



Commercial Mortgage Credit Memorandum

13-Room Motel Financing – Northern Ontario

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Executive Summary:

This report evaluated a proposed commercial mortgage financing request of \$800,000 to finance a 13 room motel located in Northern, Ontario. The property demonstrates strong operating performance, generating revenue of \$500,000 annually with EBIT of \$300,000, supported by stable demand and limited local competition. The proposed loan is secured by the underlying real estate asset, providing collateral support in the event of default. This financing is intended to support refinancing of the asset and optimise the capital structure by paying off the current vendor-take-back mortgage (VTB).

Based on the estimated cash flows and assumptions, the property is expected to generate sufficient income to service debt obligations, with projected DSCR in the range of ~4.01x. While the transaction carries typical risks associated with a single-asset exposure, non-franchised business, and seasonal variability, these are mitigated by the motel's demonstrated earnings and relatively low operating complexity.

Recommendation: Conditionally approve the commercial mortgage of \$800,000 subject to standard covenants, including a minimum DSCR requirement of 1.30x and ongoing performance monitoring, confirmation of the high EBIT margin via full financial statements, and mitigation of key-person risk (e.g., key-person insurance).

Business Overview:

Detail	Description
Location	Northern, Ontario
Property Size	13 Rooms (Motel)
Management/Ownership	Single ownership/small scale operation
Core Service	Short-term accommodation with potential of longer-term customers.

The subject property is located in the town of Northern Ontario with an estimated population of 1,600 residents. The motel primarily serves travelers, including highway traffic, regional workers, and seasonal visitors. The motel benefits from its proximity to the Trans-Canada Highways, and limited alternative accommodation options in the immediate area.

Barriers to entry are high due to limited demand density and lack of incentive for large, branded operators to enter the market. This supports higher than normal occupancy levels for the subject business.

The motel operates as a straightforward, asset-based business with minimal staffing requirements, and low operational complexity. Revenue is primarily driven by room rentals, with performance influenced by seasonal demand patterns typical of Northern Ontario markets, including stronger summer occupancy and softer winter periods.

Overall, the property represents a small-scale, cash-flow-oriented hospitality asset with performance closely tied to local demand conditions and operational execution.

Financial Analysis (Preliminary):

Detail	Metric	Calculation
Average Daily Rate	\$140	N/A
Maximum Possible Revenue	\$664,300	13 Rooms x 365 Days x \$140 ADR.
Occupancy Rate	75%	N/A
Annual Revenue	\$500,000	(13 Rooms x 365 Days x 75% Occupancy x \$140 ADR).
EBIT Margin	60%	(\$300,000 EBIT / \$500,000 Revenue)
EBIT (Net Operating Income)	\$300,000	N/A

Key Observations:

- **Profitability:** The 60% EBIT margin is significantly higher than industry averages for motels, suggesting tight control over costs, through direct owner management and a lean labor model.
- **Revenue Concentration:** With only 13 rooms, the revenue base is small. A downturn in occupancy or a loss of key clientele (e.g., local contract workers) could significantly impact the top line.
- **Occupancy Rate:** 75% occupancy rate is on the higher side of the spectrum indicating optimal marketing and consistent demand throughout the year.

Projected Debt Service Capacity:

The proposed \$800,000 commercial mortgage will be evaluated against the current \$300,000 EBIT. Assuming a 25 year amortization and an illustrative interest rate of 8.00% (based on current market conditions for commercial loans of this nature):

Detail	Metric	Notes
Proposed Loan Amount	\$800,000	Mortgage Request
Illustrative Interest Rate	8.00%	Market Estimate
Amortization Period	25 Years	Standard Term
Annual Debt Service (P&I)	\$74,808	Calculated based on above terms
EBIT (Annual)	\$300,000	Net Operating Income
Projected DSCR	4.01x	(\$300,000 EBIT / \$74,808 Annual Debt Service)

The preliminary projected Debt Service Coverage Ratio (DSCR) of **4.01x** significantly exceeds the proposed minimum covenant of 1.30x. This indicates substantial capacity to service the requested debt, even if operating performance experiences a moderate decline. However, verification of expenses and normalization of owner-related costs is required

Sensitivity Analysis:

The high DSCR provides a robust buffer against revenue volatility.

Interest Rate	15 Year Term (DSCR)	20 Year Term (DSCR)	25 Year Term (DSCR)
7.00%	\$86,057 (3.49x)	\$71,760 (4.18x)	\$67,824 (4.42x)
8.00%	\$91,552 (3.28x)	\$79,848 (3.76x)	\$74,808 (4.01x)
9.00%	\$97,296 (3.08x)	\$86,366 (3.47x)	\$81,420 (3.68x)
10.00%	\$103,288 (2.90x)	\$92,720 (3.24x)	\$88,080 (3.41x)
11.00%	\$109,520 (2.74x)	\$99,288 (3.02x)	\$95,028 (3.16x)
12.00%	\$115,984 (2.59x)	\$106,064 (2.83x)	\$102,264 (2.93x)

The Sensitivity Analysis confirms the project's robust financial stability by examining the Debt Service Coverage Ratio (DSCR) across a matrix of potential financing terms. This analysis focuses on interest rates ranging from 7.00% to 12.00% and amortization periods from 15 to 25 years.

The findings demonstrate exceptional resilience, as the DSCR remains comfortably above the minimum covenant requirement of 1.30x in all tested scenarios. Even under the most challenging combination—an interest rate of 12.00% coupled with the shortest 15-year amortization period—the DSCR registers a strong 2.59x.

Conversely, the most favorable scenario, combining the lowest interest rate (7.00%) and the longest amortization period (25 years), results in the maximum DSCR of 4.42x. This significant range underscores the financial benefit derived from securing favorable terms.

A 35% decline in EBIT (from \$300,000 to \$194,805) would still maintain the minimum acceptable DSCR of 1.30x. This level of decline would require a drop in the occupancy rate from 75% to approximately 50%, holding all other factors constant. While the 13-room structure introduces volatility risk, the current profitability level offers strong protection.

Overall, the high Earnings Before Interest and Taxes (EBIT) of the motel provides a substantial and reliable buffer, ensuring that debt service obligations can be met with a wide margin of safety, confirming the viability of the financing structure against adverse market fluctuations.

Valuation and Loan-to-Value (LTV) Analysis:

The current analysis focuses primarily on the asset's cash flow (EBIT of \$300,000). To assess the collateral coverage and ultimate security of the proposed \$800,000 mortgage, the Loan-to-Value (LTV) ratio must be determined based on the property's appraised value.

Assuming a range of potential appraised values for the 13-room motel in Northern Ontario, the resulting LTV ratios are presented below. (Note: A standard commercial LTV ceiling for this asset class is typically 65% to 75%.)

Potential Property Value	Loan Amount	LTV Ratio	LTV Commentary
\$1,500,000	\$800,000	53.3%	Excellent LTV; strong collateral cushion.
\$1,200,000	\$800,000	66.7%	Acceptable LTV; within standard lending guidelines.
\$1,066,667	\$800,000	75.0%	Maximum acceptable LTV for many commercial lenders.
\$1,000,000	\$800,000	80.0%	High LTV; likely requires additional collateral or a higher interest rate premium.
\$900,000	\$800,000	88.9%	Unacceptable LTV for a standard commercial mortgage.

Key Implication:

- **Value Threshold:** For the proposed \$800,000 loan to meet a conservative LTV threshold of 75%, the property must appraise for a minimum of \$1,066,667.
- **Next Steps:** The requirement for a formal Market/Appraisal Report (as noted in the Next Steps section) is critical. This valuation will confirm the actual collateral position and determine if the LTV ratio aligns with the institution's risk tolerance for this asset class. If the appraisal is significantly below \$1,200,000, the deal structure or loan amount may require adjustment.

Operational Assessment:

Staffing and Management

The staffing model is extremely lean:

- 1 Full-Time Employee (FT)
- 1 Part-Time Cleaner (PT)

Strengths: Low payroll costs are the primary driver of high profitability.

Risks: This model relies heavily on the manager performing the majority of the operational and administrative tasks. Any disruption to the manager's capacity (illness, burnout, job switching, etc.)

could immediately impair operations and revenue. A 13-room motel typically requires more than one FTE and one PT cleaner unless the owner is performing the majority of the work.

Market and Location (Northern Ontario)

- **Northern Context:** Credit risk is highly sensitive to the local economic profile. Northern Ontario’s economic drivers (e.g., tourism, local industry, seasonal traffic, proximity to major highways) must be assessed. Small-town motels often face less competition but are more vulnerable to local economic shocks.
- **Barriers to Entry:** High, currently there are seven motels in the area, and no new construction. For a new motel to emerge, it would take considerable time and capital. Moreover, it would take significant time to build a reputation for new competitors which increases the barriers to entry.

Credit Risk Factors:

Strengths

1. **High Debt Service Capacity:** With an EBIT of \$300,000 on \$500,000 in revenue, the motel has a substantial cushion to cover interest payments, indicating a high potential Debt Service Coverage Ratio (DSCR), assuming reasonable debt levels.
2. **Operational Efficiency:** The lean cost structure is a significant competitive advantage.
3. **Owner Commitment:** The high profitability suggests strong, committed management focused on cost containment.

Weaknesses

1. **Key-Person Risk:** The extremely small staff implies severe key-person risk. The business is likely inseparable from the manager.
2. **Revenue Volatility:** The low number of rooms (13) makes cash flow highly sensitive to fluctuations in occupancy.
3. **Local Market Dependency:** Performance is intrinsically linked to the economic stability and traffic patterns of the Northern area.

Next Steps and Recommendation:

To finalize the credit decision, the following are required:

Component	Purpose
Full Financial Statements	Verify revenue recognition, expense breakdown, capital expenditures (CapEx), and debt load (balance sheet).

Component	Purpose
Market/Appraisal Report	Determine the property's value, LTV, and assess the competitive landscape (occupancy rates, ADR in Northern Ontario).
Personal Financial Statement	Assess the net worth and liquidity of the principal borrower(s), given the high key-person risk.
Debt Amortization Schedule	Project the DSCR based on proposed loan terms.

Preliminary Recommendation: Conditionally favorable, subject to confirmation of the high EBIT margin via full financial statements, mitigation of key-person risk (e.g., key-person insurance), and verification of other reports/statement mentioned in the table above. The exceptional \$300,000 EBIT suggests that the motel can comfortably take on a moderate amount of debt.