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It is a great time to buy commercial real estate

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Prices are down, CAP Rates are up, and some owners must sell because they can't refinance! "Cash is king!" People buying all cash can certainly find some great opportunities.

But that does not mean you cannot get financing today. In most markets the underwriting standards of banks has gotten more stringent. Investors today will need 30% to 40% of the price as a down payment. This is established by the Loan-to-Value Ratio (LTV). The lender is concerned that if the borrower defaults on the loan, and they have to foreclose on the property, how quickly could they sell it. If they limit the loan to a LTV of 60% to 70% of the appraised value; a quick sale in this event should be possible. The LTV may be calculated with the following formula:

Net Operating Income Ã· Purchase Price (Value) = Loan-to-Value Percentage

Perhaps of more consideration to the lenders today is the cash flow of the property. Is there sufficient revenue to support the loan? We look at the income of a property, subtract the owner's operating expenses and what remains is the Net Operating Income (NOI). This is the money that would be available to pay back the annual cost of the loan known as the Annual Debt Service (ADS). However, what if a tenant leaves and that income stream is interrupted and reduced. Lenders will reduce the amount of the NOI they will consider available for debt repayment by using what is known as the Debt Service Ratio (DSR) or Debt Coverage Ratio (DCR). The ratio of the loan to the NOI must not be less that the DSR. Typical today is a DSR of 1.25; this is calculated with the following formula:

Net Operating Income Ã· Annual Debt Service = Debt Service Ratio

Even though the underwriting standards are tight, and LTV percentages are high, given a solid down payment financing is available. The good news is the interest rates are historically low. Commercial rates will not be as low as residential but they still are a good deal.

If someone is buying a building for their own use they may be eligible for a Small Business Administration (SBA) loan program. In some cases this can result in 90% financing! Even if the buyer wants a larger building than they need for their business, provided they occupy 51% of the building themselves they may be eligible for these programs.

Another change in our market is that many sellers today (if they have little or no debt) will consider "holding paper;" providing a mortgage loan. They may express more flexibility than traditional lenders with regard to LTV and DSR ratios. They also have an interesting fallback position in the event that the buyer defaults on their loan. They get to keep the down payment and get their building back to sell again!

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