



What commercial real estate borrowers need to know before applying for a loan - by Chris Mavros

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Before a commercial real estate borrower engages a traditional or other lending institution, he or she needs to be aware of the ground rules. The basics can be boiled down to a set of what I call the “top 10” rules. Investors that ignore them could, at the very least, throw away some hard-earned money and delay their project. At the other end of the spectrum, they may get badly burned and jeopardize their entire investment.

1. Get a handle on your borrowing power. A bank or other traditional lender will qualify you, or not, based on your creditworthiness. This includes but is not limited to your FICO score and other personal lending track records. Important issues also include the collateral you are offering, and the cash flow associated with it. Once you, and your financial or other advisor, analyze your circumstances, you will be in a better position to gauge your borrowing limit, and whether you should approach a bank.

You may also wish to consider an asset-based loan, which may be available from a private, or hard-money or another secondary market source. An asset-based lender will not focus as much on your financial history and personal creditworthiness. Instead, they give more weight to the value of the asset, since it may be seized in case of default.

2. Define the purpose of your loan, and how fast you need the funds. Determining your creditworthiness is the first step in the borrowing process but answering the why and when will also help steer you to the right funding source. The type of property you are looking at, as well as your status as a small business owner may qualify you for a loan from the Small Business Association (SBA), but if you need cash in a hurry, the SBA may not be able to meet your deadline. In that case, you could consider a bridge loan from a hard money lender, although additional fees may be involved. Either way, as you decide, consider the dynamics and the urgency of the loan you are seeking.

3. Get your documentation together. If your real estate collateral generates income, you will be expected to provide copies of any leases, rent rolls, and agreements with contractors. The lender

will likely also request documentation showing that the real estate collateral has all necessary environmental clearances.

4. Mind the details. Be prepared to provide a survey of any land that is part of your collateral. A lender will want to know about any easements or encroachments, evidence of use by other parties, and whether the property is accessible by existing roads. They will also want to be aware of any zoning or other approvals that are needed to conform with the planned use of the property.

5. Consider a loan broker. In addition to your own due diligence, a loan broker may also help. They can help you to get through the groundwork in an efficient manner, will likely have many connections across a variety of lender segments, and may be able to steer you to a lower interest rate. A broker will charge a fee, but the potential time and other savings could outweigh the cost.

6. Budget for closing costs. Bridge lenders and other non-traditional sources are usually more expensive than traditional bank lenders. With that in mind, consider the possibility of additional fees or higher interest rates, your broker or other advisor can help you to determine this, and incorporate these costs in your business plan.

7. Prepare financial statements. Your lender may ask for certain paperwork, including three years of tax returns, income and expense projections; and three years of business and personal financial statements for you and for any guarantors. It helps to have the documentation prepared by a certified public accountant (CPA). Also be prepared to hand over a formal appraisal of your collateral that has been done by an independent third party.

8. Support your case with a well-crafted business plan. Understandably, lenders will ask to see your business plan. This lets them know how you expect to use the property and how you plan to pay back the loan.

9. Detail an exit strategy. An exit plan complements the business plan, since it gives the lender additional confidence that their loan will be repaid. The exit plan will detail the cash flows expected to be generated by the collateral; and it should outline the guarantees in case the borrower defaults on the loan. A cautious lender may also ask for a personal guarantee.

10. Strike a balance (leverage isn't for everyone.) Many lenders want a borrower to put as much equity in as possible, since that reduces the lender's exposure. But you should consider your cash flow, and the tradeoff between having a cash cushion — by taking on more leverage — and the cost of the leverage, since your monthly repayment costs will be higher. Try to strike a balance that is acceptable to your lender without crimping your cash flow.

Today, many commercial real estate borrowers find they are in a good position. Interest rates are low, and the fed's recent 25-basis-point reduction in the federal funds rate is likely to drive rates even lower. Meanwhile, lenders appear to be cautiously increasing their activity, although the ride may continue to be bumpy in the near future. But borrowers who complete their due diligence in a prudent, timely manner are more likely to be successful when they apply for a loan.

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