

Financing for Commercial Real Estate

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In the real estate industry, commercial buildings are “bricks and mortar” investments bought, and later sold for profit. But to you, the acquisition of a commercial building functions as both an investment and a place to conduct your business.

For businessmen and women who plan to acquire business property, there’s good news: the commercial real estate market rebounded from the lean years of the early 1990s. Finance sources, once reluctant to underwrite all but the most secure commercial property loans, have freed up capital for owner occupied properties costing from \$500,000 to \$10 million.

While each lending institution has specific loan application guidelines, all evaluate business mortgages based on two critical factors: the financial strength of the borrower or borrowing entity, and the economic feasibility of the project.

A qualified commercial mortgage banker or experienced real estate finance professional should be consulted, of course, when applying for a loan. Still it’s prudent to review the following questions before starting the formal process.

Where will the money come from?

The U.S. Small Business Administration (SBA) offers a variety of mortgage programs administered through local and regional commercial banks. The programs include financing for new and existing properties, and some offer financing for non-real estate assets, like a printing press or furniture. Other sources are conduit lenders -- which typically are direct lenders who originate loans through in-house staff and mortgage brokers – commercial banks and insurance companies.

How much cash will it take?

The percentage of leverage or the down payment amount required for a property purchase will vary based on the lender. A mortgage secured through the SBA will require 10 percent of the purchase price, meaning you will finance 90 percent. Commercial banks, conduits and insurance companies generally require that you finance 85 percent of the loan.

How will the loan be structured?

Experts advise the owner-occupant to keep the mortgage responsibility separate from the primary business. To do this, form a separate real estate entity that will lease the building to the operating company. Also be very wary of entering into a recourse loan, which gives the holder of the note the right to sue you for repayment and not just seize the property if you default.

What will you need?

Be prepared to provide at least five years of business operating statements when applying for a mortgage. Lenders look for a solid track record, and the terms and amount of the loan will be tied to the financial strength and stability of the owner’s business.

What terms will you need to know?

Become familiar with the following:

1. Amortization schedule - Shows the breakdown of each payment of a loan by the amount applied to the principal and the interest.
2. Basis point - A finance term meaning a yield of 1/100th of 1 percent annually.
3. Debt coverage ratio - Net operating income divided by the debt service.
4. Loan-to-value ratio - Mortgage principal divided by the market value of the real estate collateralizing the mortgage.

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