



Commercial real estate financing basics: Secure the best terms, protect long-term interests - by Nicholas Racanelli

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When it comes to financing a commercial real estate property, there are many misconceptions that prevail both among real estate investors and their brokers. These misconceptions can place an investor in unnecessary risk and incurring poor terms and high costs. Understanding some basic tenets can help investors/property owners secure the best terms and protect their long-term interests.

Real Estate Financing: Myths vs. Reality

It's true that real estate is one of the best long-term investments. It's a myth, however, to think that this favorable asset cannot represent significant losses under circumstances of rising interest rates, floating rate loans that can't be refinanced or properties that are unable to carry their debt. That leads to another myth which relates to past performance as predictor of future performance. Especially today with considerable market volatility, it's not a prudent position to take. Another common myth is that liquidity in terms of capital (i.e., equity and debt) will always be available. In reality, most credit cycles feature multiple years during which liquidity is less accessible. One of the most common misconceptions is that obtaining financing is the same regardless of the source. Price and structure vary significantly from the various lenders.

Assessing Financing Options

Conventional mortgages, self-amortizing loans, insurance company financing, conventional lender and credit union financing, bridge loans, hard money financing, SBA loans, construction loans or lines of credit to permanent financing – what's the right option and from what lender. There's a lot here to understand and investors should take the time to perform their due diligence in vetting the resources and the best type of financing for their transaction.

For example, many investors automatically assume they will always get the best terms working with their primary bank. Or, they believe that most traditional banks have similar terms. While it is true that banks offer some of the lowest mortgage rates and loans can have amortization of 20-30 years, it's also true that they are inflexible with respect to down payments, credit scores and income requirements. Their loan approvals can also be quite lengthy and some banks can be inflexible about financing owner-occupied properties vs. investment properties and pre-payment penalties.

Another source for commercial real estate financing are transactional funders which concentrate their lending to real estate wholesale deals and/or funding for a property's renovation and flip for a sale. Working with these lenders demands attention to their fee structure and the project's renovation costs. It's important that the cost of the funding (interest and fees) can be recovered in the sale of the property. These lenders often can provide much quicker financing, from same day to a few days for wholesale real estate deals to a few months for a "flip" transaction.

Another option is hard money lenders; private companies whose primary focus is on the value of property for which the lending is allocated. These lenders move quickly in providing financing, but their loans require higher interest rates (e.g., 10-15%), larger down payments (e.g., 25-50%), and shorter loan terms (e.g., one year to three years).

Other financing options include Small Business Administration (SBA) 504 loans. These are two loans in one: one from a conventional bank and one from a Certified Development Company (CDC). The bank lends 50% of the required loan and the CDC lends 40% with the investor putting down 10%.

A Commercial Real Estate Finance Professional's Role

Before contacting a lending source, it's wise to first consult with a commercial real estate finance professional. This individual will provide objective advice and leverage his/her network to guide the investor to the best resources for the specific transaction. Investors can also expect to gain wisdom from the professional regarding critical finance-related considerations such as loan-to-value, debt service coverage ratio, estimating cash flow, projected net income after expenses versus gross income, cost segregation studies and most importantly, understanding the differences between lenders and their requirements. It all comes under the heading of performing your due diligence.

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