

# Nonrecourse 100 Percent Loan-to-Cost Funding Emerges

Sovereign wealth funds and hedge funds offer abundant financing opportunities

By Milton Franklin

A significant development in the U.S. commercial real estate market is the increasing investment from international sovereign wealth funds. These funds provide enormous amounts of investment money because they invest capital from their home countries' natural-resources revenues and other social programs that yield billions of dollars to their respective economies. They have also helped to bring about a particularly desirable commercial real estate financing concept: the nonrecourse 100 percent loan-to-cost (LTC) scenario.

This type of financing offers a great deal of potential to mortgage originators and their clients, helped by the fact that some U.S. hedge funds are now also offering nonrecourse 100 percent LTC. A notable difference is that the sovereign wealth funds tend to offer it on transactions from \$20 million to \$10 billion per project, while the hedge funds generally limit their funding from \$10 million to \$40 million per project.

## Investment-fund types

A sovereign wealth fund is an investment fund managed by a government agency on behalf of a nation or sovereign state. Most of these funds have been created by resource-rich, exporting countries to diversify their total revenue base, hedge export revenues and accumulate savings for future generations.

These sovereign funds generally invest globally in any asset class, including stocks, bonds, commodities, currencies and real estate. From 2007 to 2013, their U.S. investment

totals have grown nearly 80 percent, from about \$3.3 trillion to more than \$5.9 trillion. This large amount of capital provides them with a great deal of power in the world's financial markets.

Because of their vast investment horizons, these funds can take on more risk than a typical pension or endowment fund, hence their willingness to provide nonrecourse 100 percent LTC financing. Not surprisingly, there are now domestic funding sources in the U.S. that are taking advantage of their relationships with sovereign wealth funds and hedge funds to provide 100 percent financing to their clients.

## Long-term relationships

Many commercial real estate brokers may think this all sounds too good to be true and view this type of potential funding with suspicion. But its value is hard to deny, because often clients have feasible projects for funding but lack the 20 percent to 30 percent liquid cash needed to make up the balance necessary for their projects when their financing is limited to 70 percent LTC.

What makes this even more attractive to potential borrowers is that once they become a client of this type of funding sources, their funding needs may be covered for 20 or more years because of the importance of relationship-building and long-term partnerships to these financing entities. Arrangements like this have the potential to allow originators and clients to finance project after project without having to wonder where their future financing will come from.

Commercial mortgage brokers who take advantage of these opportunities have a chance to expand the types of projects they work on because these funding sources specialize in financing a wider range of property and project types than is normally encountered. This may allow brokers to increase their revenue base.

The other types of projects that originators may encounter include waste management, waste-to-energy projects and other energy-related endeavors, including alternative energy sources. Agricultural projects involving food, water and processing techniques may also be available to brokers.

The more standard types of commercial real estate transactions that 100 percent LTC financiers prefer include resorts and casinos, condominiums, hotels, and major mixed-use

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developments that combine retail and residential components. Large-scale housing-community developments with at least 300 houses are also among their favored projects. Other types of venture capital and large-scale commercial real estate projects may additionally be considered on a case-by-case basis.

### Executive summaries

The best way for a commercial mortgage broker to secure a nonrecourse 100 percent LTC deal for a client is to focus on the client's executive summary. In most cases, this will involve the broker assisting the client in writing a powerful summary. This summary is much like a job résumé. It should be a snapshot of the project's best attributes. It should also include information about the principals and their relevant experience.

The most important thing to remember is that the executive summary will be the first impression that the funding source gets of your client's project. Write it as though everything about the project depends on it. Make it convincing enough to get everyone who reads it to agree that your client's project is a sure thing. Be careful not to overdo it or make it seem too good to be true, however. The goal should be to provide an overview of the project and concept with an emphasis on what it will accomplish, how it will benefit the community and investors, and the purpose it will serve.

The summary should also include information about the project's cost and how long it will take to build. Mention the

benefits of its particular construction and how it will contribute to the strength of the project. The project's facts and data should be summarized, and information on the strengths of the project's management team should always be included.

These types of funding entities tend to focus on the borrower's management team because of the desire to form a long-term relationship with the client. You should emphasize that the members of the team have backgrounds that are relevant to the particular project to help convince the funding source of the potential success of the project.

If your client does not have the necessary background to manage and administer the project, let the lending source know that you have accounted for that by bringing personnel onto the team with the specific backgrounds necessary. Tell them what functions these individuals will perform and how the operation will be managed. You should include short bios for these personnel, highlighting their experiences that are most appropriate for your client's project.

### Transaction costs

The process for securing 100 percent LTC financing is essentially the same as for financing smaller commercial real estate transactions except that the client must have enough liquid capital to cover Society for Worldwide Interbank Financial Telecommunication (SWIFT) banking fees and other transaction fees.

These fees, depending on the amount of the transaction, may be as high as \$150,000 to

\$200,000. When compared to the 20 percent to 30 percent of the total project cost the client would have to contribute to a standard 70 percent LTC transaction, however, these fees are usually only a small fraction of what would normally have to be paid by the client.

For example, a \$100 million project will require the client to provide roughly 25 percent of the project's cost in a standard 70 percent to 80 percent LTC scenario, or \$25 million. In the case of a nonrecourse 100 percent LTC transaction, the client would be responsible for only the \$150,000 to \$200,000 in banking and transaction fees.

If the transaction does not close, these fees are refunded to the client. The typical 100 percent transaction requires some equity participation by the funding source, but this security combined with the relative low cost compared to most large-scale 70 percent LTC transactions makes it a win-win situation for the client.



Commercial mortgage brokers who wish to grow their business and substantially increase potential earnings will want to seek out sovereign wealth funds and U.S. hedge funds that offer nonrecourse 100 percent LTC financing. These funds are actively seeking new clients with strong projects to fund and with whom they can establish long-term working relationships. This emerging financing source may sound like a dream come true, but it is now a reality that's ready to be taken advantage of by commercial originators and their clients for domestic and international projects. ■