Beckner & Associates, Inc.
Commercial Real Estate Services

How Do I Finance the Purchase of a Building?

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The average person has little understanding of the financing of a commercial property. They tend to assume it is similar to the financing of a home. That is very far from reality. The transaction is more sophisticated and the funding sources are not the same. There are four major sources of funding which will be discussed below. Which one is best for you depends on whether the property is used by your company or is an investment property. Other considerations are your financial strength, the size of the loan, the length of term you desire, and the financial condition of either your company or the income stream generated by the property.

Traditional Bank Financing

Most buyers of real estate visit their local banker first when they are considering a commercial property purchase. This may not always be the best decision. Banking is a highly regulated industry which is generally interested in short term loans. Buyers tend to use their local bank because they are dealing with individuals they know and who know the most about their financial strengths and abilities. But not all banks are created equally. Some banks focus on commercial real estate while others tend to shy away from it. Almost every bank has some real estate on their books. But, the terms may vary widely.

The traditional bank loan seeks a 20-25% down payment. The term is usually 3-5 years and the rate is fixed at a rate based on the prime interest rate at the time of the loan. The amortization period is usually 15-20 years but longer amortization periods may be available. These terms are all negotiable within the requirements of the regulators. A 15% down payment is possible if you have strong banking relations and strong financials. Banks are in competition with each other to obtain loan customers. Therefore, it is wise to discuss the potential purchase with more than one bank if you want the best terms available. Unlike residential financing it is very difficult to get “preapproved.” The bank will base its decision on the specific property you want financed. You might be approved for a more expensive property as an investment because it has strong tenants with long-term leases but turned down for the same loan amount if your company has to pay the entire loan.

SBA Loan

The SBA loan is available to buyers whose companies will be tenants in the property. The company must occupy 67% of the building on new construction and 50% on existing properties. The SBA loan is actually a bank loan with a government guarantee. The SBA does not actually loan any money. The local bank funds the loan with SBA approval. Banks are designated by the SBA as being a Qualified bank, a Certified bank or a Preferred bank. A Qualified bank is allowed to make SBA loans but does not have significant experience with the SBA. A loan through one of these banks usually takes longer due to more intense scrutiny by the SBA. A Certified bank has significant experience and as a result the SBA says that loan applications will be approved in approximately three days after submission. The Preferred bank usually has a loan officer with significant experience working with the SBA and often was previously an SBA employee. The Preferred bank can approve the loan at the bank board level and the SBA accepts the loan and assigns a loan number. Obviously, the Preferred bank is usually the fastest and easiest bank with which to work. There are several in the area from which to choose.

The 7A program allows the borrower to make as small as a 10% down payment with a term and amortization period of up to 25 years with no prepayment penalty. The local bank actually sets the exact terms within the SBA parameters and the SBA guarantees 80% of the bank loan. Usually the interest rate is allowed to float at a prime plus rate. Since the loan is 100% funded by the bank they set the interest rate. The maximum rate allowed by the SBA is prime plus 2.75%. The SBA can adjust its parameters so the above must be viewed as approximations. Again, it must be stressed that the local bank sets the exact terms and not the SBA. The terms are therefore negotiable with the bank. It must be stressed that the SBA will take an application from only one bank. So care must be taken to work with the most aggressive bank.

Most banks encourage a 504 SBA loan. In this loan the borrower applies to the local bank but his application will also be reviewed by the Certified Economic Development Council (CDEC). The bank funds 40% of the purchase price with the Certified (CDEC) funding 50% based on a 10% down payment. The terms of the bank's portion are the same as the 7A. But, the CDED funds are based upon bonds sold each month at the national level. Being bonds the interest rate can be lower than that offered by the bank. But, the term is 20 years and there is a prepayment penalty if the bonds are paid off early. Further, since they involve selling bonds there are fees charged for the process. These fees can be included in the loan. Banks prefer this loan because the CDEC is willing to take a second mortgage position to the bank. Thus this loan is one of the safest loans a bank can make. Since the loan must be approved by the local CDEC board this process is usually longer than the 7A.

Generally, we encourage the 7A program since it has a longer potential amortization period and it does not have a prepayment penalty. The 504 makes sense for established stable companies who are confident that they will not move for at least five years. But, most of the companies we have worked with outgrow the property or sell the company in a relatively short time period. We encourage our clients to utilize the 7A and then refinance to traditional bank financing. Usually with appreciation and debt reduction the additional down payment required is available with current equity. Traditional bank financing will usually have a lower fixed interest rate which results in lower monthly payments.

Permanent Financing

A third funding source is from insurance companies and pension funds. These funds are available through a mortgage broker who prepares a loan package and works with the funding source to approve the loan. These loans are available for larger purchases (usually over $2,000,000 but some smaller loans are available). The advantage of these loans is that they are intended to be long-term. They have fixed rates and 15-30 year amortization schedules. For an investor or owner/user that plans to hold the property for an extended period of five years or more these loans have much lower rates than bank financing. The major drawback is the prepayment penalty. If a buyer can finance during a period of lower interest rates it can greatly improve the cash-flow of the property. These loans also remove the danger of having to refinance the property when rates are high. The cost of the mortgage broker is usually .5-1%.

Industrial Revenue Bonds

In certain circumstances Industrial Revenue Bonds are available to finance a property. To determine the potential availability of IRB’s you should contact the local Economic Development Director. Usually, the IRB’s offer tax reduction and other incentives. They are used to entice a company to move to that city. In most cases, the IRB’s are actually purchased by the local bank using traditional bank financing with the incentives going to the building owner. Except for the legalities of the bonds the loan terms are basically the same.