SCOTSMAN GUIDE
scotsmanguide.com

A Stated-Income Option on Rehab-to-Perms

Know the right things to look for to finance properties needing rehabs or build-outs

By **James Levie,** president, NCi

Small-balance commercial lending is one of the fastest-growing segments of the mortgage brokerage industry. Now, another opportunity is presenting itself in the small-balance commercial-lending arena — stated-income rehab-to-permanent loans.

A rehab-to-perm commercial loan can apply to commercial properties that need physical-rehabilitation funding and a new permanent end loan. It may apply to purchases and refinances.

The properties requiring this funding often are functioning buildings victimized by the wear and tear of time. With a face-lift, they can be brought up to contemporary curb-appeal standards and receive improved cash flow.

While driving to and from work every day, you probably have noticed commercial buildings in need of rehab. The opportunities are significant.

The right scenarios

The following three examples illustrate the kinds of scenarios that could use stated-income rehab-to-perm financing:

- A developer is purchasing a 4,750-square-foot office-condominium shell. Two banks have rejected him.

The property used to be owner-user. Funding is now needed to purchase the shell and to complete the office build-out. Without a certificate of occupancy, most lenders will not fund the purchase of the shell. And without funds to complete the build-out, the certificate of occupancy will not be issued. This is a classic chicken-and-egg problem.

To complicate matters, this borrower insists on obtaining a stated-income mortgage.

This mortgage request can be solved with a stated-income rehab-to-perm loan in the following manner. A purchase of the condo shell at $165 per square foot totals $783,750. A qualified general contractor will do the entire build-out, including walls, offices, flooring, drop ceilings, partial electrical and plumbing for $60 per square foot, totaling an additional $285,000. The total cost to purchase plus the build-out is $1,068,750.

> "Properties requiring this funding often are functioning buildings victimized by the wear and tear of time. With a face-lift, they can be brought up to contemporary curb-appeal standards and receive improved cash flow."

The client obtains an 80-percent loan-to-value stated-income mortgage to handle the purchase of the new shell and build-out.

- The subject property is an aging strip shopping center. All eight units are rented. Because of the center's appearance, the owner cannot work the rent roll up to market levels or generate maximum income. Every traditional lender approached has turned down the owner's requests.

The owner needs $393,700 to pay off the existing private first mortgage and an additional $177,000 for rehab costs. The total mortgage sought is $570,700, which is 68 percent of the "as is" value. In addition, while the borrower's credit score is more than 680, his tax returns show an adjusted gross income of less than $20,000.

This owner can qualify for a stated-income rehab-to-perm refinance.

- The borrower owns a drab, unattractive, 48-unit multifamily property. Although fully rented, the building has a low curb appeal that is holding down its rent roll. The owner seeks to refinance both mortgages on the subject property, as well as to repave the parking lot and walkways, paint the exterior, landscape, and replace all the entry doors and the exterior lighting.

Despite superior credit, this borrower has been turned down by her bank of many years. Without the ability to provide sufficient tax returns showing a global picture of her finances, her community bank is unwilling to extend any additional mortgage credit.

The owner is certain that once the rehab work is completed, she can raise rents as they come due for renewal. The projected rent increases for the next several months will justify the expenses of the rehab-to-perm refinance. In time, the return will become considerable.

The right materials

With a little knowledge, you can capitalize on these lucrative opportunities. When seeking funding for rehab-to-perm loans, keep in mind the following:

- **Lenders will require that paying tenants be in place** or legitimate leases be completed with occupancy pending completion of the build-out or rehab work.
- **Lenders will expect copies of the existing and the pending leases,** and proof of any deposits tendered.
- **You must prepare rent rolls and operating statements.**

James Levie is the president of NCi, a commercial lender. Levie has more than 30 years of commercial and residential lending experience. NCi specializes in several small-balance-commercial programs, including nonprime and stated-income rehab-to-perm. Levie can be reached at (407) 805-0503 or at leviegranicus@bellsouth.net

Continued …

For build-outs and rehabs, you will need to:

- **Obtain extensive details on the work to be done**.
- **Get a copy of executed contract between the borrower and general contractor** and get a résumé and at least three references for the contractor.
- **Determine from the contractor how long it will take** to complete the assignment.
- **Obtain copies of all plans, specifications** and any artist/architect drawings.
- **Provide digital photos** of street scenes and the front, side, rear and interior of the subject property, when possible.

The right borrowers

Stick to basic property types such as multifamily, mixed-use, office, office condo, office-warehouse and retail. Avoid specialty-use buildings such as motels, bowling alleys, gas stations, hotels and restaurants. Remember to stick with the "easy" — easy to appraise, easy to attract lenders.

Properties requiring ground-up construction are not acceptable for this kind of financing. Rehab-to-perm lenders require that borrowers be seeking interior build-outs and/or cosmetic face-lifts.

Borrowers who require a stated-income option should be mindful of credit-scoring. Most lenders will require that minimum scores be as high as 660.

"Stated income" generally means that the borrower's income is not verified. For most stated-income lenders, however, the property's income and expenses must be verified and examined when establishing the debt-service-coverage ratio (DSCR).

Because the DSCR is a vital underwriting consideration, you should try to lock in the permanent rate at the time of the rehab-loan closing. By the time the rehab work is completed, four to six months later, the permanent rates could increase. Further, the DSCR minimum may no longer be attainable.

Typically, the rehab loan phase will float at prime plus. The closing for the permanent loan will take place once all work is inspected and completed.

The downsides

As with every mortgage program, there are drawbacks for brokers dealing with rehab-to-perm loans. For example, the time from the start to finish may take three to five months. Broker fees will generally be paid only at the closing of the permanent loan. Be prepared to wait for your full compensation.

Brokers will have to put forth extra effort for underwriting. As outlined above, brokers will have to gather more than just the typical documentation required for traditional permanent loans.

Despite some drawbacks, risks and extra effort, these loans offer brokers a potential fee income that should outweigh the minor road bumps.