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MID-STATES ADVISORS
A Private Placement and Business Brokerage Firm
Newsletter

Mid-States Advisors, Inc.
Monthly Article & Updates

Good Morning,

Fall is upon us once again. At Mid-States we have seven transactions under LOIs and are pushing to close all before year end! We are just bringing another sell side transaction to market and are seeking additional opportunities. If you or a client are looking for representation selling a business or seeking funding for your business please reach out to one of our team members.

In news to no one, government bureaucrats are again racing to strike a deal on the debt limit before a government shutdown becomes a reality. While the bureaucrats posture to make themselves look good the stock market has been suffering over the last couple weeks. A US default on obligations would be very damaging and many government employees would be furloughed but government officials again fail to serve the people and only look for headlines to make themselves seem like the savior.

On to this volume's article. In the final part of the series, we continue the focus on commercial loans. This part focuses on commercial real estate loans, syndicated loans and CARES Act funding tools to provide liquidity. These tools are all helpful for funding an acquisition, a refinance or to provide liquidity to a company.

As always, if you are interested in learning more about this volume's content or if we can help you or a client in any way please feel free to reach out to one of our team members.

Best Regards,
The Mid-States Team

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JUST WHAT THE HECK IS A COMMERCIAL LOAN AND WHERE DOES A LOWER MIDDLE MARKET COMPANY GO TO GET THEM?
Part III

In Parts I and II of the Commercial Loan series we discussed the various funding tools available to purchase a business or acquire equipment, to cover day to day working capital needs and to fund growth. In this final chapter of the series, we dive deeper into the loan products available to fund real estate transactions, loan syndications and how they assist in providing liquidity in the market, and at a high level we delve into some of the CARES Act programs enacted by the US government, some of which have expired, some of which are still available to provide ongoing liquidity.

This series by no means covered all of funding programs available to business owners and management teams, but these are all widely used and highly effective tools that companies should be aware of so that they can be used when the appropriate time arises.

If after reading this final chapter, you have any questions as to whether you would qualify for one of these loans or would like to talk to a Mid-States team member about our potential assistance in understanding and acquiring one of these loans, please reach out to a team member listed below.

Commercial Real Estate Loans
There are a variety of options when seeking to finance the acquisition of or to refinance commercial real estate. The least costly option is to seek a loan from a senior debt lender such as a credit union, community bank, or medium to large commercial lender. These loans are often used with owner occupied real estate or investment real estate. Owner occupied real estate is typically perceived as a safe loan and lenders will generally provide a higher loan to value than they will against investment real estate. Depending on the institution, many lenders will not provide loans on investment real estate unless the borrower has a long profitable history in the space or is a current client of the lending institution which is comfortable expanding their lending relationship.

Lenders will typically provide an advance rate on owner occupied real estate in the 65-70% range. This means if the building is worth $1 million, the lender will provide $650,000 to $700,000 depending on business performance and financial wherewithal of the borrower. The borrower will then be required to bring the additional 30-35% of equity to the table.

For traditional loans, terms will typically be five or ten years, but the amortization will be lengthier, in the range of 20 to 25 years depending on the useful life of the building. In such situations, at the end of the term, when the loan comes due, the balance of the loan, often referred to as a balloon, comes due and is often refinanced.

Both 7(a) and 504 SBA loans can be used to acquire commercial real estate but are not applicable towards investment real estate. Lenders like to utilize SBA loans when possible because the SBA provides a guarantee of up to 75% to 85% for any losses a lender takes. In general, SBA loans provide the borrower with a longer term and the SBA requires that the term and amortization match. As an example, a 7(a) loan with a 25 year term will also carry a 25 year amortization and the loan will be fully paid off at the end of the 25 years. SBA loans can be costlier to the borrower as there are SBA closing fees and expenses involved but the extended terms and fact that closing costs can be rolled into the loan often make up for the additional cost, especially in cases where the borrower does not have the financial strength to meet traditional loan underwriting standards. Borrowers find SBA loans attractive because there are no covenants or events of default except for payment defaults. As long as the borrower makes their payments the SBA will not allow the lender to call the loan.

For housing finance loans, Fannie Mae and Freddie Mac are mortgage companies created by the US Congress. These are federally backed home mortgage companies that purchase and guarantee mortgages issued by other lenders. These agencies were created to provide a more stable and affordable mortgage market by purchasing existing mortgages from lenders, offering the lender liquidity to provide additional mortgages. These loans are available for single-family homes and are very popular with the financing of multi-family developments. These loans do not require a personal guarantee.

Wall Street offers a similar product in the form of Commercial Mortgage backed Securities (CMBS) or conduit loans. CMBS loans are fixed income investment products that are specific to commercial properties such as multifamily communities, office buildings or warehouses. CMBS loans can offer more flexible underwriting standards using the property as collateral. CMBS loans are sold and packaged into a trust, turned into rated bonds, and sold on the secondary market to bond investors. Again, this loan allows the lender to return capital to the lending pool to make more loans. CMBS loans are also assumable by a buyer if the owner decides to sell the property containing the CMBS loan.

The most expensive loan options in the real estate space are bridge loans and hard money loans. Bridge loans are exactly as they sound, they are a bridge to less costly, traditional financing. These short-term loans, typically with terms of two years or less, are often used when a company needs to acquire a property quickly or to construct a property, and currently carry an interest rate in the low to mid-teens. Hard money loans are from private lenders and are the most expensive. They carry interest rates of 20% and up and the penalties are harsh if the borrower does not perform according to the contracted terms, even resulting in loss of the property. Bridge loans and hard money loans oftentimes carry terms from six months to 5 years with the average term settling in the two year range.

All these commercial real estate loans have a place and a valid use, even the higher cost options, the important thing is for the borrower to use them in the appropriate circumstances.

Loan Syndications

Loan syndications are not necessarily different loan structures but are loans that are shared between multiple lenders to reduce lenders' concentration risk from any one borrower. In this situation a group of lenders partner to make the loan(s) to the borrower, oftentimes a corporation. Syndicated loans are usually participated out to multiple lenders due to the size of a loan request. Say for example, that a company is requesting an $100 million loan but the lender underwriting the credit has an internal cap on loan size at $75 million. That lender can then partner out the additional $25 million needed to meet the loan request while still retaining the business. It is a very useful tool to help lenders get comfortable with large loan requests and loan requests where a lender needs to reduce their exposure to a borrower.

These loans can include both revolving lines of credit and fixed loans. The loan is usually administered by a lead lending institution who will manage the relationship with the borrower. The borrower does not have any interaction with any of the lenders except for the lead administrator, who typically holds the largest portion of the loan, and there is no additional cost to the borrower.

Loan syndications are particularly useful for difficult loan requests and large loan requests.

CARES Act Loans
There were multiple loan programs that came out of the Coronavirus Aid, Relief, and Economic Security Act (CARES Act) that provided borrowers with additional capital when they could not meet lender requirements due to the Covid-19 pandemic and related industry shutdowns. Many of these programs have either run out of money or have expired but they were very helpful and more could be coming down the pipeline.

Paycheck Protection Program (PPP) loans were the most widely discussed and somewhat controversial loans. PPP loans were forgivable loans provided by the SBA but administered through lending institutions. These loans were meant to be used for payroll, mortgages, rent, and utilities and as long as they were documented to be used as such were 100% forgivable, basically equity on the borrower's balance sheet. The portion of the loans not used for the above expenses were not forgivable and require repayment. There were two rounds of PPP loans and most companies have received forgiveness for the first round and are either in the process of applying for second round forgiveness or have already received it.

Economic Injury Disaster Loans (EIDL) are loans provided directly by the SBA that do not go through a lending institution. These loans were designed to provide working capital during a period when cash was tight due to Covid-19. The loans were meant to provide "working capital to make regular payments for operating expenses, including payroll, rent/mortgage, utilities, and other ordinary business expenses, and to pay business debt incurred at any time" but do not have specific use requirements and are not forgivable. EIDL loan terms were for 30 years at a 3.75% fixed interest rate. The first round included of loans up to $500,000 and has expired but the second round is open, and the loan amounts have been increased to up to $2MM. These loans carry a payment deferment period of up to 24 months.

There were other programs instituted to respond to the Covid-19 pandemic including the underutilized Federal Main Street Loan Program, the Restaurant Revitalization Fund, and the Shuttered Venue Operator Grants which were supposed to provide working capital to shuttered businesses but these loans programs have all either expired or run out of funding.

Employee Retention Tax Credit, a provision of the CARES Act, is not a loan, but still a valuable source of cash for many companies that have experienced reductions in quarterly revenue compared with 2019. Initially, the credit was not available to entities that received PPP loans, but modifications enacted December 27, 2020 allowed companies to take advantage of the credit for qualified wages not used for PPP loan forgiveness. Essentially, eligibility of the credit requires a revenue reduction of 50% for a 2020 quarter compared to the same quarter in 2019. But for 2021, the required revenue reduction is only 20% compared to the same quarter in 2019. The refundable credit for 2020 is 50% of qualified wages to a maximum $5,000 per employee for the entire year. However, the refundable credit for 2021 is 70% of qualified wages to a maximum of $7,000 per employee per quarter – potentially $28,000 for 2021. The credit is currently set to expire at the end of 2021.

We welcome discussion and comment on this or any of our Newsletter articles. If you would like to discuss our services in more detail or to discuss the content in today's newsletter, please contact us to learn more about how we can assist your company or client. Below are the direct phone numbers and emails for a Mid-States team member who can answer your questions (yes, we answer our own phones):

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