

Financing Commercial Real Estate

First, let's define commercial real estate.

Commercial real estate can be considered to be everything in real estate that is not a house or condominium. That gives us the category ICI or Industrial Commercial Investment real estate.

It is often considered to include duplexes, triplexes, and fourplexes, as these are investment properties which are purchased to generate investment income. These types of properties are considered to be less complex investments and to a large degree are financed similarly to single-family houses. The lender's main consideration in such purchases is the financial strength of the buyer. Depending on the lenders involved a percentage of the rents may be added to the buyer's income, but the buyer's income will be the main consideration of the lender when looking at the covenant. While the building will still be checked and appraised the complexity of the mortgage transaction is not high.

Buying and Financing Larger Investment Real Estate

Purchasing larger real estate investments, such as multi-family, retail buildings, industrial buildings, strip plazas, commercial buildings, office buildings, or retail malls is a much more complicated financial process. While the lenders will look at the buyer's financial track record, financial depth and track record with real estate management, a great deal more attention will be paid in these transactions to the commercial buildings and the underlying leases since that is where the mortgage payments will be coming from! Lenders will be looking to the building's debt coverage ratio and to the building's history and stability and current condition.

When making such investments, you should definitely talk to prospective lenders including your own bank before beginning a search. Be aware however, that in this type of purchase there is almost no such thing as a preapproval.

The process is usually divided into two halves. The first is development and provision of a Term Sheet by the lender. The Term Sheet will set out the terms the lender is prepared to lend on, but it is ABSOLUTELY NOT a commitment to make the loan! It's a document used to provide clarity for both the lender and the borrower of the terms under discussion. It will set out the terms, interest rate, loan amount, repayment schedule, limitations on additional credit, loan fees, conditions that must be fulfilled by the borrower, any additional guarantees or covenants required, and due diligence requirements of the lender.

The second half of the process is Credit and Due Diligence. Usually at this point the borrower is required to pay a deposit to the lender against the lender's loan fees. [This deposit may or may not be refundable in the event the lender declines to advance the loan.] The Credit and Due Diligence period is the time where the lenders satisfy themselves that there are no hidden landmines in the deal. Due diligence requirements on commercial real estate will almost always include satisfactory review of the borrower's credit and financial strength, ability to manage the asset, satisfactory review and verification of the leases on the property, an appraisal satisfactory to the lender, completion of at least a satisfactory Phase 1 Environmental Audit. Often the lender will require a satisfactory commercial building inspection by an engineer and/or a fire inspection report. Any reports such as Environmental, Appraisal or Engineering will need to come from experts acceptable to the lender, be paid for by

the borrower and either be commissioned by the lender or come with a transmittal or reliance letter in favor of the lender.

This second half will result in either a turndown or a Commitment Letter from the Lender which will promise the loan, set out the terms of the loan and any conditions and their due dates.

In most cases you will need to use a lawyer approved by the particular lender to do the mortgage. Sometimes if your own lawyer is one approved by the lender you will be allowed to use your lawyer to do both the mortgage and the closing of the purchase but this is by no means assured.

Buying and Financing a Building for Your Own Business

This is one of the most difficult types of purchases in commercial real estate to finance.

Remember when your last employee asked you for a salary letter because they were buying a house? Next thing you heard they got the house, got the mortgage, were moving in-no real problem at all!

Remember the last time you as an entrepreneur bought a house? The bank never asked you for a salary letter, did they?? No, they wanted a whole lot of expensive paperwork, financial statements from your accountant about your business and your personal financial statements and probably several years Notices of Assessment (NOA) for income tax from Canada Revenue Agency! And I'll just bet that your employee got his approval a lot faster than you got yours!

Well, get ready for the ride!

The lender is going to want even more paperwork when you're buying a commercial building for your business! They're also going to want you to have more equity to put in than if you are merely buying the property to lease out as an investment. You see, the lenders see themselves as a partner in your deal - and they've usually got more in the deal when it's done than you do!

Talk to your accountant ahead of time! Have him ready to submit at least three years of profit and loss statements and balance sheets for your business and for you personally. You will also need documents from Canada Revenue Agency that show all taxes fully paid up to date including income tax and HST and fully paid up to date remittance of all statutory deductions and remittances such as WSIB. This is all in addition to the documentation and reports in the section above [Buying and Financing Larger Investment Real Estate].

All of this applies when purchasing a commercial location for your own business whether it's a single small industrial unit for sale, an industrial condominium for sale, a commercial condominium for sale, an office building for sale, or a warehouse for sale.

Time goes past very quickly during the conditional period in an agreement purchase and sale-have this paperwork ready in advance of the purchase!

Buying New Construction for Your Own Business

Usually when buying new construction commercial real estate such as a single small industrial unit for sale, an industrial condominium for sale, a commercial condominium for sale, an office building for sale, or a warehouse for sale, what you're getting is referred to as a shell.

Very little will be finished inside the building that you're buying!

Usually the builder will have installed the HVAC and installed the drops in the unit - but the distribution ducting will not be there, because the ceiling is not there.

The cement walls and steel roof deck will be in place. The cement floor will be in place.

Rough ins for washrooms will usually be in place. Sprinklers may or may not be installed but the drop length may not be correct for the ceiling you contemplate.

In the event that you're using your own contractor to finish out the unit, the lender will want to see and approve the construction contracts. They will also require a strict accounting of all monies paid out for the construction. They will also require construction lien holdbacks until the time for liens has expired. They will require that all contractors, plumbers, and electricians etc. be licensed and insured. They will also strictly require that all building permits and permissions be in place and properly closed before final advance.

Keep every single bill, invoice and contract! Keep evidence of payment whether it's a cheque or a credit card receipt and be prepared to submit it!

I well remember brokering a purchase of a medical shall for a client of mine. This client ordered deluxe ceiling tiles on the Internet from a company in Montréal. She had evidence of the payment on her credit card bill - But the lender insisted on having a copy of the paid invoice before doing the final advance! Unfortunately she had misplaced the email with the invoice! The lender had us all turning cartwheels until she found the invoice in her spam folder!

I sincerely hope that this article has been of some assistance to you. The process of financing a commercial real estate purchase is complex, but, armed with advance understanding of the process and with the assistance of a competent commercial real estate broker, a competent accountant, and a competent commercial real estate lawyer - the path can be reasonably smooth.

In the event that I can assist you with the purchase, sale, or lease of your commercial real estate, please either fill out a contact form on www.Timreed.ca or contact me via the phone numbers on the website. I would be most pleased to speak with you!

Tim Reed

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