

Property Ownership for  
Small Business Owners

# Define Phase Summary of Findings



# Property Ownership for Small Business Owners

## Introduction

Purchasing property can be an important strategic step for many small businesses, but current real estate offerings and financial tools are not set up to make ownership easy for entrepreneurs. Owning property can give small business owners more control over the decisions that impact their businesses, increase their stability, and help them become a "stabilizing force in the community," as one interviewee added. When a small business owner is not concerned with the risk of their lease being terminated, they have the opportunity to build long-lasting connections with their customers and the broader community. Furthermore, small business owners have been shown to invest more in communities where they own property, driving productive, local economic growth.<sup>1</sup> They increase local employment, provide product diversity, and strengthen community decision making and identity.

While property ownership may not be the right decision for all small business owners, those that believe property ownership is the right step for their business face unique challenges and a lot of red tape when trying to access affordable mortgages—both residential and commercial.

Small business owners have expressed challenges including a “wall of bureaucracy,” large cash down-payment requirements, lengthy financial statement provisions, and often biased and discriminatory lending practices. Other barriers, such as distrust of traditional lenders among small business owners, can be harder to quantify. Whether mistrust stems from historical bank failures or negative personal experiences, it can impede access to capital.

**We want to help remove these barriers.**



### Primary Research

This Design Phase Summary of Findings is based on Property Ownership for Small Business Owners Future Economy Lab (FEL) primary research, including interviews with small business owners and industry experts. Secondary desk research will be cited.

<sup>1</sup> Lung-Amam, W., & Alvarez, N. (2022). To Narrow the Racial Wealth Gap, Help Entrepreneurs of Color Own Property. Bloomberg. <https://www.bloomberg.com/news/articles/2022-04-28/small-business-real-estate-can-narrow-the-racial-wealth-gap>

## Research Process

For the last several months, [SecondMuse Capital](#) and [Silver Lining](#), with the support of [Wells Fargo](#), and a 13-person design committee of industry experts and small business owners, have been working together on a Future Economy Lab focused on property ownership for small business owners. In this lab, we aim to develop innovative methods for entrepreneurs to purchase residential and commercial real estate.

Our ultimate goal is to co-create a financial instrument to **mobilize financial capital and other resources to small business owners so they can purchase property.**

Given Silver Lining's extensive experience helping small business owners reach their financial goals, our initial research was focused on property ownership, legal structures, and existing mortgage products. We reviewed 28 literature sources, including academic research, news articles, opinion pieces, podcasts, and reports. On October 5, 2022, members from SecondMuse Capital, Silver Lining, and the design committee convened to discuss the initial research findings and hear firsthand experiences of small business owners trying to purchase property.

To further understand the challenges around property ownership for small business owners, we conducted 35 45-minute interviews with small business owners, investors from traditional lending institutions, impact investors, non-profit organizations, government-sponsored enterprises, and other individuals with extensive knowledge on this topic.

The following sections summarize key findings of the interviews, desk research, and expertises of the FEL team, and our 13 design committee members.



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LITERATURE SOURCES  
CONSULTED



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45-MINUTE INTERVIEWS WITH  
SMALL BUSINESS OWNERS,  
INDUSTRY EXPERTS AND  
INVESTORS BOTH IN THE  
TRADITIONAL AND  
ALTERNATIVE LENDING  
SYSTEM



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PARTICIPANTS

## Key Findings

We have organized the key challenges small business owners face into two sections: Section A explains the barriers imposed by providers of capital, and Section B includes the challenges that arise from the daily realities of running a small business.

These challenges vary between service-oriented companies (i.e. restaurants, coffee shops, barber shops, salons, etc.) and product-oriented companies that sell directly to retailers or wholesalers. Additionally, the needs and challenges associated with purchasing residential properties differ from those that arise with the purchase of commercial property. At this phase in the lab, our findings reflect both forms of property ownership.

For service companies, having commercial properties in a desired community could mean a significant increase in revenue from foot traffic, as well as strong uplift from synergies with other services in the neighborhood. These companies typically rely on cash flow models, not asset models, so their revenue can change dramatically due to factors outside of the business owner's control, including economic downturn, demographic changes in the community, and more. Therefore, property ownership in a strategic location within a community could be one of the most vital factors contributing to overall business growth and stability for owners.

For product companies, having their own properties means stability for their employees, potential inventory storage space, and possible increased orders from local retailers. The positive impact of property ownership for a product company is less than that of service companies, but the risks are also smaller, since most product companies can predict their monthly revenue with greater certainty.

To both mitigate potential future cash flow risks and serve the companies with greatest need, it would be strategic to build a portfolio of mortgage products that are offered to both service and product-oriented small businesses.

“The space is in a perfect location. I love the space. It's beautiful. There are a lot of challenges still with the building just in general. But it gives me a lot of anxiety in thinking about trying to grow the space and thinking about what I am going to do when I move because I've invested all of this money, time, and energy into the space and my lease is actually up in a few months. And you know, I'm pretty sure I'm gonna stay **but my rent is more than my landlord's mortgage.**”

Small business owner  
Future Economy Lab Interview

# Key Findings

## Section A: Imposed Barriers

### **Large Down Payment**

In advance of property purchase, small business owners are required to provide 25 to 35% of the total cost of the property as a down payment. Mortgage providers will only disburse their funds once a small business owner has transferred the down payment to the seller of the property (or the notary or lawyer handling the transaction). In addition, United States banks require that 100% of the down payment comes from the small business owner to show “skin in the game”. This means that small business owners cannot receive any part of the down payment as a gift or crowdsource it from the community. Currently, entrepreneurs are left with two choices—either they deplete the accumulated retained earnings in their businesses or they deplete their personal savings. This often means that after purchasing a property, small business owners have less liquidity and are more vulnerable to economic cycles and any unforeseen business challenges (e.g. shipment delays or extended receivable terms).

### **High Threshold for Approval and Limited Flexibility in Repayment**

Mortgage providers require small business owners to have sufficient Earnings Before Interest, Taxes, Depreciation, and Amortization (EBITDA) in their companies to service the property debt at a minimum debt service ratio of 1.30 : 1.00. Additionally, COVID-19 has demonstrated that even with the best cash flow planning, there is still a possibility of an unexpected slowdown in the revenue or increase in irregular expenses. In these circumstances, the only currently available solution for entrepreneurs is to use existing personal or company savings, or to leverage personal assets.

### **Standardized Mortgage Terms**

Despite the fact that traditional financial institutions impose strict mortgage conditions, small business owners often feel compelled to enter into relationships with these institutions because they will have access to lower interest rates, which ease the above mentioned cash flow risks. These conditions include both pre-funding terms (e.g. 35% cash down payment, personal guarantees, a need for a property appraisal, and an environmental report), as well as ongoing monitoring conditions (e.g. quarterly reporting and maintenance of restrictive financial covenants).

At the same time, capital providers are unable to price their risks below a minimum unless they can attain a certain level of standardization and scale. This means that traditional financial institutions are prevented from providing flexible terms and exceptions for small business owners. This often leads to a difficult compromise that small business owners have to accept—they either attempt to qualify for a traditional mortgage with a lower interest rate or they seek out more flexible loans that are priced much higher.

“...we meet with a lot of entrepreneurs. A lot of these entrepreneurs would want to own space. They don't think it's an option. **It doesn't even occur to people that they even have a slight chance at an opportunity to own a place.**”

FEL Interview with an industry expert

## Section B: Existing Market Challenges

### ***Inconsistent Approval Process With Limited Transparency***

Due to perceived financial and reputational uncertainties, small businesses are often perceived as higher risk by traditional lenders, limiting their access to affordable capital. While a small business owner's credit score is used to assess the likelihood of loan repayment, the business's cash flow is a larger determinant in securing a loan for property ownership. Traditional investors will often loan to small businesses with less than average credit scores if the business's cash flow is high enough to prove their ability to repay the loan. However, this does not align with information from many small business owners who expressed that their historical financial statements could show that they had the cash flow to support monthly repayments.

### ***Limited Access to Technical Assistance and Advisors***

While small business owners have the expertise to manage their businesses, many mentioned that they require additional financial knowledge specific to purchasing property. Currently, small business owners have limited access to trusted advisors with a genuine interest in the success of their businesses.

### ***Lending Systems Not Set Up to Serve Small Businesses***

Several interviewees shared that traditional lending systems are not set up to accommodate small businesses, especially when it comes to property ownership. In contrast to their larger counterparts, small businesses are unique in many ways. They do not have the extensive resources or knowledge-base that larger corporations may have, and while small businesses may face similar risks to their larger counterparts, they may also be more vulnerable.

“...dealing with local municipalities can be daunting, frustrating, and aggravating, even for us as professionals to deal with them every day. So, as a property owner, or potential property owner, ***not knowing where to navigate, not knowing which direction to go into, it can be very daunting and frustrating.***”

FEL Interview with an industry expert



## Section B: Existing Market Challenges

### ***Additional Responsibility of Property Management***

A common concern in our findings was that for those who wanted to pursue property ownership, the purchasing process as well as the additional property management responsibilities could become a burden in the midst of keeping up with the demands of the business's primary operational needs.

### ***Lack of Community Ties and Assessment Flexibility***

Philanthropic and for-profit investors have recognized the economic and social implications when small businesses thrive, including job creation and increased support of community-related causes. An interviewee shared data on how small businesses are far more likely to give to community-related causes at higher rates than large institutions operating in the same area.

Local community banks generally go beyond traditional underwriting methods; they will often build personal relationships with small business owners to learn more about the owner's resilience when faced with setbacks and their dedication to their business goals. Despite this, much larger institutional lenders may lack sufficient community ties as well as flexibility in application assessment partly due to increased automation of the loan application process to increase internal efficiencies, limit personal biases, and reduce regulatory risk.

“Really, it boils down to do you want to make a loan to someone with a **good character** with a **team** that's already developed or is in the process of **developing** a network. ***And that's pretty much it.***”

FEL Interview with an industry expert

### Character-based lending


*Character-based lending works on the basis of character and capacity, as opposed to the bank approach of credit and collateral*



## Possible Solutions to Explore

In order to address the challenges that have emerged, small business capital providers like Silver Lining would need to both structure a different type of mortgage product to address Section A barriers and create a service package for tailored technical assistance to meet some of the needs identified in Section B. Many interviewees described scenarios in which a trusted financial advisor could have ameliorated the situation, including reviewing the costs associated with purchasing a property, providing estimates on costs associated with property maintenance, and ensuring a better understanding of how the owner's financial statements will impact their ability to purchase property (e.g. writing off certain expenses such as vehicle repair or a new computer is great for minimizing a tax burden, but it can make the business look less profitable). The SLAP program (Silver Lining Action Plan) already includes many of these necessary elements, and Silver Lining recognizes the importance of including them in any future mortgage product they might design. Components of this service package could include a dedicated account manager, regular check-in calls, technical resources, online tutorials, and access to networking events.

In the lab's **November 8th workshop**, we explored five possible solutions. As illustrated in Appendix B, these ideas represent the trajectory of the product's impact—with Ideas 1, 4, and 5 addressing the most acute challenges small business owners face today, and Ideas 2 and 3 looking at chronic market failures for small businesses. **During the workshop, we worked towards co-creation of a blended proposal that included elements of each idea.**



“When you can work **strategically, within communities**, particularly around ... the idea of co-ops, where the people in the building have a say in what gets down in that retail space, you can start to mitigate some of it. And then **by enabling small businesses to be property owners, they can actually have the agency to determine how they operate and where they operate.**”

FEL Interview with an industry expert



## 01

# Idea: Alternative Mortgage Terms, Collective Insurance, Quasi-Equity

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These ideas focus on challenges associated with existing mortgage products in the market. They expand on Silver Lining's current approach of providing financial solutions that put small business owners first. The lab is also looking for approaches that have already been tested elsewhere in the market, whether in the U.S. or globally.

## Equity Pathways

### *Quasi-Equity Product for a Down Payment*

Small business capital providers like Silver Lining could consider providing a quasi-equity loan to small business owners to finance their down payment requirement.

The loan would contain patient terms and be subordinate to all other liens on the property.

The loan would help small business owners obtain property financing from mainstream lenders.





## Equity Pathways

### **Community Equity**

Community equity would share the risks associated with the down payment amongst community members.

One option would be to provide a crowdfunding platform. Examples of these solutions are:

[ATB Financial](#) - a provincially owned Canadian bank that launched a crowdfunding solution in March 2016. It allows small business owners to fundraise for the equity portion of ATB Financial loans.

[GLS Bank](#) - one of the members of Global Alliance for Banking on Values that launched an equity crowdfunding platform in February 2017 for businesses that are looking to obtain term loans from the bank.

Crowdfunding could be accompanied by favorable terms for the small business owners, such as matching the amounts raised through a potential equity fund, or allowing equity to be staged. The capital provider could advance ~85% of the property's cost and give small business owners 12 months to raise the remaining 15% of the down payment through the local community where they will physically be located.

### **Shared Appreciation Mortgages**

The concept of shared appreciation mortgages has been adopted in Canada to address both the rapidly rising costs of owning a personal home for middle income families and the equity gap that nonprofits face when trying to buy their own office space.

Capital providers could explore raising a fund to partially subsidize the down payment amount for small business owners. In exchange, they would secure a title against the property that would allow it to co-benefit from any future value gains from the property when it is refinanced or sold.

### **Collective Property Purchase and Leasing**

Co-working spaces have become more common in the last five years and the concept of co-leasing a space as a group of small business owners is appealing to many entrepreneurs. The benefits of co-leasing a space together range from business synergies (i.e. accounting, marketing, and legal services) to financial risk mitigations.

We could expand this model by considering a potential pathway for synergetic small businesses to collectively pool their equity, co-purchase a property together, and sign one master lease in which they are all liable for honoring the mortgage terms.

Another possibility to explore is creating a mortgage product in which complementary businesses in the same geographic area are matched through an algorithm and offered participation in a property loan as a way to build out their behavioral scorecard, obtain experience in managing their first owner-occupied property, and access a community of other businesses for support.





## Cash Flow Pathway

### Collective Insurance Product

Cash flow for small businesses can vary both on a predictable (e.g. seasonally) and unpredictable (e.g. economic downturn, pandemic) basis.

One potential approach is to explore an insurance product equal to a cumulative 5% value of each property in their mortgage portfolio. Small business owners, in exchange for a portion of their future equity gains in their properties, would rely on this insurance for a fixed period of time to mitigate their risks if their cash flow becomes unstable or they are unable to make mortgage payments.

## Standardization Pathway

### Trajectory Of Mortgages

A pathway to explore is separating the offered mortgage amounts into separate groups, but offering small business owners the same blended interest rate for each group (i.e. taking a portfolio approach).

This pathway would translate into a graduation trajectory whereby a small business that self-identifies the need for purchasing their own property might first be recommended for a type A smaller mortgage amount with the most flexible and patient terms (i.e. purchasing an office space within a larger commercial property or participating in a collective mortgage product with other small businesses). An example of a flexible condition could be recognizing small businesses' ability to pay historical rents as a qualifying factor for a mortgage, regardless of their profitability in the previous two years.

Based on the behavioral scorecard around type A mortgage performance, the small business could graduate to a type B mortgage with flexible terms, but also elements of standardization. The final type C mortgage product would be fully standardized.

Capital providers could offer the desired flexibility of terms for those who need it most while still obtaining the necessary cost of capital in order to offer blended interest rates.

## 02

## Idea: Lease to own product

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This idea focuses on the inherent challenges that small business owners identified, including the associated risks of owning and managing a property (often for the first time) while still operating a business. In response, we are exploring the potential pathway of a lease-to-own mortgage product.

Capital providers would raise a fund to purchase a portfolio of real estate properties, then design a spectrum of loans that meet the variety of needs. The providers would transition into property ownership and management instead of being solely a financial intermediary.

**Note:** From the small business owner's perspective, this idea could offer a promising solution that currently does not exist in the market. However, the inherent risk of this pathway lies with a capital provider's ability to raise funds at a cost that still allows it to charge acceptable interest rates in line with a fixed income product.

## 03


## Idea: Collective Ownership

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This idea looks at shifting the entire approach of lending to small business owners and transitioning from the current centralized model of intermediary lending to a decentralized model of community collective property ownership. This idea also expands the solution to include other stakeholders, such as municipalities.

The capital provider would not only be a trusted advisor and direct capital provider, but also an orchestrator of the capital solution. One potential approach would be for small business owners to establish a community fund that would obtain capital to purchase a portfolio of properties. The community fund would capitalize itself through a blend of debt from intermediaries, as well as equity from community bonds. Municipalities would act as guarantors in the fund.

**Note:** The key appeal of this idea is the radical flexibility that participating small business owners would be able to attain by accessing a portfolio of properties that they collectively own, manage, and govern.



“So a **bunch of farmers got together and everyone put \$15,000 into a pot, and they built a little building. And then they rented that out to someone who came and operated the cafe there.** So you know, that's a form of crowd lending, or crowd investing in the sense that you have a lot of different people coming together to create a building or property. And then you find a tenant to operate that building.”

FEL Interview with an industry expert

## What's Next

The Future Economy Lab team is looking forward to convening at our **January 18th, February 15th, and March 15th workshops**. We will be discussing the learnings from the lab to-date and begin co-designing solutions that will mobilize financial capital and other resources to small business owners so they can purchase property without barriers.

