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FINANCIAL FOCUS



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Accountants & Advisors

Your Accounting for a New Economy

Negotiating Commercial Real Estate Loans In Today's Economy

Over the last few years real estate industry investors have experienced difficulty in securing large commercial real estate loans. The constricting of credit has led to a shortage of capital available and lenders are requiring much larger down payments, but there are steps real estate investors can take to improve the terms of the loan and potentially lower their down payment, and lock in a rate cap on an adjustable rate mortgage without “paying” for extra points.

Before the recession many lenders were offering 75% loan-to-value on office buildings, retail centers, and industrial buildings. In fact, in 2006 and 2007 some lenders were making loans with as much as 80% loan-to-value, but now a potential buyer would be hard pressed to find a loan with more than a 60 – 65% loan-to-value. Further complicating matters, sellers, for the most part, are no longer allowed to carry back a second mortgage behind their first mortgage loans. The increased risk in capital for potential buyers has inevitably led to a reduced interest in the real estate market and put an additional burden on an already struggling industry.

With lenders regularly requiring investors to put down 35 – 40% percent in cash, a \$2,000,000 loan would necessitate an \$800,000 down payment. This represents a prohibitively large investment for many potential buyers. However, with your lender's consent the following agreement could bring the down payment into a more manageable range.

Let's take the example of the \$2,000,000 loan detailed above:

1. The buyer would put down \$500,000 in cash. A significant amount and more than enough to demonstrate his intentions to make the required loan payments and maintain the property. It is also in line with the 25% down payment lenders were requiring before the current recession.

2. To make up the difference, the seller could then carry back a second mortgage on a different property owned by the buyer.

This type of arrangement can be a valuable tool in helping to minimize the down payment and acquire new property.

Another impact of the economic downturn is that most commercial loans are saddled with an adjustable rate rather than the more desirable fixed rate. Most borrowers, no doubt, will want a limit on how high a rate can go. This is called an interest rate ceiling or cap, and a lender will usually charge the borrower a point or two on their loan to establish a cap.

However, the investor has some leverage in these negotiations as well. The lender wants a limit on how low an adjustable rate can go called a floor. A loan with both a ceiling and a floor in place is said to have a collar, and can serve as protection for both the borrower and the lender.

Often times a borrower can get the adjustable rate ceiling set on their loan, without paying any points, by simply agreeing to a floor.

Even in these trying times there is room for negotiation, and there are things investors can do to improve the terms of a proposed loan. It just may require a little out-of-the-box thinking.

If you have any questions or would like additional information on LGT's Real Estate Niche, contact your trusted advisor at Lane Gorman Trubitt, L.L.P. or Richard Trubitt, the partner-in-charge of the Real Estate Group at (214) 461-1433 or by email at rtrubitt@lgt-cpa.com.