one of the following buckets: acquisition, refinance, construction, bridge, or rescue. However, much is just semantics as you can have a bridge acquisition for example. But usually, an acquisition or refinance is assumed to involve a stabilized property unless further indicated. Each stage has different risks and considerations a lender needs to consider in reviewing the commercial loan request to determine how they might feel comfortable structuring the loan, and what loan terms they are able to offer given the risk of the stage.

Lenders also classify commercial loans by property type. Most lenders usually have a specialty or preference for certain sub-types of commercial properties and will modify their underwriting and available loan terms based on that property type. The desirability of certain property types for a commercial lender are both internal and external. External factors would include property location, economic and market factors, and demand for that property type. Internal factors might include the allocation need or lack thereof for that property type in a lender's portfolio, historical performance and default risk of that subtype within their portfolio, and even personal experience or bias from the decision makers within a particular lending institution.

By Loan Stage:

Acquisition

This is the most common stage an investor might be seeking new financing. At this stage, an investor is purchasing a stabilized commercial property and needs to supplement their down payment with a commercial mortgage. Down payment equity typically coming from the investor(s) with cash or 1031 exchange proceeds from the sale of another commercial property.

Refinance

Refinances are also a common stage to request commercial financing. This can include "rate and term" refinances which usually take advantage of current market conditions to improve their interest rate, re-amortize the loan payment schedule or structure a more flexible loan to better fit their goals. This can also include "cash out" refinances which tap into the property's equity to provide proceeds to the borrower for investment or personal use.

Construction

Construction loans are used for commercial development projects to provide investors with funds in order to complete a commercial property project. Funds are distributed to the developer in draw phases in order to mitigate risk to the lender. The developer and lender will have a close relationship as they stay in frequent contact during the course of the project. There is a more in-depth scrutiny in evaluating these projects and financing due to the inherent risk of the project failing and not having a completed and stabilized piece of collateral.

Bridge Financing

This is a niche type of lending usually provided by debt fund and private lender sources but has also been offered more recently by select banks. Bridge loans do exactly as they entail, they bridge the financing gap between a commercial property's current situation and the end result. This may include a vacant building that needs financing until lease-up, or a distressed property in need of funds to complete a rehab stage or repositioning. Quality deals that just require a "quick close" also fall under this category. Bridge loans are utilized on requests that cannot qualify just yet with institutional quality lenders but are still partially stabilized and have less risk than our next stage described.

Rescue Financing

Rescue financing is also commonly referred to as "hard money" financing. While bridge financing involves having an investor with a solid plan for the project and exit strategy for the take-out loan, rescue financing may not be as clean cut. This stage is for properties that are heavily distressed, have loan qualification issues and perhaps not a clear-cut path to institutional financing. Due to the high risk, these loans are typically only financed by private lenders that require additional equity and higher interest rates in order to justify the risk.

By Property Type:

Multifamily Buildings

Multifamily buildings are the most common commercial property type. It's important to recognize that multifamily is considered commercial only when there are five (5) or more units. Anything (1-4) units for lending purposes is considered residential and would be handled by a residential loan source. Besides traditional multifamily complexes, multiple units on different parcels can qualify for commercial multifamily financing, as long as there are above (5) units total and those parcels are adjacent and adjoining. Condominium buildings with an investor owning (5+) units on various floors would not qualify, neither would (5+) single family residences bundled together but in different neighborhoods of a city.

Office Buildings

Office buildings are usually categorized as urban (skyscrapers and high-rise buildings in major metropolitan areas) or suburban which include low and mid-rise buildings usually more spread out or in an office park setting. Office buildings are also classified as Class A, B or C - the higher being more desirable to both tenants and lenders. They can also be categorized by lenders based on tenancy, for example: traditional office, co-working, creative office, flex space or medical office. Tenancy and lease structure can be an important consideration for a lender as demand and outlook for certain industries and office space can affect the occupancy of a property, and thus the income and ability of the borrower to repay.

Industrial Property

Industrial properties can be categorized into manufacturing, storage and distribution, and then flex industrial which usually has a higher office component than the other two compared to the warehouse. These properties can have multiple tenants, or be leased to a single tenant both third party or owner-user for a business. Industrial properties are recently in higher demand with lenders given the e-commerce shift our economy has been experiencing over recent years. Industrial properties however also carry more environmental risk for lenders, and loan qualification more heavily focused on the tenant's income sheet financials if the entire building is leased by a single user.

Owner-User

The term owner-user as a property type is very flexible. It is usually coined as "owner-user" because it signals the loan qualification will be based on the company financials of a business owner, as opposed to an investment property's Net Operating Income (NOI). Lenders usually have a different division or program to handle these requests different from investment properties. As such, the owner-user property type can be industrial (such as a manufacturer), office (such as a law firm), retail (such as a Mediterranean restaurant) or a business owner operating a self-storage facility property.

Retail Property

Retail properties are properties where you shop, dine and experience. These include malls, strip centers, neighborhood centers, outlet malls and free-standing retail buildings. Retail is usually multi-tenanted, and many times anchored by a large tenant such as a grocery store or a pharmacy. With the COVID impacts on small business and the economy, retail properties now undergo tremendous scrutiny and conservative underwriting as many have had vacancy driven up and lease rates decline, putting the landlord in a more difficult position to repay their commercial mortgage.

NNN Leased

NNN (Triple Net) properties are a special sub-type of retail property, although sometimes can be considered industrial. NNN refers to the lease structure of a single-tenant property, with the landlord being expense responsible "net of taxes, insurance and maintenance". The tenant handles all expenses and passes through a simple agreed rent amount to the landlord, making the investment property very "hands-off" and attractive to novice investors who are not experienced in commercial or don't desire to be heavily involved in the management. Because repayment relies solely on the income of that single tenant, lenders will scrutinize the tenant's credit rating (if available), financials, lease and competitors in the market.

Mobile Home Parks

Mobile home parks are organized plots of land that have built a tenancy of detached mobile homes. Most of the time the actual mobile home or coach will be owned by the tenant, while the investor owns the land and rents the space to the tenant to occupy with that mobile home. Mobile home parks can have high profitability given the low expense ratio for owners which translates into good loan qualification based on calculations but can often run into hurdles with lenders based on location, quality of the park, the aspect of transiency of tenants and occupancy being less predictable, or the overall stigma surrounding quality of tenants which can be a concern for many reasons to a lender.

Self-Storage Facilities

Self-storage facilities lease space to individuals for storage of excess inventory or personal belongings. These leased spaces are known as units with renters having full-time access and owners managing the leasing of those units. Mini-storage is interesting because it is the only property type that can be financed as both an investment property or an owner-user property, since self-storage investors both own the property and manage the operations. This property type is attractive to lenders due to high diversification and easy turnover coupled with high demand right now for storage space. The management experience and historical occupancy of the property is usually under the microscope the most with lenders.

Hospitality

This property type category predominantly refers to hotels and motels, but can also include golf courses, event centers, water parks and amusement facilities. These are usually "owner-user" as opposed to an investment property since it is so specialized, with the property owner also owning the business. Due to COVID impacts, financing for hospitality is primarily from very specialized lending sources that are heavily involved with and understand the hospitality industry and carry very conservative underwriting standards and loan conditions. The historical performance of the hotel, financial strength of the operator and loan guarantor, and rating of the "flag" (i.e., Marriott, Hilton) or lack thereof are most important to potential lenders.

Special Purpose

This category is essentially a catch-all for any other remaining commercial property type. This can include churches, car washes, museums, bowling alleys, gas stations and wineries to name a few. The important component of a special purpose property is that it is intended for a single limited use and cannot be converted to a different use without a very large capital investment. This particular and limited use does not make the property very liquid or marketable to a large investor base should the lender need to foreclose. For this reason, only agency lenders or private money lenders typically can finance the special purpose products.

Raw Land

Raw land is exactly what it sounds like. It is the uncollateralized, underlying dirt of a property. Most commonly, raw land is either purchased for business storage (perhaps agricultural equipment, distribution vehicles, etc.) or as land for a pending development project of any commercial sub-type. Because there is no structural collateral or income value as there would be with a multifamily property or leased NNN property for example, the lender is left with an extremely illiquid asset upon foreclosure. For this reason, raw land is the most difficult and most expense to an investor to finance.

Commercial real estate finance, like any industry, has a language of its own. The last section of this eBook has a complete glossary of commercial mortgage terms for your reference during your loan process. We do however think it is important to further explain a few key concepts that as a landlord or investor you should understand as they will affect either your qualification or your resulting loan terms. Having a working knowledge of the below concepts will help facilitate a productive discussion and comparison during the LOI (Letter of Interest) stage with HarborWest. Each of the key concepts below are common discussion topics that are addressed on a Lender's term sheet.

Amortization Period

An amortization period is essentially the length of time the mortgage payments are spread to calculate monthly payment. A fully amortized loan would be paid off at the end of this period, whereas a partially amortized loan would have a remainder or balloon payment at the end. Amortization period should not be confused with the term (or maturity as its commonly known). For example, a commercial mortgage can commonly have a 25-year amortization but a 10-year loan term or maturity. This means that the payments for the mortgage will be spread over 25-years as if the loan were to be paid down to zero at the end of that period, but the actual loan would be called "due and payable" at the end of 10 years. Since the 25-year amortization period was not lived out, there is a remainder or balloon payment due to the lender.

Most often, multifamily properties will have a 30-year amortization and core commercial properties, or owner-user will have a 25-year amortization (30-years on core commercial can be negotiated for stronger deals). It's always more attractive to lenders to have a lower amortization, as the loan would be paid down quicker and leave more equity in the property – which is important to lenders when evaluating default risk. A lower amortization can sometimes help negotiate lower interest rates or additional perks. However, reducing the amortization period (whether lender determined based on comfort level, or borrower requested for a better deal) creates a higher mortgage payment. Since maximum loan amounts (LTV) is cash flow determined, this higher payment would negatively impact maximum loan amount qualification if the property is "cash flow restricted".

Fixed Rate Period

This refers to the period of the loan that the interest rate is fixed. Most commercial mortgages are typically "hybrid" loans where the loan is fixed for only a portion of the loan term. For example, on a 30-year amortization & term for a multifamily bank loan, the rate may only be fixed for the first part of that term. Most commonly, those options are 5, 7 and 10-year fixed rate periods. The longer the rate is fixed, the higher the interest rate will tend to be. In rising interest rate environments, lenders are less inclined to offer longer fixed periods as they will want to recapture higher future interest rates when the market rises. Conversely, in a declining interest rate environment – lenders will often offer discounts to push borrowers to longer fixed period programs, as their profit margin is highest at this point.

There are indeed programs with longer fixed period than 10-years (HarborWest can offer up to a 30-year fixed program for select multifamily properties), and there are also programs with lower than 5-years fixed (for example, 1-year fixed or even quarterly adjustable / not fixed rates). These types of loans are to be utilized when you either (1) need the lowest possible interest rate in order to

maximize tight loan proceeds and increase LTV, or (2) when the property is not stabilized and there needs to be rehab completed with a plan to refinance. In this scenario, you'll want a lower prepayment penalty which comes with lower fixed rate periods, or it may be a rehab project with a shorter "bullet" or loan term (say 12-month project), so the rate will float or have a very limited fixed period.

Interest Rate

The interest rate of the mortgage will usually be the most discussed loan term during your process. While the other loan terms in this chapter can be just as important, the cost of the mortgage of course is the primary factor in this entire process. If the cost of obtaining the debt is too high to justify, the remainder of the terms are unnecessary to discuss. Interest rates can be fixed, adjustable, or a "hybrid" where the rate is fixed for a portion of the term and adjustable for the remainder. Interest rates in commercial real estate can range from the 2.50% range for larger multifamily properties in primary markets to 14.00% for raw land debt with private lenders. Obviously, that range is extremely large - but the key concept here is that the interest rate will correlate to the level of risk to the lender. Rate covers risk. Commercial loan requests that are strong (stabilized, preferred geographic area, low LTV, strong leases and historical performance, etc.) will carry lower risk of default and earn a lower interest rate. Conversely, high risk loan requests require a higher rate in order to justify the lender making an offer. Lenders will usually determine interest rate by taking an index rate (example: LIBOR, 10-Year Treasury Rate, Prime Rate) that fluctuates with the market, and adding a "Margin" which is essentially their determination of risk and profit margin.

Within this general parameter of risk vs. rate, negotiated loan terms can also affect the final interest rate. For example, a base rate can be established by a lender for a commercial loan request but have "add-on" options if the borrower elects to have a shorter prepayment penalty, non-recourse vs. recourse, or an interest-only payment period during the loan as a few of the most common examples. Investors can also earn rate discounts from lenders most typically for accepting a lower LTV maximum, sponsor deposits (banking relationship), or an adjustable rate vs. a fixed rate. Fixed interest rates are also usually higher the longer you fix the rate - so a 10-year fixed rate is always going to be higher than a 5-year fixed rate, and you will need to decide if the difference in payment is worth the additional protection period.

Commercial mortgage rates are usually a factor of three elements: the market index the lender has selected to use, the lender's margin/spread over that index, and borrower selected program features.

The market index can be one of many indexes available to the public. The market index serves as a benchmark. It is a third-party index that the lender does not have control or influence over that will move with the market. Each index might arguably have certain benefits to the lender or borrower to be used (please discuss further with HarborWest). Some of the most common indexes used include:

Commonly Used Market Indexes

- US Treasury Bonds (T-Bill)
- Secured Overnight Finance Rate (SOFR)
- London Interbank Offered Rate (LIBOR)
- Interest Rate Swap (SWAP)

- Constant Maturity Treasury (CMT)
- Prime Rate (Prime)

The second component of determining commercial mortgage rates is understanding the lender's spread/margin. This is why commercial loan rates are not available online. While indexes can be referenced online at any point, the margin or spread is determined solely by the lender on an individual basis. Lender spread is a determination of risk. The larger the level of risk in the commercial loan request, the higher the lender's margin needs to be in order to compensate. Rate covers risk and the spread on the rate is the lender's yield for financing that risk. Since every commercial loan request will have its own profile of risk and lender requirements and appetite are constantly changing, each commercial loan quote needs to have its own proper due diligence for an accurate representation. There are both qualification factors and program factors that can affect commercial interest rates. Qualification factors are determined with due diligence and would be risk-adjusted. Program factors are offerings provided by the lender and selected by the borrower and are usually optional.

Qualification Factors Affecting Rate (+/-)

- Available Liquidity
- Net Worth
- Sponsor Experience
- Credit Score
- Past Credit Events
- Property Type
- Property Location
- Quality & Condition
- Appraised Value
- Loan-to-Value (LTV)
- DSCR Ratio
- Debt Yield Ratio (DY)
- Tenancy Risk
- Tenant Quality
- Historical P&Ls

Program Factors Affecting Rate (+/-)

- Fixed Rate Period – Longer fixed rate terms (+Rate)
- Non-Recourse – No personal guarantee (+Rate)
- Prepayment Penalty – More flexible or no prepay (+Rate)
- Interest-Only Periods – No principal paydown (+Rate)
- Loan Amount – Certain loan program access (-Rate)
- Loan-to-Value (LTV) – Lower LTVs with more equity (-Rate)
- Banking Relationship or Deposits – Additional business (-Rate)
- Additional Cross-Collateral – Additional equity & lower LTV (-Rate)
- Paid Points – Upfront fee increasing lender yield (-Rate)
- Lower Amortization – Expedited principal paydown (-Rate)

In advanced situations, some lenders can also offer interest rates determined by a "SWAP". An interest rate swap is a derivative contract whereby two parties (counterparties) agree to exchange one stream of interest payments for another, based on a specified rate index and principal amount.

In the world of real estate lending, the most common type of interest rate swap is a fixed for floating exchange. In this scenario, one party exchanges a fixed stream of interest rate payments for a floating rate stream of payments. Both borrowers and debt issuers (lenders) have the ability to capitalize on interest rate movements by entering into derivative contracts called an Interest Rate Swaps. By doing so, either party can either: (1) obtain protection in a rising rate environment; or (2) obtain lower payments in a falling rate environment. However, both parties can't be right. Interest Rate Swaps are a zero-sum game, meaning one party is going to "win" and the other is going to "lose" depending on which way rates move (*source: Property Metrics*).

Our HarborWest team can help negotiate the lowest available market rates for you by providing access to the most competitive lenders and using our relationships with these lenders to negotiate offered rates. We will also provide an effective rate comparison analysis between loan offers, and available options for rate discounts should they be available.

Rate Lock

Once the basis for the final interest rate has been established prior to accepting a loan offer from one of HarborWest' lenders, the next consideration is a rate lock. Every lender works differently in this aspect. Most lenders will have the index rate and margin to the rate (collectively the effective rate) determined upfront. However, the index rate used (LIBOR, 10-Year Treasury, etc.) will fluctuate daily with the market. Additionally, a lender's margin may also increase if the level of risk determined during underwriting ends up being evaluated to be higher than when the loan request was first reviewed. Not all lenders offer rate locks on their loan programs. Lenders that do offer rate locks typically will commit to a 60-day rate lock, but sometimes can be negotiated to 90 days if appropriate. The typical deposit for a rate lock is a 1.00% fee upfront (so that would be a $50,000 deposit provided to the lender on a rate locked $5,000,000 financing).

Reviewing the lender's particular rate lock policy is crucial before acceptance. The general sentiment for most rate locks is that neither party can benefit from an increase or decrease in rates. Should rates go up during loan processing, the lender does not get the benefit of a higher yield, and conversely if rates should decline the borrower does not pick up the savings. The second notion addresses cancellation: should the lender not approve the loan for any reason, the borrower is due back their full deposit. If the borrower cancels the loan request mid-processing, the lender is able to keep the deposit. Within these general parameters, there is an enormous amount of gray area and interpretation. Be sure to discuss benefits and risks of rate lock policy with HarborWest during the loan origination process.

Loan-to-Value (LTV)

This is probably the most common commercial mortgage term you will encounter. Very simply it is the percentage of debt compared to the overall value of the property. It is also the inverse of the equity percentage in the property. For example, a $6,000,000 loan amount on a $10,000,000 property value would be a 60% LTV. Inversely, that would equate to a 40% equity or down payment of $4,000,000 – to get to a 100% consideration of combined debt & equity. Most commercial mortgage programs will go as high as 75% LTV. However, some multifamily programs for top-tier requests can go up to 80% LTV and owner-user business real estate loans can go as high as 90% LTV with government financing.

As we always mention, rate and equity cover risk. The first limit to LTV is comfort level by the lender. If a lender is less comfortable with a property, they will require more equity in the property to create a larger "buffer" in the event of potential foreclosure. So even if the lender's program limit may be higher, the maximum LTV may be reduced arbitrarily based on how they determine deal risk. The second limit to LTV is the cash flow of the property. Most commercial mortgage programs will analyze cash flow ratios (see DSCR and DY described below) to calculate the maximum loan amount they will lend. Depending on how conservative or lenient the lender is on the property and requirements, one lender to another will have different maximum loan amounts quoted to the borrower. The "Value" component to this is usually based on the appraisal report conducted assuming the lender agrees with the valuation. However, the lender can adjust the appraisal if they see fit to conclude a value that they deem more accurate. Additionally, if the request is on a purchase transaction – the lender will consider the lower of the purchase price or appraised value and limit LTV based upon that lower figure.

Another key point related to this concept is Loan-to-Cost (LTC). LTC is an additional qualification standard that is considered when the property is a new construction build or has undergone major renovation in the last 24 months. Lenders will have different requirements, but typically the highest LTC available is 85%. For example, let's say on a $10,000,000 valued property -- based on LTV a lender is willing to do 70% or $7,000,000 on the loan amount. However, the borrower purchased the property 6 months ago for $4,000,000 and put $2,000,000 worth of rehabilitation into the property (for a total Cost consideration of $6,000,000 even though the appraisal came in at $10,000,000). In this case, most lenders would then factor in their LTC requirements – which at 85%, would be a maximum $5,100,000 loan. Much lower than the $7,000,000 loan offer if the LTC wasn't considered. Usually this is a matter of seasoning and will not be considered after 24 months of ownership.

Recourse vs. Non-Recourse

Recourse refers to personal guarantee (PG) of the commercial loan. Full recourse loans mean that the principal owners of the property are required to sign and personally guarantee the commercial mortgage. Should the property result in foreclosure and there be a deficit on the sale, the lender would have recourse to pursue the signers to recoup their losses. Full recourse is the default structure for most commercial loans, and on all owner-user business real estate loans. However, less demanding requirements can be considered on select investment properties. Some lenders offer partial recourse (say 25% or 50%) meaning their recourse in the event of foreclosure deficiency would be limited to that amount. Select lenders can also offer non-recourse options to reduce personal liability and limit mortgage liability to only the entity owning the property. This can be very attractive to all investors, but especially those with large personal assets to protect, or a risky project that the investor knows has a chance of failing. Many larger deals can also be syndications where the buyer pools investor funds in order to purchase a commercial property. Those syndicated investors are very unlikely to be willing to personally guarantee a loan especially when they only own a small fraction of the investment and will only accept non-recourse loans as a condition to investing in the pool.

However, even on non-recourse commercial loans, there always still needs to be a "sponsor" – someone to sign for the entity and also for what are commonly referred to as "bad boy carve-outs". These are exceptions to the non-recourse clause that would trigger recourse liability on that sponsor. Most of the time this includes and is limited to default caused by fraudulent or criminal activity. That sponsor also needs to meet basic financial requirements of net worth and liquidity. Basically, there needs to be a well-healed signor behind every deal, even large syndications. Usually, the rule of

thumb on full recourse loans is that anyone with 20% or more ownership or anyone that has a management / decision making role in the entity will provide personal financials and sign recourse as a sponsor. Most of the time the availability of non-recourse loans depends on the equity in the commercial property. The idea being that if there is going to be limited or no recourse available from the borrowers, the lender needs to base their comfort level on the property as a stand-alone. They need to feel good that there is enough equity that they will never need to pursue any sponsors in the event of default. So most non-recourse loans have an LTV limitation that hovers around the 50-55% LTV range.

A few preferred lenders can negotiate non-recourse status on higher leverage requests for a small addition to the rate or for a very attractive property. Some lenders in fact only offer non-recourse financing because their loans are setup to be securitized and sold. So the property needs to stand on its own as an investment regardless of borrower relationship or strength. These defaulted non-recourse loans are offered by CMBS lenders and Agency lenders, while non-recourse is a negotiation for the Banks, Life Companies, Debt Funds and Private Lenders.

Debt Service Coverage Ratio (DSCR)

DSCR is probably the primary cash flow metric used by commercial lenders to determine eligible loan amount on a commercial request. The DSCR is calculated by dividing the NOI (net operating income) of a property, by the ADS (annual debt service). The NOI of a property can be different from lender to lender, depending on their underwriting standards and also any exceptions they are able to make – the higher the NOI, the higher loan amount a property will qualify for.

For example, for a self-managed property in a top market where the appraiser notes a 3% average vacancy – one lender might underwrite a 3% vacancy expense and 0% management expense, while a second might have a 5% vacancy factor and 5% underwritten management fee (in case they ever had to foreclose and implement a manager). The latter scenario would result in higher expenses and thus a lower net operating income (NOI). The annual debt service (ADS) is simply the annual principal & interest mortgage payment total, based on a particular loan amount, amortization and fixed interest rate. So in theory, the lower the interest rate or longer the amortization – the lower the ADS and higher the loan amount qualification. So if the NOI was $400,000 per year, and the ADS for the loan amount requested calculated to exactly $400,000 – the DSCR would be 1.0 precisely.

Most DSCR requirements will be quoted as (1.15x, 1.25x, 1.30x, etc.). Meaning for example, if a lender has a DSCR requirement of 1.25x – they are requiring that the NOI be 25% higher than the annual debt service (ADS) at minimum, to determine the amount they will lend. Once you understand how the DSCR, NOI and ADS work together – you can always use two in order to calculate the third.

Debt Service Coverage Ratio (DSCR) = Net Operating Income (NOI) / Annual Debt Service

Debt Yield Ratio (DY)

The debt yield (DY) ratio is the second most used calculation used by commercial lenders to determine qualified loan amount. The debt yield is simply the net operating income (NOI) divided by the Loan Amount (LA).

For example, a property with an NOI of $550,000 and a loan request of $8,000,000 – would be a DY ratio of 6.87%. This means that the lender would have a 6.87% cash-on-cash return on its money if they had to foreclose on the property day one. So if a lender has a debt yield requirement of 8.00% on all of their transactions, the NOI for this particular property would be used in an inverse calculation to determine the qualified loan amount. Based on a $550,000 NOI and an 8.00% debt yield requirement, the maximum loan amount in this case would be $6,875,000 ($1,125,000 lower than the borrower's initial loan request of $8,000,000). So working with lenders that have a lower debt yield requirement will maximize loan proceeds for commercial real estate investors.

Debt Yield Ratio (DY) % = (Net Operating Income (NOI) / Loan Amount) x 100

Prepayment Penalty

One of the most important considerations in commercial real estate financing is also one of the most overlooked, the loan prepayment penalty. Most commercial lenders are going to include a prepayment penalty clause in the loan to cover themselves should the borrower request to pay off the loan before it is due. Lenders typically require this because prepayment interrupts their business plans that have assumed the interest income generated from the loan across the entire term and might reduce their yield if they are forced to reinvest loans at a prevailing lower rate. Commercial loans can range from having no penalty (which can be negotiated by HarborWest) to lock-out loans which cannot be paid off at all. However, the three most common structures of prepayment penalty are step-down, yield maintenance and defeasance.

Step Down Prepay - A declining balance is probably the most favorable prepayment structure to borrowers. The borrower is responsible for paying a flat percentage fee based off the loan amount should they pay off the balance early, and that fee declines as time goes on. On a hybrid adjustable loan, the fee period will typically match the fixed rate period, but the most competitive lenders will offer shorter periods or reduced fees. Step down penalties are most commonly found with lenders where the loan is held on their own balance sheets. An example of this might be a $3,000,000 loan on a 5-year fixed program with a "5-4-3-2-1-0%" prepay. This means that should the loan be repaid in the first year of its life, there would be a 5% penalty in order to be allowed to do so. In this example, that penalty would be $3,000,000 x 5% = $150,000. If the repayment was in the second year of the loan at 4%, that penalty would drop to $120,000. And so on, until after the 5th year when the penalty expires and there is none. At times it is negotiable to have an "annual allowance" where you can pay down a percentage of the loan balance (usually 20%) without triggering the penalty.

Yield Maintenance - This structure essentially requires the borrower to pay a fee equal to the difference between the amount of interest that would be earned on the loan if it were carried throughout the entire term and the amount of interest that would be earned if the lender reinvested the borrower's prepaid principal in treasury securities of the same term. Typically, the yield maintenance penalty is calculated by taking the present value of remaining payments multiplied by the difference between the interest rate on the loan and a pre-specified index rate. If current market rates were higher than the loan rate, there would be no calculated penalty but still be subject to a minimum fee which is typically between 1% and 3%. Yield maintenance calculations can vary sometimes between lenders, so it's important to review specific language and implications with HarborWest before accepting any loan offer. Our team can provide you with an overview and example upon request, but in general the earlier in the term the loan is repaid the higher the penalty will be so this prepay structure is best for a long-term hold. Additionally, it is less preferable in a declining interest rate environment. Should prevailing market rates be lower at the time of refinance

than what the lender is currently earning, that differential loss will be considered and be on the shoulders of the borrower. Conversely, in a rising interest rate environment, the lender would benefit from recouping their money and lending it out at a higher rate - so the prepayment fee to the borrower would be smaller.

Defeasance - This clause is typically seen exclusively in CMBS lending and requires the borrower to provide treasury securities equal to the value of the subject property to the lender. Whereas yield maintenance is the prepayment of the loan, defeasance is actually a substitution of collateral. The defeasance process involves a variety of different parties and is typically very expensive to commence. The original collateral and projected cash flows are substituted by the borrower with a portfolio of treasury notes designed to generate cash flows that match the loan obligations. A “successor borrower” will take the place of the original borrower, and the lien on the original borrower’s property is released. The successor borrower will make the ongoing debt service payments. The protection that defeasance provides bondholders is necessary to preserve demand and is one of the reasons that CMBS can enjoy the term and pricing advantages that it does. Defeasance is extremely involved and expensive, so clients should be very confident that the commercial property will be a long-term hold and that they have no plans to sell or refinance the property during the life of the loan.

Within these three common structures, it’s also important to note any type of lockout period. A lockout is an absolute restriction on borrower prepayment. Lockouts can be structured for the entire term of the loan but would more commonly be written for specified periods during the beginning of the loan. Some lenders offering permanent financing also will allow the borrower to prepay a certain percentage (usually 20%) of the principal balance each year without penalty, and in the event of full loan repayment only the remaining principal balance is subject to the penalty. There are even select lenders that offer no prepayment penalties to borrowers on both permanent and temporary financing. Make sure to discuss the details of prepayment with your adviser or lender before making any financing decision that could affect your exit strategy.

Assumability

An assumption clause is a feature of a commercial loan that allows another person to take over (or assume) the loan terms and responsibility from the original borrower. The new owner or borrower typically will pay the lender a 1.00% fee and need to meet the lender’s qualification requirements by going through their underwriting process. However, if approved, the new owner can take over the current owner’s debt. This might be beneficial to the new owner if the market has shifted, and interest rates have risen. Having this feature added to your loan terms by HarborWest can be an added safeguard to your long-term strategy for the property. It is especially important if you enter into a long-term fixed loan with a matching stepdown prepay penalty or yield maintenance structure. Should you desire or need to sell the property, the prepayment penalty can be considerable if the mortgage was recently originated. You can avoid this fee and have it waived if the property is sold and the loan assumed by a qualified new owner/borrower. Where this can sometimes be a problem is when the new buyer needs a larger loan (higher LTV) than the original mortgage can provide, or if it does not contain features that might be important to the new buyer (non-recourse, interest-only payments, loan conditions, etc.).

Single-Asset Entity

A single-asset entity is exactly what it sounds like: a legal ownership entity (most always a limited liability company LLC) that will own the commercial property and nothing else. Borrowers will commonly setup an LLC for property ownership to protect personal liability and for tax purposes. On recourse loans, the "veil is pierced" as owners of the LLC will sign personal guarantees – so the limited liability created by the LLC really only applies for legal liability such as lawsuits from tenants or property guests.

Non-recourse loans from CMBS and Agency lenders typically require single-asset ownership however because it makes it easier for securitization, and also quite honestly it is easier for lenders to expedite foreclosure on a property and have less complications and hurdles in court if the ownership is a simple single-asset LLC and doesn't involve any other assets or liabilities to consider. Depending on the owners, their assets and goals – a single-asset ownership may be the game plan anyways, or it could be seen as a costly and unnecessary pain required that they would prefer to not involve. You will want to consult with HarborWest, your attorney and also tax preparer to determine what is the best route for your personal situation.

Impound Accounts

An impound account is a reserve account setup by the lender to collect funds set aside for a specific purpose. The most common requirement is impounding for property taxes and property hazard insurance. The borrower will make their monthly payment, which includes principal & interest towards the loan amount, along with an annual amortized amount for property taxes and insurance. Once the property taxes or insurance premium comes due, the lender will make those payments on the borrower's behalf or notify them of payment and allow them to access the impound account. This essentially "babysits" these funds to make sure they are paid and are usually required as a loan condition for borrowers that may have a history of missing payments or barely meet minimum financial qualifications with the lender. An impound account is important for these two items because property taxes are the only item that take priority over a mortgage lender's first lien on title (meaning past due taxes are paid first before the mortgagee upon foreclosure sale), and because the mortgagee is the loss payee on the insurance policy. Should a major hazard occur at the property, the lender wants to be certain the losses are covered and not lose the payee benefits due to the borrower not following through with their insurance payments on-time.

Impound accounts may also be established for other situations that are a concern for the lender. An example might be if the subject investment property is a 40,000 SF industrial building leased by a single tenant, with their lease coming due in the third year of the loan. A lender might be very concerned about the tenant moving out, and the borrower put in a situation where they have a mortgage payment to make, but no offsetting property income to pull from. In this scenario, a lender might require an impound account to be setup to collect an amount they see appropriate after considering how long it might take to re-tenant and also the amount of concessions that new tenant might require on a new market lease. So if the lender determines (usually from the appraiser's evaluation) that it would take on average 6 months to find a new tenant for the subject property, and that market TI/LC (tenant improvement allowance concession & listing agent leasing commission) is $X.XX per square foot – that might be the additional amount the lender requires to be collected, until that tenant renews their lease or the anticipated vacancy event is realized.

Lastly, an impound account might be established for any major deferred maintenance at the property. A good example might be the property inspector noting a new roof or replaced AC units be

crucially needed within 12 months – when not held back at closing, this amount is usually impounded monthly to make sure the borrower has the funds to complete the deferred maintenance within the timeframe noted.

Loan Conditions

Loan approvals will often come with closing conditions to satisfy on the borrower's side. These may be conditions that were made known to the borrower at the beginning of the loan process when the request was quoted, but also may come at loan approval after the lender has conducted their full due diligence and maybe uncovered an issue or changed their stance on a particular factor. All loan conditions will include standard requirements such as a minimum DSCR requirement, maximum LTV, a clean title report, hazard insurance, and executed mortgage documents. However, additional requirements will be added to the standard requirements on a case-by-case basis.

Some examples of additional requirements may include decreasing vacancy below 10% prior to funding, installing carbon monoxide detectors in all units, a letter of explanation for a particular credit issue, an updated entity document filed with the state, or a holdback reserve account to be established for a major deferred maintenance issue. Loan conditions can be "prior to approval (PTA)", "prior to docs (PTD)" or "prior to funding (PTF)". Meaning the condition is required to be satisfied before it can get the next stage towards the transaction closing. Loan conditions are probably the most negotiable of all loan terms. HarborWest will leverage their lender relationships to help minimize or negotiate loan conditions to make the requirements as flexible as possible and the loan process as smooth as possible.

Commercial Loan Costs

Originating a new commercial mortgage, both purchase loans and refinance loans, have associated costs. These costs are higher than residential loan costs due to complexity and appear higher than residential loans as fees are charged upfront and itemized. While residential loans can "build in" loan fees and costs into the rate, which in turn is paid over time by the borrower through that higher rate – commercial mortgages do not typically do this. Residential loans are more streamlined than commercial and less complex on the underwriting side. Commercial appraisals for example take on average three (3) weeks to complete due to the research and analysis required on the investment property, and 2-3x more costly. In addition, lender underwriting of the property and/or business has associated costs, and loan documents can have fees if they need to be attorney reviewed or negotiated.

Most commonly, costs to an investor to originate a new commercial loan would be a 1.00% point origination fee to the lender (for example, 1.00% point on a $5,000,000 loan would be $50,000), the cost of property reports (determined by property type and lender requirements but can include appraisal, environmental, inspection, engineering and seismic analysis), and some form of processing fee that packages costs of underwriting, loan documents, legal fees and miscellaneous costs such as background checks and credit reports.

Each lender will have their own fee structure as part of their loan offer. HarborWest can help provide you with a cost comparison between each lender and offer and analyze the effective interest rate (APR) after factoring in lender costs.

Post-Close Requirements

Lenders may have requirements imposed on the borrower post-closing which may be both standard or situational. Standard post-close requirements are usually annual reporting which can include submitting an annual property rent roll, income statement, and sponsor tax returns to the lender for audit purposes. Many banks will have a portfolio manager that tracks the commercial loans they own and monitors their performance to assess any potential risk of default. Situational post-close requirements are case-by-case and are usually to satisfy loan conditions. Examples might be providing evidence of a deferred maintenance item being repaired within a timeframe, a minimum balance in an established bank account with the lender for relationship rate discounts, or quarterly vacancy reports on say a multi-tenant office building that has a history of high vacancy that concerns the lender. Post-close requirements can be for the life of the loan or cancelled upon satisfaction if it is more of a conditional item.

Borrower Qualification

Borrowers should be prepared to furnish detail and documentation on both the purchasing or vesting entity along with basic information on the key principal individuals involved in the transaction. Commercial lenders are mostly focused on the collateral property for qualification, but borrowers are still reviewed and expected to meet their minimum requirements. Strong borrowers (financially, experienced, etc.) can also help improve qualification for the most competitive programs so a review of this is important to securing best available financing.

Recourse vs. Non-Recourse

This term refers to the borrower(s) signing personal guarantees for the commercial loan. A recourse loan requires personal guarantee, while a non-recourse loan does not. However, even non-recourse loans require some level of guarantee for “bad boy” carve-outs which typically refer to criminal or fraudulent activity by the borrower causing default. A lender will determine who (or how many) guarantor(s) will be required based on the buyer profile and qualification, but typically is required of any manager (if the borrower is an entity such as an LLC) and also any person that will have 20% or more ownership. Non-recourse loans typically will anchor more on the property instead of the borrower for security or require a high equity position compared to the debt proposed. A recourse loan with qualified signers can make a loan request more attractive to a lender when dealing with more difficult properties.

Personal Financials

The personal financials of the borrowers (typically any person owning 20% or more of the purchasing entity along with all Managers) will be collected and reviewed by the lender. Lenders want to evaluate whether the individuals signing for the loan have the financial strength and wherewithal to make their mortgage payment or balloon payment should the property run into issues and no longer operate at a net income that can cover the mortgage payment. Lenders will want to see the entire picture, but the primary factors that are analyzed are liquidity, net worth, and annual income. These are considerations that show a borrower has access to other sources of capital and lower the risk of default on the loan.

A client should expect to furnish bank statements, tax returns, and complete a verified personal balance sheet. While every lender has their own policies and requirements, there are a few general guidelines in the industry: a net worth equal to or larger than the loan request, M1 liquidity to cover at minimum 12 months’ worth of principal and interest payments, and a global cash flow of 1.20x or higher. Your personal balance sheet will be pre-screened during the loan origination process and verified during underwriting. It is important to have HarborWest fully review your balance sheet prior to accepting a loan to hedge against any underwriting issues, especially since each lender will have their own guidelines and requirements.

Business Financials

Business financials are especially important on owner-user commercial real estate transactions such as an SBA loan. If the client is a business owner operating his company from the subject property, the ability to repay is dependent on the profitability and success of that company, and not on the cash flow of third-party tenants since they do not exist. Additionally, if there is only a single recourse guarantor on an investment property loan and that individual's annual income is highly or solely dependent on their owned business, those financials will also usually be evaluated.

A client should expect to provide historical business tax returns (usually the preceding 3 years and preferably CPA audited), interim financials since last tax return filing, and current business financials (i.e. income statement, balance sheet, accounts receivable/payable, debt schedule, etc.). Lenders will analyze your business financials first for ability to pay the proposed mortgage based both on current and historical operation. They will also review for positive and negative trends in the income/expense categories, growth and scale, and any potential financial issues that would impact the borrower's ability to repay. A few common examples would be a single customer being responsible for the majority of the company's sales and income, or an equipment loan interest expense that is in a discount period but will significantly increase next year for the company.

Business Outlook

This is usually only a consideration for owner-user transactions where the loan qualification is based solely on the borrower's business. Financials as described above are the primary determinant, but other considerations are also considered. A lender is not (and usually cannot) be an expert on a client's business or know their industry as well as the client, but a very high-level assessment will likely be taken to see if the lender wants to move forward. For example, a company offering outdated retail services to consumers, or a business that is anticipated to be negatively impacted by pending state regulations, might not be attractive to some lenders. In addition, if the borrower owns a company that is the sole source of income for that person, a lender might give a second thought to this before making a loan offer or defining their loan conditions.

Credit & Character

Loan qualification comes down to the lender wanting to determine to the best of their ability how likely you are to default on your new mortgage payment. While they can't predict what will happen in the future, they surely can evaluate how you've done in the past. Credit reports and background checks help accomplish this best. Commercial lenders like any other creditor want to see a history of solid repayment and a clean record. Past credit issues are not a deal killer per say, but any past instances do need to be addressed early on and might make a client ineligible for certain programs. Lenders will also want to see a clean background check for criminal record, court records and lawsuits, and many times will do a general online search of the borrower and affiliates for anything online that might be concerning or curious.

This qualification category in our opinion has the grayest area - credit and character issues are many times explainable or solvable. It's importance also differs from lender to lender, and even from decision maker to decision maker within that lending institution. Having a strong grasp for lender flexibility with these hurdles is important to securing quality financing, as many lenders take

advantage of credit impacted investors and corner them into loan programs they may not necessarily deserve. HarborWest uses our experience and relationships to solve credit and character hurdles during application to ensure you have a fair opportunity at the market's best available programs.

Sponsor Experience

With investment property financing, experience is a key factor for a lender although also another subjective factor similar to credit and character described above. In general, lenders want to see owners and investors with experience to successfully operate the subject property. That may be experience with a certain commercial sub-type, or experience in a certain market or situation stage. A longer history of experience, larger portfolio of similar properties or stronger resume of professional experience supporting the investor's case of being able to own and manage the property without the lender being concerned – the better the lender will feel, and the more aggressive they can get on loan terms. They may also evaluate your property manager if you have professional management in-place.

Many times, this can be a subjective assessment and decision and an area where the borrower and lender disagree. Lack of experience can be a deal killer many a time or can impose unwanted conditions such as requiring third-party professional management (decreasing NOI to the client) or switching management companies which can be a hassle if it cannot be waived by your mortgage broker. You will want to address this potential hurdle upfront before accepting any loan offer. Hurdles with this requirement can usually be mitigated by higher equity, professional property management requirement, or a higher yield to the lender for the risk.

Property Qualification

Commercial mortgage qualification is primarily based on the asset. This is probably the largest difference between residential and commercial lending: most of the scrutiny is focused on the property instead of the borrower. At the end of the day these are investment properties and need to stand on their own, especially if the loan is "non-recourse" without personal guarantee of the owner(s). Many times, a commercial mortgage is not held on the portfolio for the lender but instead sold to a different institution on the secondary market or participated by other lenders in order to further divide the risk or free up funds for smaller lenders to lend to other customers. Qualification for commercial financing is in a nutshell a determination of risk for the lender, and what loan terms make them feel comfortable with that risk. If the lender is not confident in the property's future performance, they will adjust their underwriting or offered terms that do make them feel comfortable.

Property Type

The asset type (multifamily, office, retail, etc.) is the first factor a lender will evaluate when looking at a new commercial loan request. Many lenders specialize in one property type(s) or another as each have their own nuances or favorability. They may also have a limited allocation for the year to lend on certain subtypes, so depending on how full each "bucket" might be a lender will have preferences and more attractive terms for different subtypes throughout the year. Economic and market factors can also affect the desirability for certain product types. A great example recently would be the shift

to e-commerce business vs. brick and mortar, or COVID-19 -- both have put a black mark on most retail and hospitality properties which have not been open or performing, and also have put tremendous scrutiny on multifamily property rental collections in states with tenant friendly eviction laws.

Property types like multifamily are more common and always a desirable asset class for most lenders. Other asset types like special purpose (churches, event centers, museums, etc.) can be very specialized to only a few select lenders that understand these industries and have available programs.

Property Location

Location, location, location. You hear it all the time. And just as it rings true to an investor, so too does it for a lender who shares ownership with you. Lenders mostly want to see properties that are in major metropolitan markets as opposed to rural areas, in areas of high traffic count and visibility, and ideally in an area with less competition or potential for future competition. Environmental concerns also factor into this if the property is neighboring to heavy industrial use or properties with tenants such as laundromats or gas stations as these can have environmental damage that trickle over to the subject property.

Location may also be important internally to the lender, depending on again their portfolio allocation, or desire to stick to markets that they know best or specialize in. If the lender is a bank, they might also have lending “footprints” where they can only finance deals if the property or borrower falls within an acceptable distance from a bank branch. A full market and location analysis will typically be performed by the Appraiser, who will provide very insightful data on the demographics, traffic count and competitive properties in the area to the Lender. While this data is considered, it is usually the lender’s experience with similar properties in their portfolio and personal familiarity with the market area that moves the needle the most. HarborWest tracks and maintains relationships with lenders that specialize in certain markets in order to provide the most competitive financing quotes to our clients.

Quality & Condition

This hurdle is usually evaluated by the inspectors that complete the on-site inspections of the property on behalf of the lender and delivers their report(s) to them for review. Many times, this is solely an appraisal, but depending on the property type/features and lender requirements, may also include an environmental report, building inspection, earthquake seismic analysis or a visit from the lender themselves. Besides the environmental concerns explained above in Property Location, the physical condition of the property can be a concern for a lender. Any health and safety issues need to be cured prior to loan funding, which may include mold in-units, deteriorating staircase steps, major roof damage, or lack or adherence to state or city building code.

The second consideration is any “deferred maintenance” which can be a subjective and negotiated item with the lender. Lenders commonly will hold back or reserve the cost for any noted deferred maintenance until cured, which can be an issue if the investor is counting on a specific predetermined loan amount offer. Common examples of this would be parking lot asphalt repairs, stucco or window repairs, and A/C unit replacements.

Besides hard line requirements, there is also simply a “curb appeal” aspect to this. Although a property’s curb appeal or attractiveness per say may not directly correlate to its condition or performance, there is still a subjective aspect to a credit decision and decision makers would prefer to have an attractive property. One instance where this isn’t usually a factor is when the property is appropriate for a bridge loan or rescue loan. It is understood by these lenders that the quality or condition of the property may be a selling point for the investor whose strategy is rehab and repositioning of the asset.

Appraised Value

The property appraisal is a very important factor in determining the final loan terms from the lender. A property appraisal will be completed by an accredited appraiser that specializes in the specific commercial subtype and usually in the same market as the subject property. The property appraisal will give the lender important information to consider including likely market value, rental rates and trends, market competition and demographics, physical assessment, and a boots on the ground inspection of tenant operations, property condition, and property management.

The appraised value many times does not agree with the owner’s estimated value or the purchase price if the financing is for an acquisition. Since an appraisal is really an educated opinion by the appraiser, an investor does not need to agree with their assessment. Perhaps the appraised value comes in lower than expected based on the appraiser’s opinion, but the investor has a different opinion and is still confident to move forward on the purchase. However, for a lender, the appraiser’s assessment always takes precedence over the investor’s opinion. Lenders will usually consider the property value to be the lower of the purchase price or appraised value. Where this becomes an issue is when evaluating the maximum loan-to-value (LTV).

For example, let’s say a multifamily property is under contract for $8,000,000 but the appraisal comes in at $7,200,000. Let’s also assume the lender has a maximum 70% LTV condition on their loan offer. Pre-appraisal the loan amount expectation was $5,600,000, and post-appraisal that loan amount would be adjusted down to $5,040,000. That lower appraisal resulted in the investor needing to bring in an additional $560,000 to close escrow -- which many times the investor may not have. To avoid this potential issue (and potential loss of investment or escrow deposits), HarborWest can help pre-determine the appraisal value using their contacts and resources and prepare standby backup options to hedge this scenario. This might include bridge loan options, a standby lender that can finance a second trust deed, or a competing option with a higher maximum LTV that is able to assume the property reports from the failed lender.

NOI & Cash Flow Ratios

Cash flow is arguably the most important factor for a lender when evaluating a commercial loan request. There are many uncontrollables to a lender once a lender funds the loan. Management could fall apart, tenants could go bankrupt and vacate their leased space, borrowers could suffer financial hardships, the property could be impacted by damage from a storm – and numerous other possibilities, all leading to the borrower’s ability to repay the mortgage being afflicted. A lender can impose loan conditions to help mitigate some of these risks to a degree, but at the end of the day the responsibility lies with the borrower and the market.

So, having security and comfort in the property's historical, current and pro-forma cash flow ratios can create huge leverage for an investor. The better the property can predictably cash flow, the more "buffer room" there is for things to go wrong. The NOI (net operating income) is the primary number all ratios are based and can be calculated differently depending on the lender and their underwriting. Meaning one lender to another likely will not have the same NOI even though they both evaluate the same property financials. Most commonly, lenders will use a DSCR (debt service coverage ratio), LTV (loan-to-value ratio) and DY (debt yield) ratio calculations to determine the cash flow strength of the loan request. These concepts are explained in a different section of this guide.

In general, a higher DSCR and DY ratio and a lower LTV ratio will make a loan request more attractive. Lenders will have their program minimum requirements but may be able to make exceptions for a deal they want or for brokerages like HarborWest that they work closely with on other loan opportunities.

Overall Tenancy

The value of a commercial property is determined based on the income of that asset. A key concept to understand for an investor is that when you purchase a commercial investment property, you are not buying a building – you are buying the cash flow which is secured by the leases and collateralized by the building. The tenancy and cash flow created from those leases are what create value. The leased value of an investment is most always greater than the physical collateral value. Strong tenancy creates good cash flow and low risk, which is attractive to both the investor and the lender.

An assessment of the tenant base will be conducted by the lender. They will consider the diversification of the tenants, the square foot allocation risk, the general strength or outlook for a tenant's industry, and any potential future legal risk a tenant may pose. Lease audits will also likely be conducted to determine the rent collections presented are accurate, and that there are no major risks hidden in the lease that could affect the current contract as understood. Other factors such as the tenant's tenure at the property, length of the lease and potential for vacancy are also considered. If the tenant, both core commercial or multifamily, has a government subsidy partner such as a city housing assistance program or are government grant sponsored, those contracts and risk of non-payment will also be considered. Should the property be a single tenant leased investment (for example, a NNN leased Starbucks), scrutiny on that tenant will be crucial as the entire property income relies on that tenant's lease. Single-tenant (NNN) considerations are explained in a different section of this eBook, but in general lenders will want to analyze the tenant's lease, financials, and credit in determining how comfortable they are with them.

Conversely, an asset class like multifamily that may have hundreds of tenants/units, will be highly diversified and not easily affected by a vacancy. Typically for multifamily, historical occupancy can help shed light on a property's operations, management, and competition in the market. Local laws that would affect an entire tenant base are also considered, such as rent control measures and eviction moratorium laws (such as during COVID-19).

Legal Considerations

The performance of the property and strength of the borrower to make their mortgage payments are determined by the above factors. Verifying all potential legal issues however are equally as important in order to allow the property to operate freely without any legal hurdles. These potential issues can affect rent collection, value and equity, and legal responsibility by the lender which can be costly. While much is unpredictable and uncontrollable, lenders will want to evaluate they feel as comfortable as they can with the following: equitable and rightful title to the property, coverage of insurance claim risk, conformation with all legal requirements including city building codes and tenant rights, a “clean slate” confirming no current legal claims to property or borrower(s), waiver of environmental risk, and a comprehensive review and completion of documents completed by both the tenant (leases, estoppels, SNDAs) and borrower (loan documents, promissory note, guaranty, legal waivers, etc.).

These considerations are usually requirements on all commercial mortgages as a condition to approval and are essentially non-negotiable items, while the other qualification factors discussed above are used to assess the risk of the deal and determine the lender’s final loan offer.

Identify Mortgage Brokerage

Shameless plug for our company and client services here – but locking in an experienced and qualified commercial mortgage brokerage is your first step to a successful loan process. While many industries these days have been subsidized by online access and technology, commercial real estate financing remains very much a relationship-driven business. Lender programs and appetites are constantly changing, and tracking these changes is more than a full-time job.

Many lenders and programs are also unavailable to the general public (life insurance companies and select private investors for example), as these lenders do not want to serve as a "call center" for loan inquiries, and only have the capacity to entertain quality loan packages from trusted sources they have experience with. Relationships also play favor to investor clients here, as a commercial mortgage brokerage can frequently negotiate more favorable loan terms based on volume origination to a lender or call in favors for exceptions to policy for a more attractive offer to the investor. Having experience in the commercial loan process is also important, as it is always more complex than a residential loan process and takes expertise to recognize opportunities or solve issues that always arise.

Most of the time, there is no additional cost to the investor for brokerage services, as the net fees are paid by the lender. Just as you would retain a CPA for tax filing or an Attorney for legal services, partnering with the right commercial mortgage brokerage is essential to obtaining the best available financing and having a seamless loan process.

Scenario Assessment

You have options. Many lenders are limited to the programs and terms they can offer investors and clients will often feel that they need to conform to these limited offers. There are a multitude of commercial lenders in the marketplace at any given time, each with their own specialization and flexibility. There truly is a best "fit" for your commercial loan request. Each investor and even each property or transaction is going to have its own unique strategy, hurdles and needs. It is crucial to have a discovery process with you as a client to determine two things: (1) what you desire and what is important to you, and (2) what challenges we might encounter during our process.

First, we want you to get everything you want in this process. While low fees and interest rates are important to all clients, each investor may have different thoughts or needs on loan terms and structure. An example might be ensuring the loan does not have a prepayment penalty if the investor intends to sell the asset in the upcoming years or negotiating with the lender to not require a personal guarantee if it's important to the client not to risk their personal assets in the event of foreclosure.

Secondly, we need to anticipate challenges, so you have a clean process. Skipping this step can cost you time, money, and legal liability especially if you are in escrow to purchase. We want to identify potential issues upfront and either cure them or review with the selected lender before accepting their offer. Examples of this might be known credit or background issues with the borrower that have not been discovered yet or reviewing potential scenarios should a large tenant be at risk of vacating or giving notice during the escrow process.

Review and Analysis

Our team will do an extensive review of both borrower and property documentation. Since each request has its own profile and challenges, the documents required and discovery questions to the client will be different. We will review your file from every angle that a commercial lender will eventually, to uncover any potential hurdles and determine the eligibility for commercial financing given your request. We will make recommendations to cure potential issues that would affect your loan application (examples: credit repair, liquidity seasoning, increasing occupancy, re-negotiating or renewing tenant leases, etc.) in order to give you a game plan to have the most attractive loan request package possible to potential lenders.

We will also run different financing analyses for you to use as a tool to determine how different leverage points or changes in rate and terms might impact your investment ROI on the property. Lastly, our team will share with you the cash flow calculations that will likely impact your request to see if we need to adjust expectations. Our hope is that whether we work together or not, this step will be informative for you as an investor and in good faith give you market knowledge you can use to improve and grow.

Broker Packaging

This step is completed internally by HarborWest. Our team will put together an organized and detailed loan request package that will be used to discuss financing with potential lending sources. The loan package will consist of property and borrower documentation provided by you along with insight, analysis and recommendation made by our company. Many of the most competitive lending sources in the market have strict requirements on loan request packages that brokerages must adhere to be considered for financing. However, every lender down to main street lenders such as community banks and credit unions appreciate an organized and detailed package. This allows for a quick and clean review on their side and developing a reputation for quality work as a brokerage is imperative to developing good lender relationships. And it’s those experiences and relationships that over time allow us to negotiate exceptions and more favorable terms for our clients.

Lender Negotiations

Once your loan package is finalized, HarborWest will start discussions with the best-in-class lenders for your request. While our company has partnered with over (275) various lenders nationwide, we typically can immediately assess after package completion which market lenders are going to be the best fit based on the desired client loan terms and the challenges that will need to be overcome. Your loan request package will be sent to a dozen or less commercial financing sources, and we begin our process of advocating for you and negotiating best available offers. This process might bring to light a new strategy or a re-discussion of the request with the borrower depending on results. We will negotiate with our funding sources for the most aggressive rates and fees, most flexible loan terms and conditions, and remain transparent with you along this process.

Our goal is to be your advocate and partner, not the gatekeeper to you securing financing. Our advantage is being able to use our access and relationships during this stage, but also being able to create a “bid environment” between lenders - resulting in lenders fighting to earn your business, instead of the other way around.

Loan Option Selection

Upon receipt of final negotiated offers from our selected lending sources, HarborWest will compile and summarize the offers onto a client-friendly spreadsheet so we can easily compare loan terms, review together to discuss strengths and weaknesses, and make a final selection on the program that is the best fit for your request. Besides determining which lender offers the most competitive financing, we can also make recommendations based on our past experiences with that lender and previous client feedback. While the loan terms are the meat of the eventual selection, having experience with that lender and their commercial loan process is also important – if they cannot perform and honor those loan terms or be flexible on issues that may arise during approval, those offered loan terms mean nothing. Loan servicing and banking relationships might also be an important factor depending on the type of transaction. While most commercial loans are transactional, customer service post-closing, annual reporting requirements, or banking relationship opportunities might also be important considerations to a borrower client.

In addition, besides a comparison of commercial loan options, HarborWest can also provide further analysis to aid in your decision-making process including: APR Analysis, Leveraged Cash-on-Cash Analysis, Amortization Forecasting, and Lease vs. Own Comparison.

Lender Due Diligence

Once you have selected your lender with our recommendations, we move into the lender's due diligence and approval process. An upfront deposit is usually required for most transactions for both good faith and also to cover the costs of property reports. Due diligence is the lengthiest portion of the loan process. Depending on the type of deal, this can range anywhere from 3 days for a bridge or private loan to over 60 days for permanent loans with institutional lenders. You will want to consult with HarborWest on estimated time frames if you have specific deadlines to meet from escrow or otherwise.

The lender will complete a thorough review of borrower and property qualification (as described in another section of this guide), including property reports and inspections, evaluation of borrower strength, and cash flow underwriting to determine if it meets lender requirements. This process likely will require additional paperwork and questions or discussions above what was compiled by HarborWest earlier in the process as underwriting proceeds. HarborWest will complete as much as possible on your behalf, and advocate for you on issues and hurdles that arise that might impact your original offer. Depending on the complexity of the property and loan, this step can be quite simple or very lengthy.

The value of working with HarborWest is two-fold -- leveraging our relationships to secure the best loan quotes and leveraging our experience to make sure this step goes smoothly. HarborWest makes sure all potential issues or hurdles are handled upfront before due diligence even starts and is proactive in providing solutions for things that will arise.

Lender Approval

After the lender has completed their due diligence, their management or committee will approve the final loan terms. Depending on the results of their due diligence, a lender may modify their original offer to conform with their cash flow ratio requirements or mitigate any new risk factors that were discovered during their due diligence. This can be very startling to a client and impact their ability or willingness to complete the transaction if the terms are no longer acceptable. This is rarely the case when working with HarborWest, as our team will identify and address any potential issues before lender selection, and if needed use our relationships and negotiation power with the lender to help ensure your initial loan terms are honored as expected.

Most of the time, a final approval term sheet will be issued and can be compared to the lender's initial offer from when the process first began (Letter of Interest, or LOI as its commonly known). However, sometimes either by lender policies or borrower requests, the approval can be divided into two stages. The first being a "credit approval" whereas the lender approves the loan based on personal or business qualification and is contingent on property qualification and "property to final approval". This is usually done to the benefit of the borrower since property reports are not ordered until credit approval is received, which protects the borrower from losing the cost of the reports if credit would not be approved. A tight escrow time frame might prohibit this option, and force the property reports to be ordered upfront and processed simultaneously with credit underwriting.

Condition Satisfaction

Loan approvals always come with condition to funding. All lenders will require the basic requirements to a transaction including verifying and updating property insurance, proper title insurance, executed loan documents from the borrower(s) and coordination with the escrow provider to coordinate the closing and recording of the lien(s) and other standardized requirements. Beyond this however, a lender may impose new requirements on the client not addressed in the due diligence phase. This might be as simple as a copy of recent bank statements to update now outdated documents, or as laborious as curing a tenant or property inspection issue prior to funding, which can be troublesome should a buyer be under strict escrow deadlines.

The ability to request some items to be completed post-closing or be waived can be extremely valuable to protect a client's transaction. HarborWest is able to minimize loan conditions with the lender during the approval process and request certain conditions to be "post-closing" if any particular condition would hold up a deal and prevent the client from closing escrow.

Post-Closing & Servicing

Upon loan closing, you will be provided with copies of all important documents related to your transaction (we also retain a copy), including executed loan documents, escrow documents, hazard and title insurance policies, property reports such as appraisals and physical or environmental inspections, and all submission items included in your loan submission package. You will be given instructions on your first payment, loan servicing contact information, and a calendar of important dates related to your new mortgage including any dates of interest rate adjustment or deadlines to complete repair items post-closing if required. The lender will provide instructions for loan servicing

either with them internally or with a third-party servicer and be in contact with you for annual reporting if that is part of their policy and requirements.

Our services to our clients are life-long and not strictly transactional – as such, the HarborWest team remains at service to you should you have any questions post-closing or need advice and further assistance during the life of the loan with your new lender, as a thank you for your business and new partnership with HarborWest.

Documentation Required

Each commercial loan request is unique and will require different documentation in order to process your loan application. Below is a list of documentation you will want to start preparing although some items might not be applicable. Some documentation is required upfront in order to apply for commercial loan options, while others won't be required until lender underwriting HarborWest will provide a more defined needs list to you after an introductory discussion with you and can also provide template forms if needed.

Property Related

- Current Property Rent Roll
- Historical Income/Expense Statements
- List of Recent Capital Improvements
- Copy of the Purchase Contract or Closing Statement
- Copies of Tenant Leases and/or Lease Abstracts
- Any Past Property Reports (if Available)
- Current Mortgage Statement (if Refinance)
- Property Tax Statement/Bill
- Property Manager's Contract & Resume
- Property Insurance Policy & Premium

Borrower Related

- Vesting Map (Breakdown of Ownership)
- Entity Documentation (if LLC, Corporation, etc.)
- Personal Financial Statement
- Schedule of Real Estate Owned
- Federal Tax Returns, Personal & Business (2-3 Years)
- Business Interim Financials (if Owner-User)
- General Resume and/or Real Estate Investor Resume
- Recent Credit Report (if Available)
- Letter of Explanation for Any Credit or Character Issues
- Bank Statements (2-3 Months)

ABOUT THE AUTHOR

Colin Dubel is the lead commercial mortgage advisor and President of HarborWest Commercial Lending. He is responsible for the development of new and existing lender relationships and is the primary point of contact for new clients. He is also responsible for overseeing his team during loan underwriting, processing, and closing.

Prior to forming HarborWest Commercial Lending, Colin was Associate Director of Charter Capital Group where he arranged financing nationwide for commercial and multifamily properties. He also held positions in asset management for Irvine Company, and at CBRE in both their market research and financial consulting groups for the Western Region.

Colin graduated from the Business Economics program at UC Irvine where he developed the undergraduate real estate group for the university. He is a licensed and experienced real estate broker in California (#01907126) and an active member of the commercial real estate finance community including the National Association of Industrial and Office Properties (NAIOP) and California Mortgage Bankers Association (CMBA). He is currently a CCIM member pursuing the Certified Commercial Investment Member (CCIM) designation.

CONTACT US – COLIN DUBEL

EMAIL: colin@harborwestcommercial.com
MOBILE/TEXT: (949) 735 - 6415

ABOUT HARBORWEST

HarborWest Commercial Lending is a nationwide commercial mortgage brokerage and advisory firm based in Southern California. We represent commercial real estate owners, investors and business owners in the capital markets to arrange financing for their investment properties. Our team maintains long-standing relationships with over 275 commercial lending sources and leverages these relationships to ensure our clients are connected with the most competitive market financing available. Clients also benefit from our team’s experience in quarterbacking the underwriting and loan processing stages to help ensure a smooth and successful funding.

Our company was formed in 2017 by our President, Colin Dubel. After a successful early career at larger commercial real estate firms, Colin wanted to develop a company to fill a large gap in the commercial lending industry. What he found during his tenure was that the higher quality commercial mortgage companies catered solely to large corporations and their transactions. Individual investors and family offices were being cornered into less competitive options from scattered sources and were not being treated as valued clients.

Colin started HarborWest to bring quality work and top lender access typically reserves for larger corporations, to the middle-market investor. Our team prides itself on providing the absolute best loan product and customer service to our loyal clients. We look forward to showing you why our company is #1 as rated by Google Business reviews.

30/360 An interest rate accrual method in which the interest calculation assumes that all 12 months of a calendar year have 30 days and uses a 360-day year. An Actual/360 interest calculation charges interest for all 365 calendar days using a 360-day year. Therefore, borrowers pay 5 days less interest than under Actual/360.

Acceleration Clause The acceleration clause is the section in a mortgage that says if the borrower sells the property or places a second mortgage / mezzanine loan on the property that the bank can immediately demand to be paid in full.

ACH Stands for Automated Clearing House. Refers to Auto-Pay for a commercial mortgage for loan servicing.

Actual 360 An interest rate accrual method in which interest calculation charges interest for all 365 calendar days using a 360-day year. A 30/360 interest calculation assumes that all 12 months of a calendar year have 30 days and uses a 360-day year. Therefore, borrowers pay 5 days more interest than under 30/360.

Actual 365 An interest accrual method in which the annual interest will be divided by a 365 day year, and the interest for each interest period will be the interest for the actual number of days in that period. The number of days in the year for periodic calculation is usually one of three choices: 1) actual days in the year (365 or 366 for leap years), 2) always 365 days, or 3) always 360 days (based on 12 x 30-day months). Each interest basis reflects a choice for computing the number of days in the interest period and the number of days in the year in which interest is paid.

Actual/Actual An interest accrual method in which the annual interest will be divided by a 365-day year, and the interest for each interest period will be the interest for the actual number of days in that period.

Adjustable-Rate Mortgage (ARM) Mortgage for which the interest rate adjusts periodically up or down through a set index. The initial interest rate usually is lower than that for fixed-rate mortgages, but monthly payments can go up or down when the rate is adjusted. Also called a floating rate mortgage.

ADS Stands for Annual Debt Service. This is the principal and interest total payment made for the first 12 months of the loan. Typically used to calculate the DSCR by using the ADS and the NOI amount.

Agency Refers to government-sponsored entities (GSEs) such as Fannie Mae, Freddie Mac and the SBA.

Allowance Permission to prepay a certain percentage of a commercial loan every year without triggering the prepayment penalty. Typically, a loan will have an allowance of up to 20% before the prepayment penalty takes affect.

Amortization The period over which principal and interest payments are scheduled. A fully amortized loan would have a $0 balance at the end of the amortization period. A partially amortized loan will have a balance due (balloon payment) at the end of the term.

APR (Annual Percentage Rate) The effective interest rate a loan would have if one accounted for costs associated with securing the loan, such as closing costs and points. It represents the annual cost of a loan and is thus a more reliable indicator for comparing different mortgage options.

Assumable Loan A loan that can be transferred to a new owner when a property is sold. The loan terms including the amount, rate and conditions typically remain the same. The new owner also needs to qualify with the lender.

Assumption Fee A fee paid by the borrower to the lender for the paperwork and processing of records necessary to approve and document a new debtor. Applicable on an assumable loan as described above.

Bad Boys This is the same as Carve Outs and together referred to as the bad boy carve outs which is an exception provision in a non-recourse loan whereby the lender preserves the right to still seek damages for its losses. Non-recourse lenders will frequently create carve outs for fraud and toxic contamination. If you defraud the lender or fail to disclose toxic contamination, the lender will therefore still be able to come back after you for its losses.

Balloon Payment The balance due at the end of the loan term or maturity. This is common on a loan that is not fully amortized. For example, a loan with a 10-year loan term but a 25-year amortization will not have the loan completely paid down when the loan is due at the end of 10 years. That remaining balance is satisfied by a balloon payment.
.

Basis Point 1/100th of 1% (0.01%), typically stated as a number of basis points over an index rate. For example, a rate difference between 3.00% and 3.50% would be fifty (50) basis points. Typically used when referencing interest rates and loan points.

Blanket Loan Refers to a mortgage that covers more than one parcel of real estate owned by the mortgagor.

Borrower The individual or entity that is the primary repayor of the subject property mortgage. The borrower is responsible for making all payments and fees associated with the loan over the life of the loan. Legal mortgagor.

B-Piece Buyer The B-piece buyer is the buyer of the mortgage-backed bonds rated lower than BBB by Standard & Poors. The B-piece is often called the first loss piece, and it is by far the riskiest investment in the offering. B-piece buyers enjoy a lot of power because without someone to buy the first loss piece, the offering will fail. They therefore enjoy very high yields.

Bridge Loan Short-term mortgage financing that is in place between the termination of one loan and the beginning of another loan. Also, a form of interim loan, generally made between a short-term loan and a permanent (long term) loan, when the borrower needs to have more time before taking the long-term financing.

Bullet Also known at the Maturity or the Term. Refers to the period of time in which the debt must be paid off.

Buydown The process of paying additional points on a loan to reduce the interest rate. Buydowns can be temporary or permanent.

Cap The maximum amount that the interest rate or payment may increase for an adjustable-rate loan, regardless of index changes. An interest rate cap limits the amount the interest rate can change, while a payment cap limits the increase in monthly payment to a specific dollar amount.

Combined LTV The ratio between the loan amounts of all loans on a property and the value of the property. The ratio is commonly expressed as the percentage of value a lender is willing to finance. It differs from the loan-to-value (LTV) ratio only when the property has more than one lien.

CapEx An expense line item that includes expenses for anticipated capital expenditures required to maintain a building and future capital improvements of major building systems (e.g. HVAC, parking lot, carpets, roof, etc.). CapEx stands for Capital Expenditures but is also known as Replacement Reserves. CapEx is important to identify in an income statement because the expense in non-recurring and can affect calculations and value if not excluded.

Capital Stack The capital stack is the sum of the first mortgage plus any second mortgage plus any mezzanine loans plus any preferred equity plus the buyer's down payment or the developer's equity contribution. It is the breakdown of debt and equity on the property.

Carve-Out An exception provision in a non-recourse loan whereby the lender preserves the right to still seek damages for its losses. Non-recourse lenders will frequently create carve outs for fraud and toxic contamination. If you defraud the lender or fail to disclose toxic contamination, the lender will therefore still be able to come back after you for its losses.

Cash on Cash Also known as the cash yield. The basic formula is the annual before tax cash flow / total cash invested. This is the best way to determine the investor yield when using leverage.

Conduit The financial intermediary that sponsors the conduit between the lender(s) originating loans and the ultimate investor. The conduit makes or purchases loans from third party correspondents under standardized terms, underwriting and documents and then, when sufficient volume has been obtained, pools the loans for sale to investors in the CMBS market.

Conventional Loan A mortgage not obtained under a government insured program (such as FNMA or SBA).

Correspondent A lender, servicer or broker approved to exclusively originate a loan for another funding lender.

Credit Tenant Lease A credit tenant lease is a long-term lease on a triple-net (NNN) basis to an investment grade company - a company with a credit rating from Standard and Poor's of BBB or better. A commercial building leased on a long-term, NNN basis to CVS Pharmacy is an example of a credit tenant lease.

Crowdfunding Crowdfunding is the practice of funding a project or venture by raising many small amounts of money from a large number of people, typically via the Internet. The difference between peer-to-peer lending and crowdfunding is that P2P lending typically involves small loan amounts ($5,000 to $50,000), and just one investor lends the entire loan amount. Crowdfunding can sometimes involve much larger amounts, where lots of different investors chip in a little bit to make the loan or the equity investment.

Debt Service Coverage Ratio The Debt Service Coverage Ratio is defined as the Net Operating Income of the proposed project, as projected by the appraiser, divided by the annual principal and interest payments on the proposed takeout loan. Debt Service Coverage Ratio = Net Operating Income / Proposed Annual Payment on the Takeout Loan. The Debt Service Coverage Ratio is customarily expressed to two digits, such as 1.17 or 1.32. The Debt Service Coverage Ratio must usually exceed 1.25. In other words, the projected Net Operating Income, as determined by the independent appraiser selected by the bank, must be at least 125% of the annual principal and interest payment on the proposed takeout loan.

Debt Yield Ratio The Debt Yield Ratio is defined as the Net Operating Income (NOI) divided by the first mortgage debt (loan) amount, times 100%. For example, let's say that a commercial property has a NOI of $437,000 per year, and some conduit lender has been asked to make a new first mortgage loan in the amount of $6,000,000. Four-hundred thirty-seven thousand dollars divided by $6,000,000 is .073. Multiplied by 100% produces a Debt Yield Ratio of 7.3%. What this means is that the conduit lender would enjoy a 7.3% cash-on-cash return on its money if it foreclosed on the commercial property on Day One.

Deed of Trust An instrument used in many states in place of a mortgage. Property is transferred to a trustee by the borrower, in favor of the lender and re-conveyed upon payment in full.

Deed of Reconveyance When a borrower has paid in full on a mortgage, the lender then awards the borrower a deed of reconveyance. This document also becomes a part of public record. Also known as reconveyance deed and recon.

Default The failure to perform an obligation as agreed in a contract.

Defeasance Defeasance is the substitution of government securities for the property as collateral. A Borrower desiring to obtain a release of its property from the trust may purchase and pledge to the trust a collection of government securities that are specifically selected to generate sufficient cash to make all monthly payments due on the loan through and including any balloon payment due on the maturity date. Defeasance is not prepayment. Technically the note remains outstanding but is repaid from cash flow from the government securities purchased rather than through cash flow generated by a property. The property is released to the Borrower free from the mortgage lien.

Deficiency Judgement A court order to pay the balance owed on a loan if the proceeds from the sale of the security are insufficient to pay off the loan. Deficiency judgments are not allowed in all states.

Delinquency A loan payment that is overdue but within the period allowed before actual default is declared.

Due Diligence The process of investigation, performed by investors, into the details of a potential investment, such as an examination of operations and management and the verification of material facts.

Due-on-Sale Clause A provision in a mortgage or deed of trust that allows the lender to demand immediate payment of the balance of the mortgage if the borrower sells the home.

End Loan A permanent loan that is used specifically to pay off a construction loan. End loans are more commonly known as takeout loans. All takeout loans are permanent loans, but not all permanent loans are takeout loans. For example, a refinance used to pull equity out of a property would be a permanent loan but not a takeout loan.

Equity The difference between the property value less the total debt liens on the property. This is the net value of the property to the owner.

Exit Fee A fee owed to a commercial real estate lender when a loan is paid off. This is usually presented as a point fee and is more common on bridge and private loans. An origination fee or loan point usually collected upfront at the origination of the loan might be pushed to the back end or exit when the loan is paid off.

Foreclosure The process by which a lender takes back a property on which the mortgagee had defaulted. A servicer may take over a property from a borrower on behalf of a lender. A property usually goes into the process of foreclosure if payments are no more than 90 days past due.

Forward Commitment A written promise from a lender to provide a loan at a future time.

Good Faith Deposit The upfront deposit from the Borrower to the Lender to begin the loan underwriting process. The amount is determined by the Lender and usually covers the property reports and an overage. This is usually separate from a Rate Lock Deposit.

Guarantor Also known as a sponsor. A guarantor is someone who signs personally for a commercial loan. Usually Borrowers that are entities will have their managers and majority partners sign as Guarantors for the loan.

GSE Stands for government-sponsored entity and includes lenders such as Fannie Mae, Freddie Mac and the SBA. Also more commonly referred to as Agency lenders.

Hard Money Usually short-term loans designed for properties that do not cash flow, situations requiring quick closings, or borrowers or transactions that cannot qualify for conventional financing.

Hybrid Loan A part fixed rate loan and part adjustable-rate loan. Most commercial real estate loans are hybrid loans and have a fixed rate for the first portion of the loan, followed by a period of adjustable rate.

Impounds Impounds are additional mortgage payment collections above and beyond the principal and interest payment collections. A lender may “impound” for property taxes, insurance, tenant improvements, leasing commissions or deferred maintenance among other things.

Interest Accrual Method (UI) The method by which interest is calculated through the loan term; options include Actual 360, Annual 365, 30/360, and Actual/Actual.

Interim Financials This refers to the most recent year of business financials that are not reported yet on a tax return.

Index A published interest rate, such as the Prime Rate, LIBOR, Treasury Bill / Treasury Note rate, 11th District COFI, etc. Lenders use indexes to establish interest rates charged on mortgages or to compare investment returns. A final note rate typically includes an Index Yield plus a Spread.

Interest Rate The sum charged for borrowing money, expressed as a percentage.

Investment Grade An investment is considered investment grade if it is rated BBB or better by Standard & Poors.

Junior Debt A mortgage that is subordinate to the claims of a prior lien or mortgage; a second mortgage.

Leverage Using someone else's money to purchase a property. Refers to the ability to use the investment as collateral for a loan.

Lien A legal claim or attachment against property as security for payment of an obligation.

LIBOR The short-term rate at which banks will lend to each other in London. Commonly used as a benchmark for adjustable-rate loans. Stands for London Inter Bank Offering Rate. This is a common index used for commercial real estate loans.

Loan Documents Documents prepared by a lender in conjunction with granting the loan to the borrower; may include a promissory note, deed of trust, and required loan disclosure documentation.

Loan-to-Cost Ratio The most important ratio in commercial construction loan underwriting is, by far, the Loan-To-Cost Ratio. The Loan-to-Cost Ratio is the construction loan amount divided by the total cost of the project, the result being multiplied by 100%. Loan-To-Cost Ratio = (Construction Loan Amount / Total Project Cost) x 100%.

Lockbox Provision The trustee is given control over the gross revenues of the underlying properties in a CMBS. Property owners only have claim to cash flows net of expenses. Expenses include debt service, taxes, insurance, and other operating expenses. The lender ensures they are repaid first before owners get their distributions.

Lock Out Clause A provision in a mortgage or deed of trust that prohibits early prepayments. This can vary lender to lender, but in the case where it is considered it is usually only for the first few years of the loan.

LOI Stands for Letter of Interest. Also referred to as a Term Sheet or Letter of Expression among others. An LOI is a summary of loan terms that a lender is proposing to the Borrower before the underwriting process commences.

LTV The Loan-to-Value Ratio is defined as the Loan Amount / Value. A $5,000,000 loan request on a $10,000,000 property value would be a 50% LTV.

Maturity Refers to the period in which the debt must be paid off. Also known as a loan term or bullet.

Margin The amount that is added to an index rate to determine the total interest rate for an adjustable-rate mortgage. The margin may also be known as the spread.

Mezzanine Loan A mezzanine loan is similar to second mortgages, except a mezzanine loan is secured by the stock of the corporation that owns the property, as opposed to the real estate. Because stock is personal property and not real property, a lender can foreclose on a mezzanine loan faster than the real estate. It is a loan on equity instead of debt like a commercial mortgage.

Mini-Perm Mini-perms are short term commercial first mortgages, typically made by commercial banks at interest rates that are much lower than those offered by bridge lenders. Mini perms are most often created as part of a construction loan request.

Mortgagee The lender in a mortgage transaction.

Mortgagor The borrower in a mortgage transaction who pledges property as a security for a debt.

Mortgage Broker the entity that acts as a go-between between an investor/landlord and mortgage lender, handling the loan origination and the processing of the loan. A broker does not make direct loans to buyers but works to find the best deal and finally collects fees as part of the mortgage process.

Multifamily This refers to a residential property that has 5-units or more. When a property has 5 residential units and above it is considered and underwritten as a commercial property. A property with 1-4 units is considered residential property.

NOI Stands for Net Operating Income. The total income less operating expenses, adjustments, etc., but before mortgage payments, and non-recurring expenses such as capital improvements, tenant improvements and leasing commissions.

Non-Recourse A mortgage in which the lender will not pursue personal liability against the borrower. The lender's security is the real estate being financed. Usually subject to standard carveouts including fraud and misrepresentation.

Notice of Default To initiate a non-judicial foreclosure proceeding involving a public sale of the real property securing the deed of trust, the trustee under the deed of trust records a Notice of Default and Election to Sell the real property collateral in the public records.

Note This refers to the Promissory Note which is part of the loan documents to borrowers and outlines the rates and terms of the commercial loan.

Origination Fee A fee calculated as a small percentage of the value of the loan, charged by a mortgage lender or broker for processing the loan. Usually calculated in loan points. A 1% origination fee (1 point) of a $5,000,000 loan would be $50,000.

Owner-User This refers to a commercial real estate property that is both owned by the Borrower and whose tenant is owned by the Borrower. Owner-user properties are business real estate for business owners.

PAR No loan origination points charged. This sometimes can be done in exchange for a higher interest rate.

Partial Recourse A combination of recourse and non-recourse conditions in a loan.

Permanent Loan A permanent loan is a first mortgage on a commercial property that has a common commercial loan structure usually of a 5-year fixed rate or longer and a 25-year amortization or longer. Usually termed to distinguish from a short-term loan such as a bridge loan or construction loan.

PFS Personal Financial Statement. This form provides a summary of a Borrower’s assets and liabilities.

Phase I An assessment and report prepared by a professional environmental consultant which reviews the property - both land and improvements - to ascertain the presence or potential presence of environmental hazards at the property such as underground water contamination, PCB’s, abandoned disposal of paints and other chemicals, asbestos and a wide range of other potentially damaging materials. This Phase I Environmental Site Assessment ("ESA") provides a review and makes a recommendation as to whether further investigation is warranted (a Phase II Environmental Site Assessment). This latter report would confirm or disavow the presence of an environmental hazard and, should one be found, will recommend additional review and/or mitigation efforts that should be undertaken.

PITI Stands for principal, interest, taxes and insurance. This would be the four components of a mortgage payment if it was an amortized loan with impounds.

Points Points are a one-time charge assessed at closing by the lender or broker for loan origination. One point equals 100 basis points, or 1% of the loan. Referred to as a "par loan" if no points are charged by the lender.

Portfolio Loan A commercial real estate loan that the lender has no intention of ever selling off. The loan would stay within the real estate portfolio of the lender.

Prepayment Penalty A fee penalty charged to a borrower who makes a prepayment on a commercial loan both partial or in full. The three most common forms of prepayment penalty are "yield maintenance," "defeasance," and "stepdown” or “declining percentage”.

Prime Rate The interest rate that commercial banks charge their most creditworthy borrowers, such as large corporations. This is a popular index for commercial real estate loans most commonly SBA loans.

Principal The amount of debt, not including interest, left on a loan. Principal is the face amount of a loan.

Promissory Note Also known shorthand as the Note. It is part of the loan documents to borrowers and outlines the rates and terms of the commercial loan.

PTA Prior to Approval. Refers to a loan condition and when it is required to be addressed.

PTD Prior to Documents. Refers to a loan condition and when it is required to be addressed.

PTF Prior to Funding. Refers to a loan condition and when it is required to be addressed.

Recourse A type of mortgage loan in which the lender's remedies in the event of borrower default are unlimited, extending beyond the property to the borrower's personal assets.

REIT A real estate investment trust, sort of like a mutual fund that buys and operates commercial buildings. REIT's are exempt from Federal income taxes, as long as they pass 90% of their earnings through to their shareholders.

Rent Roll A Rent Roll is a tenancy list that summarized the leases. A Rent Roll may include unit numbers, tenant names, lease start, lease end, current rent charge, market rent change, and any special notes or considerations that would be on a lease abstract.

Securitization The process of turning a pool of mortgages into bonds that can easily be traded in the organized securities market.

Senior Loan This is a commercial loan that is in first lien position. The primary loan on a property above and secondary financing.

Servicer Institution acting for the benefit of the certificate holders in the administration and servicing of mortgage loans in the CMBS. Functions include reporting to the Trustee, collecting payments from borrowers, advancing funds for delinquent loans, negotiating workouts or restructures (as permitted by the PSA), taking defaulted loans through the foreclosure process, and liquidating defaulted loans and REO.

Single Asset Entity This is a commercial real estate ownership entity whose only asset is the subject property and whose only debt is the subject property mortgage. No other assets or liabilities encumber the entity.

Small Balance A term that usually refers to loans that are under $5,000,000. However, it is a term used loosely and may be a different amount considered depending on the lender or person you are speaking to.

Sponsor Also known as the Guarantor. A sponsor is someone who signs personally for a commercial loan. Usually Borrowers that are entities will have their managers and majority partners sign as Sponsors for the loan.

Spread Also known as the Margin. The amount that is added to an index rate to determine the total interest rate for an adjustable-rate mortgage.

Sizing Refers to a lender or broker analyzing the 3 most common loan calculations: the Loan-to-Value Ratio, Debt Service Coverage Ratio, and Debt Yield Ratio.

SREO Schedule of Real Estate. A form that provides details of the real estate owned by a Guarantor.

Stabilized Refers to a commercial property being 100% occupied at or near market rent levels. Stabilized means the property has reached its potential and is collecting the likely maximum potential rent.

Stepdown Refers to a stepdown prepayment penalty or a declining percentage prepayment penalty. The prepayment penalty for the loan declines or “steps down” every year that passes into the life of the loan. A 5-4-3-2-1-0% structure would start with the first year penalty at 5% and decline until the penalty expires to 0% in the fifth year.

Subordination Clause A clause in which the holder of a mortgage permits a subsequent mortgage to take priority. Subordination is the act of yielding priority. This clause provides that if a prior mortgage is paid off or renewed, the junior mortgage will continue in its subordinate position and will not automatically become a higher or first mortgage.

SWAP Refers to a SWAP contract interest rate structure explained in more detail in this guide.

Takeout Loan A takeout loan refers to the permanent loan that pays off a construction loan. A developer is “taking out” the construction loan with a long-term loan.

Term The length of a loan. Also known as Maturity or the Bullet.

Third Party Reports Reports from third part professionals such as appraisals, environmental reports, title reports, structural engineering reports, surveys, etc.

TI/LC Stands for reserves for tenant improvement and leasing commission replacement reserves (TILC). Tenant Improvements refers to the expense to physically improve the property to attract new tenants to new or vacated space which may include new improvements or remodeling. May be paid by tenant, lessor, or both. Typically, tenants are provided with a market rate TI allowance ($/sq. ft.) that the owner will contribute towards improvements. The tenant must pay for amounts above the TI allowance desired by the tenant. A Leasing Commission is an amount, usually a percentage of the total lease transaction, earned by a real estate broker or leasing agent for his services.

Combined, the annual projected cost of tenant improvements and leasing commissions (TILC's) are deducted from the net operating income prior to determining the net cash flow available for debt service coverage.

Trailing 12 The income & expense of a commercial property from only the 12 months preceding the month of the analysis. This would arguably be the most accurate reflection of the property's operations as it the most recent annual data available.

Tranche A tranche is slice of the yield of a mortgage-backed security. There are always various (6-12) tranches in a securitized offering. The buyers (investors) of the lower tranches enjoy lower yields, but they enjoy priority of payment if problems develop within the pool of underlying loans.

Underwriting The process of a Lender of deciding whether to make a loan to the Borrower and at what final terms.

Yield Maintenance A prepayment premium that allows lenders to attain the same yield as if the borrower made all scheduled mortgage payments until maturity. The lender collects a lump sum from the borrower based on a formula that considers the present value of the difference between the prepaid loan's interest rate and current rates with a similar maturity date.