

Advanced Real Estate Seminar

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Agenda

- Capacity Ratios (Cash Flow)
- Carry Costs and Flipping
- Residential Properties
- Commercial Properties
- Commercial Appraisals
- Commercial Inspections
- Environmental
- Making an Offer (Commercial Property)



Capacity - Cash Flow

- GDS/TDS – Residential (<5 plex)
 - Most A+ Lenders Look For 32/40, some alternative lenders will go 40/50 but you will pay higher interest rates and premiums
 - Gross Debt Service Ratio (Mortgage + Heat + ½ Condo Fees + Taxes)
 - Total Debt Service Ratio (GDS + monthly payments on all your debts, including car payments)
- Debt Service Ratio – Commercial (> 4plex)
 - 1.2 Earnings Coverage (debt service ability)
 - Minimum 600 Beacon score
 - Up to 85% LTV on Multiplexes, some lenders don't allow 2nds and VTB
 - Up to \$25mm, some lenders don't go below 1mm



Carrying Costs

- Most flippers underestimate the carrying costs of the loans on a project. It is not unusual to have 2 or 3 different lenders (including the VTB).
- Carrying cost for 2nds and privates can quickly eat up the profit in a flip and can make you less competitive when bidding on a project.
- Experience counts, lenders like to see that your projects come in on time and within budget. Prepare a flipper's resume.
- Quick flip in residential is usually less than 1 year.
- Quick flip in commercial is usually less than 3 years.



Residential Properties

- All lenders consider a 4 plex a residential property and therefore use your income + a rental offset and your credit to determine if you get a loan.
- Non-owner occupied properties are considered higher risk by the lenders and therefore charge higher interest rates.
- When you lose a tenant in a rental property, 3 months of vacancy can kill you if you don't have a reserve. Lenders know that you can walk away from a rental easier than your personal residence.
- Rental offset varies based on lender and 80% is usual. Some will go as high as 95% depending on location of property.
- Not all rental properties in Ontario are regulated. Check out <http://www.cmhc-schl.gc.ca/en/co/reho/index.cfm> for a free guide on renting.
- Lenders don't like to lend on properties that could be on the market more than 180 days if foreclosed. So most rural properties need special lenders.
- Some lenders don't like to lend on multiple properties (more than 3 or 4) to minimize their risk.



Commercial Properties

- Lenders use the cash flow of the property to determine the loan amount. Net operating cash flow must be 1.2 times the debt service.
- Lenders use automatic minimum carve outs when determining the cash flow. For example, 5% for maintenance, 5% vacancy, 5% management fee (even if the property is self managed).
- Location of the property is key to getting the best interest rates. Some lenders avoid high vacancy, run down, and problem areas.
- CMHC provide insurance on multi unit residential properties for LTV to 85%. This enables some purchases to happen without secondary financing.
- Vendor take back for 1st and 2nd mortgages are common in commercial sales. Real estate agents that are trained in commercial properties are not afraid of alternative or creative lenders on one property.
- Distressed properties that do not cash flow are extremely difficult to get loans for. Owner financing is usually required.
- Most lenders will require an appraisal, environmental and inspection before making a loan. Its not unusual for this to take 1-2 months to complete.
- All institutional lenders specialize in specific types of commercial properties and can be pretty selective. For example, gas stations, trailer parks, and garages are hard to finance at lower rates.
- It is not uncommon for mortgage brokers and lenders to charge you lending fees. Always ask what the upfront and closing fees will be.



Commercial Appraisals

- Residential properties are appraised based on comparables and can cost you \$200-300.
- Commercial properties are appraised based on the lesser of a) comparables, b) net operating income, and c) replacement cost. Make sure you shop around for an appraiser who is familiar with the area. All lenders have an approved appraiser list.
 - a) They use similar properties in the area that have sold in the past to estimate the current value.
 - b) They use the net operating income and an average cap rate for the area to determine the current value. The average cap rate can be a highly judgemental value influenced by a lot of factors including location, knowledge of area, and appraisal company guidelines. This is usually the lowest price.
 - c) They try to estimate the cost of rebuilding a similar property from scratch using current building guidelines. It is very rare for this amount to be the lowest amount.
- Commercial appraisals can take 2 weeks or more to complete, and expect the appraiser to spend 1 day or more on site. They may require access to every unit.
- Commercial appraisals start at \$1,000 and the sky's the limit. The bigger the property, then the higher the cost.
- A lender and CMHC will use the appraised amount to lend, which could be less than the purchase price. Be prepared to scramble for more down payment cash than expected in this case.



Cap Rates

- Capitalization Rate or Cap Rate is calculated by taking the NOI (net operating income) divided by purchase price.
 - For example noi of 80,000 on a property being sold for 1,000,000 gives you a cap rate of 8%.
- By itself the cap rate means the rate of return if you paid cash for the property.
- Does a higher cap rates mean that the property is cheap relative to noi?
- To determine if a property is cheap it must be compared with the cap rates of similar properties in the same area.
 - For example Toronto cap rates regularly go as low as 3-4% while Windsor is regularly 13%
 - Market conditions
 - Unemployment
 - Vacancy Rates
 - Quality of Tenants and leases
- A property with a low cap rate in a high cap area may be overpriced
- A property with a high cap rate in a low cap rate area may have something really wrong with it.



Commercial Inspections

- Commercial inspections can take 2 weeks to prepare a report and cost a minimum of \$2,000.
- Roof, key systems (boilers, security, etc), and structure (foundation, walls, etc.) are the most important items checked.
- Fire retrofit may not be complete, and the city can make you bring the building up to code on sale.
- I usually do a walk through with a commercial contractor first, to keep costs to a minimum.



Environmental

- Depending on the type of property a lender may request a Phase 1, or Phase 2 Environmental study. A typical phase 1 study takes a minimum of 10 business days.
- Gas stations, garages, and certain types of properties almost always require a Phase 2.
- Phase 1 can cost a minimum of \$2,000 and a Phase 2 can cost a minimum of \$14,000.
- Phase 1
 - Records review
 - Site history and land use review
 - Potential for contamination
 - Survey required
 - Visual site assessment
 - Review for asbestos, pcb, insulation
 - No sampling or testing at this stage
 - Interviews
 - On site and government reviews
 - Estimates for removal and further testing if required
- Phase 2
 - Lab testing and bore samples are usually taken
 - Infrastructure for future testing installed if need



Offers

- Sample conditions in a commercial offer. It is not unusual for a commercial deal to have 2 months of due diligence.
 - Financing
 - Solicitor review
 - Inspection
 - Environmental
 - Cooperation from seller to provide any paperwork requested
 - No condemnation proceedings
 - No litigation pending unless disclosed
 - No environmental proceeding
 - Full and accurate disclosure of all items
 - Liens, work orders, violations disclosed
 - Contracts and leases
 - No new contracts or leases without buyer permission
 - All current work to be completed on closing
 - Existing survey at cost to seller
 - Seller to maintain property until closing in the same way as they have to date
 - Contracts to be assumed by buyer
 - That the seller can transfer all existing utilities and contracts to buyer



Thank - you

- Please email us with feedback @
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