# How to Close a Commercial Real Estate Loan Transaction

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A commercial real estate loan is the single most important transaction for a privately owned business, and it is a close second to shareholder transactions for a publicly owned business. Purchasing commercial property may lead to lower expenses and greater control over the business as a whole. Commercial mortgages may also be used to refinance property that has already been purchased in order to obtain lower interest rates, payments that fit into company budgets or to secure capital with commercial property equity. However, closing a commercial real estate loan is not always easy. The following guide provides information and tips on closing commercial real estate loans as quickly and efficiently as possible.

## What Is a Commercial Real Estate Loan?

In addition to being one of the most important business transactions a company will make, a commercial real estate loan is also one of the largest transactions made by a business. Commercial real estate may include land and existing buildings, which may be repurposed for the business or demolished to make way for new structures.

When considering commercial real estate, the old adage about the importance of location holds true. The property must be in a location that will maximize the efforts of the business and support its long term growth. However, a business cannot go overboard by purchasing more property than is financially comfortable. In today's business and social climates, sustainability has also become an issue, and property should have elements that allow the land to be made sustainable without putting financial strain on the company purchasing it.

The number one problem with making commercial real estate purchases is the expense. Very few companies have the free capital to complete such a purchase with cash, and even those with full coffers understand that free cash is best used to grow sales and profit. This makes a loan necessary for the purchase of commercial property, but closing the loan comes with a set of headache-inducing requirements that can only be overcome with experience or knowledge of the process. Once the property is purchased, however, many businesses begin to experience increased revenue and grow a stronger asset portfolio, both of which produce a balance sheet that business owners and shareholders like to see.

## The Importance of Purpose

When a business applies for a commercial real estate loan, all aspects of the company are diligently scrutinized by the lender. The financial institution that is originating the loan will need to know the general purpose of the property and how the business will specifically make use of the land and any existing structures.

The first fact that anyone who wishes to close a commercial property loan should know is that commercial lenders are financial institutions and not real estate companies. They do not want to own property. Foreclosing on commercial property equals a loss for the lender, but this loss can be mitigated or turned around with particular types of property or property meeting specific criteria.

Of course, nothing can keep some businesses from defaulting on their commercial loans, so lenders end up owning property that they do not care to own. Once ownership of commercial property is transferred to a lender, its goal is to sell that property as quickly as it can for as much money as possible.

One of the techniques that lenders use to increase the chances that they will be able to resell property should it fall into their hands is to write loans only for property that can be used for multiple purposes. While some lenders will take a chance on limited-use or single-use properties, many others will not even consider writing loans for such properties.

Examples of properties that may be difficult to acquire a loan to purchase include churches, cemeteries, mobile home parks and car washes. On the other hand, the types of properties that lenders prefer to approve for loans are warehouses and office buildings. These types of properties can serve multiple purposes and can serve the needs of businesses in a variety of industries.

Another technique used by lenders to screen for risk is to consider the specific plans a business has for the property after it is purchased. Lenders are more likely to loan money to companies that will occupy the property as an operations or administration center. In addition, lenders are apt to give better interest rates and loan terms for properties that are occupied by the buyers. Statistics show that a business is less likely to default on a loan for property that is to be used as its headquarters. Businesses will find it difficult to secure loans for properties that are only to be used as investments. These properties require strong financial statements from the business and may include higher interest rates and inflexible terms.

**Loan Amounts**

Very few lenders will originate a loan for 100 percent of the appraised value of commercial real estate. One of the reasons for this is that commercial real estate has a higher value than most residential real estate. Property with higher value carries greater risk for commercial lenders.

Commercial properties usually start in the range of $250,000 and go up from there. One missed payment on loans for this amount can create a substantial loss for a lender unless a down payment is made on the property. In addition, the fees for foreclosure and the resale of foreclosed commercial properties are greater than the fees for residential properties.

For these reasons, most lenders will require a minimum down payment of 20 percent of the value of the property. If a business cannot produce a down payment of this amount, the only way it will be considered as the basis for a loan is if the property can be purchased at a price below its appraised value.

The only loans that are excluded from the 20 percent minimum down payment are loans that are guaranteed by the U.S. Small Business Administration (SBA). SBA loans may only require a down payment of 10 percent.

**Revenue, Expenses and Cash Flow**

Among the top considerations of lenders for commercial property are business financial statements. High revenue, low expenses and a strong cash flow are vital for successfully closing commercial real estate loans. In some cases, strong financial statements can substitute for other criteria that lenders use to approve loans, such as the number of years the business has operated and the planned utilization of the property.

Lenders need to know that a business's cash flow is sufficient to cover both the loan principal and the interest in the timeframe established in the terms of the loan. Even though many different payment structures can be used, including balloon payments, interest-only payments and quarterly payments, they all require sufficient cash flow.

Some lenders have strict cash flow requirements that could be as much as 50 percent over and above the amount of a regular loan payment. This ensures that a business will have enough cash even in periods when sales are low.

To discover if a business has sufficient cash flow, it is necessary to calculate its earnings before interest, taxes, depreciation and amortization (EBITDA). For the best chances of successfully closing a commercial real estate loan, a business should have monthly EBITDA in the range of 25 percent to 50 percent greater than the monthly loan payment.

**Documentation**

No hard and fast rules exist for what kind of documentation is required to close a commercial real estate loan, but generally speaking, the more documentation a business can provide, the better its chances. Lenders will let each business know what documents are required, and it is best for those in charge of the transaction to understand that these requirements are put in place for the protection of the lender.

Two sets of documents are usually required. The initial set of documents is used to verify the ability of the business to repay the loan and is requested during the approval process. After approval, another set of documents is required to confirm that the property is sufficient as collateral for the loan.

Documents requested by a lender may include any or all of the following:

• Financial statements for the past three years
• Current leases
• Rent rolls and estoppel certificates
• Title insurance with the proper endorsements
• Survey plats
• Environmental safety reports
• Inspection reports for structures

The preceding list is by no means exhaustive. Lenders may ask for additional forms of documentation at any time before closing the loan. Purchase agreements signed by a business should include sufficient time for the delivery of all documentation to the lender to decrease the risk of an aborted closing.

**Closing Costs**

A business in the process of purchasing commercial real estate should plan ahead of time for the impending closing costs. In most cases, when a buyer and lender work closely together on the deal, closing costs can be kept to a minimum. However, the minimum closing costs can still add up to a substantial amount. If these costs are not accounted for, then the business may experience trouble when it comes time to pay them. If the costs will be figured into the amount of the loan, then the business must treat them as part of the cost of the property. Closing costs may include the following:

• Inspection fees
• Attorney fees
• Environmental audit fees
• Site survey fees
• Title insurance