How to Package a Project Loan Request

By James Conlow

Financing is about one thing: Profitable Exit for the Financier.

The financing request for a loan must satisfy a single basic requirement:

1. **Verified proof of profitable loan repayment for the financier.**

Lender's evaluate the probability of a profitable exit based on a combination of many factors including the "Five C's":

1. **Capacity** which refers to your ability to meet the loan payments and pay off the loan. The prospective lender will want to know exactly how you intend to repay the loan.

   With a project loan, loan repayment is often made by gaining another loan. This is either a "take-out" loan at completion of the construction or in the case of an interim loan you will need to provide proof that you have another loan (or equity investment) lined up to pay off the interim debt. Proof is a verified loan commitment from another lender.

   The lender will consider the cash flow from the project, the timing of repayment, and the probability of successful repayment of the loan. Lenders will also consider payment history as an indicator of future payment potential. For example, if you have a history of not paying back loans then it becomes more difficult to obtain additional loans.

2. **Capital** which is the money invested in the project by the current owners; also known as "skin in the game". This skin in the game is an indicator of how much risk is borne by the owners if the project were to fail. Essentially, lenders look for a strong commitment from a borrower represented by a substantial equity investment by the borrower. Most of the time, this commitment takes the form of equity that owners have personally invested in the project. If you have not invested substantially, do not be surprised if the lender asks for your personal assets to be injected into your project. Lenders want to know that you will be harmed if you fail to pay. If you have equity in your home, be ready to pledge it, particularly if you do not have any other forms of equity. If you are not willing to pledge personal assets, why would a lender take a risk with their assets that you are not willing to take yourself? Lenders understand that there is a positive correlation between a borrower's commitment and the likelihood that the loan will be repaid. The amount of equity required by a lender varies. Depending on the risk of the proposed venture, you may be required to inject 50 percent (or more) of the total capital needed. However, an average of 20 to 25 percent is commonplace. Lenders consider the company owner's debt-to-equity ratio to understand how much money the lender is being asked to lend (debt) in relation to how much the owners have invested (equity). A high debt-to-equity ratio can indicate that the company already has a high level of loans and could be a higher financial risk.

3. **Conditions** which refers to the intended purpose of the loan, for example working capital, design, market studies, entitlements, or pay for construction. The size of loan in relation to the specific use will help the lender evaluate your loan request. Conditions also include the national, industry level, and local economic situation. A volatile or unstable economic situation or market problem can negatively impact the evaluation. However, positive expectations can increase the likelihood of obtaining the loan.

4. **Character** which, from a lender's perspective, is the obligation that a borrower personally feels to repay the loan. Since there is not an accurate way to judge character, the lender will decide subjectively whether or not you are sufficiently trustworthy to repay the loan. The lender will investigate your payment history, your financial report, review a credit bureau report, and consider your educational background and experience in business. The quality of your references, the quality of your financial report, how open you are about sharing your information, and the background and experience of your employees will also be considered. Lenders like openness, they want to know all about you. They take a dim view of folks that are unwilling to show personal financial statements.
5. **Collateral** which is a form of security for the lender. Lenders usually require collateral as a type of insurance in case you cannot repay the loan. If you default on the loan, then the lender takes possession of the collateral in place of the debt. The loan agreement should carefully specify all items serving as collateral. Equipment, buildings, accounts receivable, and inventory are all potential forms of collateral. In most cases the Lender will ask for personal guarantees from owners.

Please note that a lender never wants to own a project and therefore "collateral" is the last thing that a lender looks at when evaluating a loan request.

For a lender, the most important issue to determine is "How will the loan be repaid?"

A financier has three basic questions: "What's in it for me?" "How do I make 100% sure that I will be successful?" and "How do I salvage my investment if there is a disaster?"

Additionally the people at the financial institution have a basic personal requirement: "If things go wrong and I'm called on the carpet by my boss, my investors, auditors, or governmental agencies, I need a file full of evidence to show why I made the decision to finance what now looks like a train wreck."

Every element of the package must be in writing: Verbal presentations simply don't fit in the file and the verbal presentation will not be available in a few years when the financier's executives are called on the carpet. Additionally the loan approval committee will never see the developer's verbal presentation. The entire request must be in writing and it must be able to stand on its own. Additionally not all members of this committee are expert in what they need to know and we must bend over backwards to give them a warm fuzzy feeling.

As a project developer you cannot truly comprehend the mindset of a financier. Not only is the financial world an alien environment, but financiers are different from each other. Do you think I'm wrong about this and that you have it wired? Most of us have trouble understanding the mindset of our children and spouse.

Here are some things to consider:

1. We must present an opportunity that is attractive to the Lender.

1. It needs to be the right type of project. It needs to fit the needs and criteria of the financier.
2. It needs to provide attractive risk adjusted returns to the financier.

You need a better package this year than last year for several reasons: Banks are not as liquid as they were. Too many development deals have gone south. Many appraisals have been found to not be factual. Once burned, twice shy. The world has changed. We are in a credit crunch.

Financiers are not in the charity business. This should be obvious but we see packages everyday that assume the financiers are impressed by the good that a project will do for the world rather than the good the project will do for the financier. Sure financiers like to finance projects that are good for the world – but the first requirement is maximization of profitability for the financier.

2. We need to show a clear path to loan repayment; a verified path that the financier can easily understand.

First we need to show in no uncertain terms how the financier will be paid back with an attractive ROI. At root this means we must show why the "market" will come and buy the finished product at a profitable price, (or that another lender will pay off this lender), and we must show that the development team has the ability to complete and sell the project. We need to show that we understand all of the risks (market risks as well as execution risks) and that we have an executable strategy to complete the project with particular emphasis on "pay-off" of the financier <u>with all risks considered and mitigated</u>.

This "plan" must be written because the financier needs to fill the file with the reasons he or she made the decision to fund. Verbal presentations are not relevant. Opinions about how great the project is are not relevant unless clearly presented in writing. The package needs multiple verified documents from believable parties.

3. For Interim Loans, we need verification that another lender will pay off the current financier.

This pay off is the exit strategy for interim financings.

4, We need to show underlying salvage value.

The package needs to show verified salvage value. Today an appraisal is required, but it's not sufficient. We need more documents than ever before to satisfy this requirement.

The Financing Request Package answers these questions:

Question 1: *If you build it will they come?* This is the market question. The only way to answer this question in a way that satisfies the financier is with believable market studies performed by third party professionals.

Question 2: *If they come will they spend enough money* to make this a profitable project that satisfies the hunger of the financier? This is a continuation of question 1: you need market studies.

Question 3: Can the team market and sell the product? You can hire this talent onto the team.

Question 4: Can the team design and complete the project for the price? You must provide a detailed, positive, believable complete answer to this question. But notice that this is question #4. The first 3 questions, *the market questions*, are of primary importance.

Underwriting is mostly about finding something wrong so that the project can be rejected. The job of the financing request package is to make sure that *first* the financier loves the project (because of its return) and *second* to make sure the jerk in the back office (me) can't find a reason to reject it. You will rarely meet the persons that make the financing decisions, therefore the package must tell the story.

Standard Package for Development Financing

A financier needs many questions answered in order to ascertain: What is the opportunity? What are the risks? What does it take for us to engage and drive this through to success?

In addition to a typical loan request form, a financier needs to see the following items included in the package to assess the viability of a project:

1. **One page Investment Summary:** A one-paragraph executive summary (a simple description you would use to tell your grandmother about the project) together with a spreadsheet showing the opportunity.
    a. Half page written description
    b. Half page of numbers
2. **A two page Executive Summary** (a standard professional executive summary).
3. **The Request:** Term sheet or proposal for moving forward. This includes your request and the financier's payoff. (You would be surprised at how many packages we receive that fail to mention how much money is being requested and how it will produce a return to the financier).
4. **The Project Business Plan:** At core a business plan tells the reader how the project will make money. It describes all aspects and operations of the project from initiation through pay off of the financier. Include pro forma financials. Put in your rationale for decisions you have made with respect to land use and product mix. What is special about this project? Complete description of the project.
5. **Pre-Sales / Pre-Lease:** Provide real documentation. This helps confirm an exit strategy.
6. **Market Studies:** Believable market studies are core to the package. This shows the feasibility of paying off the financier.
7. **Marketing Plan** for the Project: Provide a market study including regional populations, demographics, competitive projects, and how buyers in this region make buying decisions. How do you intend to handle sales for the project?
    a. **Who will buy?**
    b. **Why will they buy?**
    c. **When will they buy?**
    d. **How much will they pay?**
    e. **Why will they buy from your project rather than another?**
    f. **Does this project fill a real need?**
    g. **What is the competition?**
8. **History and analysis of the project to date.** Description of the property today and any changes since you became involved. Who are the players on all sides and what have they done? Include information about planning, government officials, and personnel from utility companies. Contact list.
9. **Project Description:** The documents you use to describe the project. Masterplan, elevations, floor plans, etc. Try to make this exciting.
10. **Any other documents that describe the project.** Drawings, photographs, maps…

11. **Project Ownership**, current and proposed. List every stock holder, every partner, every person that thinks they have any ownership connection. Who might come out of the woodwork?
12. **Current Debt Structure.** Provide a complete report. You will need a Title Report and copies of all current notes, etc.
13. **Company/Project Ownership** and structure. List every large stock holder, every partner, every person that thinks they have any ownership connection. **Financiers will need financial reports for every person with substantial ownership in the project.**
14. **The Team.** Describe your team and provide resumes of all relevant players. Describe the whole team including your independent contractors such as designers, marketing companies, builders, real estate brokers, consultants, etc. This is your team and you can take advantage of all their past success and experience.
15. **Valuation.** Provide Pro Forma Assessment of value today and the value at each projected milestone. What is your estimate of the future market value of each product type and how have you determined this value? Provide market studies to back up your estimates.
16. **Appraisals:** Provide current appraisal by trusted third party. The financier may need its own appraisal too. *A word about appraisals: At least one appraisal is required and often financiers need more than one. But an appraisal is not sufficient in today's environment. A financier needs other proof of value. This is because most financiers have suffered loss because they believed an appraisal that over-valued a project.*
17. **Financials (Actual and Pro Forma):** Provide industry standard estimates of all development and construction costs required to achieve each milestone (to be believable these estimates must be by a trusted third party like a known general contractor). Include other costs such as marketing, facilities care, operations cost and maintenance, Taxes, etc. Source and use of funds. Forecast of cash requirements during execution (tied to schedule).
    a. Financiers need to see how much skin you have in the game. How much have you and others actually spent to date? Please provide your accounting including a complete breakdown and even receipts for major expenses. You can include sweat equity, as appropriate.
    b. How much is owed to others? List all actual and potential debts. Have you made any promises to anyone? Include sweat equity, if appropriate.
    c. For Income Property: You need pro formas showing the operations for each operating category, showing all revenue and expenses resulting in the net operating income each year after construction completion for 5 to 10 years.
    d. Source and use of funds
        i. Historical, to date.
        ii. Planned: What are you going to do with the money from this financing?
18. **Schedule:** Provide a schedule of your plans, including milestones, with respect to the development process and the construction process. What does it take in a step by step process to get from point A to point Z with respect to time, professional resources, approvals, and money? How can we speed this up? What are the potential roadblocks? (Point Z is when the investor gets his return and is no longer at risk).

19. **Current Conditions with respect to Schedule.** Description of current condition of the development process. Provide current Environmental Reports, Title Reports, Entitlements.
20. **Entitlements:** Description and analysis of current condition with respect to planning, approvals, zoning, easements, maps, and permits. Every municipal jurisdiction has some differences so provide a complete description of what the zoning means. (for example, I have no idea what CD2-7 means). Pretend you are describing this to a person that does not understand entitlements (because you are – there will be people on the loan approval committee that do not understand and need to be educated). What specific approvals are required, what agencies are involved, and what are the target dates?
21. **Other Agreements:** What is the condition of all agreements with governmental authorities and utility companies? What specific problems are you facing? What are the future problems? What future agreements are required? Is there any bad blood?
22. **Description of problems** in the process (include solved problems, current issues, and items that you think are upcoming). List your solutions.
23. **Infrastructure:** Description and analysis of sitework, utilities and common infrastructure. What is currently supplied and how, by what entity, what needs to be added, include estimated costs and schedules, include proposals from contractors.
24. **Environmental Reports** and mitigation plans for any issues.
25. **Problems:** List and describe any safety issues, hazardous materials, environmental problems, and other risks. Who is responsible? List all remediation plans and proposed remediation plans. Show that you understand the risks and that you have a realistic plan.
26. **Risks** and how you plan to mitigate.
27. **Profitable Exit for the Financier.** Spell it out.
28. Tell me why I should trust you with my hard earned money. Many good projects fail. Collateral is not enough. Financiers do not want to foreclose on you. They want all of their investments to perform in accordance to the plan.

The above list is too much for some projects and not enough for others. Every project is unique and you need to include all relevant information to convince the financier that he/she should make a decision to provide you with funds.

The many catch 22's …

No matter how complete a developer thinks the package is, the financier will ask for more documents. It is of no use to become frustrated by this. Financiers use the presented package to develop next steps and questions. On the other hand a financier will not bother to look at an incomplete package. They simply have too many "complete" packages to analyze… So you must create and submit a complete package knowing that the financier will find something deficient.

Many developers want a financier to present a term sheet on an "incomplete package" with a list of deficiencies. While this seems reasonable in the development world it is considered unreasonable in the financier's world. There is no profit in trying to get a financier to move outside of his/her comfort range. Just submit a complete package.

Checklist for Financing Package:

1.	**One page Summary**		
2.	**A two page Executive Summary**		
3.	**The Request**		**A loan request describing exactly what is requested and that this lender will be placed in first position**
4.	**The Project Business Plan**		**A complete narrative that does not rely on verbal presentation**
5.	**Pre-Sales / Pre-Lease**		
6.	**Market Studies**		
7.	**Marketing Plan**		
8.	**History and analysis of the project to date**		**A complete narrative that does not rely on verbal presentation**
9.	**Project Description**		**A complete narrative that does not rely on verbal presentation**
10.	**Other descriptive documents**		
11.	**Project Ownership**		
12.	**Current Debt Structure**		**We need a copy of all current notes.** **We need verification that current note holders will subordinate.**
13.	**Company/Project Ownership**		
14.	**The Team**		
15.	**Valuation**		
16.	**Appraisals**		
17.	**Financials (Actual and Pro Forma)**		
18.	**Schedule**		
19.	**Current Schedule Conditions**		
20.	**Entitlements**		
21.	**Other Agreements**		
22.	**Description of problems**		
23.	**Infrastructure**		
24.	**Environmental Reports**		
25.	**Problems**		
26.	**Risks**		**and mitigation plans**
27.	**Profitable Exit for the Financier**		**Need a letter from the next lender stating that it will pay off the loan.**