

## **Guide to getting a Commercial Mortgage**

### What is a Commercial Property?

A Commercial Property is a Property with a Business Use. So it includes shops, offices, warehouses, petrol stations, hotels, restaurants etc etc. For the purpose of this guide we are going to exclude buy to let properties which fall into a separate category from both residential and commercial property.

### What is a Commercial Mortgage?

A Commercial Mortgage is a mortgage used for the purpose of financing the purchase of a Commercial Property. In order to get a Commercial Mortgage you have to be purchasing either the freehold of the Commercial Property or a long lease ie 99 years or more. If you are purchasing a traditional 15 or even 21 year lease of a Commercial Property then the Property is not considered an Asset in the same way as a freehold or long lease. Again for the purpose of this guide we are excluding such Properties

### Who buys Commercial Property

There are two categories of Buyer. The first and most common is the Owner/Occupier. The person who is going to operate the Business that is run from the Premises. The second category is the Investor who wants to hold the Property as an Investment and lease it out to third parties.

### What is the difference between a Commercial and Residential Mortgage.

The most important point to understand is that the way Lenders view a Commercial Mortgage and a Commercial Property is completely different from the way they view residential property.

Many first time Commercial Property Owners think that a mortgage is a mortgage and that the rules that apply to a Residential Mortgage will apply to a Commercial Mortgage.

They expect to see a wide variety of Commercial Mortgage options including offset mortgages, fixed term mortgages, tracker mortgages etc. They expect 80 or 90% funding to be available ( although in the current market that is not so easy now even for Residential Mortgages)

They expect to see mortgage rates of between 2 and 5%. Most importantly they expect to see lots of Lenders competing for their business.

They are wrong on all counts. There are only a small group of serious Commercial Lenders. They will normally only offer a repayment mortgage. Many Buyers will only get loans at 10% or more and will be required to pay a deposit of 30 to 40%.

Many in reality are not keen to lend on Commercial Property because their loan books are full of Commercial Property loans that are not of good quality and they do not want more. There is not a lot of vigorous competition to lend

### Why is the Commercial Property Market so tough?

Commercial Property is a lot less sellable / rentable than residential property. That is not true of all Commercial Property in all locations but it is true of most. If you have a warehouse with a successful business operating from it then it is a great security. But if that Business leaves and you want to sell or rent that property it can be a very difficult proposition to find a person to buy it. That is why many Commercial Properties can take a long time to rent between Tenants.

The market for Commercial Property is much harder to evaluate. If you have a residential property it is fairly easy for a lender to work out what its likely value will be if they take possession and have to sell to recover their loan. Of course mistakes still occur and if there is a sudden downturn in the market then Lenders can make a loss. But they are less likely to do so if they have acted prudently than with Commercial Property.

If you have to repossess a Commercial Property you are less certain in reality who will actually be prepared to buy it when you have to sell. Even though the Property may be attractive and in the right area you still need to find a Commercial Buyer who wants to buy that particular Property.

### What factors will a Lender consider when deciding to grant a loan?

Owner Occupiers of a Commercial Property are probably getting their main income from the Business that they operate from the Property. So it is more difficult to assess their ability to repay. Most Lenders will want to see at least 3 years accounts. They will want properly prepared accounts and tax returns to show the income and tax paid. This is where the tax dodger who takes their money in cash will have a problem because a Lender will not lend against undeclared income.

Lenders will take into account relevant expenses related to your net profit. So if you pay yourself a wage that is in effect an earning that could go towards payment of a mortgage. The same applies to dividends or to rents that you pay but will not pay if you move to a freehold building.

The Lender then has to ask can your business afford the repayments out of its turnover/ profit. The Lender will be aware that business fortunes can change rapidly.

So the first and most important consideration a Lender will have is can you afford the repay the Loan.

Next the Lender will want to consider the value of the Property against the value of the loan. They will want to see in most cases a substantial deposit from your own resources, In many cases that will be 30% or more

Then they will have to value the Property. That valuation will be important but not as important as the ability of your Business to repay the loan. Clients with no mortgage but low income declared are often very surprised that Lenders take very little comfort from having lots of equity in a property. The Residential Market has become tougher in this respect as well but basically there is still a much better chance of borrowing in

the Residential Market if you can show your loan is well below say 50% of the value of the Property. That does not apply for Commercial Mortgages

Your business experience and business plans will be a lot more important to Lenders in the Commercial Market. How successful are you at running your Business.

What is your Business.? Is it one that is likely to be able to continue to generate enough income to pay off your Mortgage? What are your plans for the future when you move into your new premises.

How secure is your business if you are not able to run it. Lenders many want to see you have Insurance to cover the situation where you cannot operate your business due to death or ill health

We would suggest that these are not unusual points to consider and that most Borrowers who were going to lend on a Commercial Property would be asking these questions. But what is strange is that a lot of Business people applying for loans just do not anticipate that these questions will be asked and have difficulty in supplying answers to them

### Fees

A Commercial Loan will incur you in a number of fees most of which will be higher than for a residential loan. You will have to pay for a valuation. You will have to pay a broker fee if you use a broker to source your loan. You will have to pay a fee to the Lender which can be 1 or 1,5% (or even more) of the loan.

You will have to pay legal fees both for yourself and your Lender. These will be higher than for residential purchases With a residential mortgage the Lender will normally use your Solicitor to do the work on their behalf as well. For Commercial Loans the Lender often will not want to use your Solicitor but will want to use their own Solicitor who you have to pay for.

### Legal Work

Commercial Purchases can be a lot more complex than residential purchases The property is being used for Business purposes. There are far more rules and regulations that govern such use than for a residential property. In addition many different Businesses have different rules and regulations that are relevant to that particular business that they have to follow regarding Property that they use. These differ from Business to Business. A nursing home a Petrol Station and a Post Office for example are all governed by different specific rules related to those Businesses,

So your Solicitor ( if they are doing their job properly) has to check if there are any issues relating to those issues in respect of the Property As a result the standard enquiries used by most Solicitors run to over 30 pages of detailed questions in many cases with supplementary forms for different types of property. That is before your Solicitor raises his or your own specific queries

In addition if the Property you are purchasing includes a Business and employees then this raises a whole set of new documentation and legal points your Solicitor needs to consider.

Consideration has to be given to rules relating to rights and responsibilities towards existing employees when a Business is taken over for example. Most people know that you cannot just take over the Business and ignore those employees or consider them the Seller's problem because as the new Owner they automatically become your responsibility. Not only from the day you take over but for all claims they may have prior to your taking over.

You also have to consider what warranties and contract documents you should use in respect of the purchase of the Business

### Benefits

Why should you bother to get a Commercial Mortgage?

For many businesses you may be surprised to hear us say they do not actually make sense. The advantage of a lease is that you have no upfront capital cost. You can leave the Property when the lease comes to an end but (subject to certain special cases) have the right to stay if you want and get a new lease. If you want to leave mid-term it is often possible to find someone to take the lease over.

If you know that your Business Plan will involve major expansion you may know that pretty quickly your current premises will not suit. So unless you are into Commercial Property Investment you will not want to keep your current premises but move to larger premises

The structure of your Business and the other parties involved may make buying a Commercial Property an issue. What happens if say you are a partnership and one partner leaves and wants their share of the Property? How can that be facilitated? To avoid those issues many Businesses will not want to buy a Commercial Property

The type of Property you want simply may not be available to purchase or not at a realistic price. If you want posh offices in the City of London you are just not going to find it practical to buy a freehold property for them unless you are a mega business

But now let's see the type of business where it makes lots of sense

If you have a steady business unlikely to grow and require more space in the unit that you purchase then a Commercial Property has many advantages. So say you are a vet and you have identified the area you want to work in and you are not looking to take on partners why rent if you can buy?

You are unlikely to need more space in the future. Often the cost of a mortgage can be less than the cost of commercial rent. You have no fear of rent rises. You will have a valuable asset when you retire which you have paid for out of your earnings.

Even if you have a business that is going to expand if it is expanding by acquiring new units to add to the existing units it owns then purchasing a freehold makes sense. MacDonald in its early days purchased the freehold sites it built restaurants on and its founder Roy Kroc considered his real business to be property. The value of owning the freehold of his sites made the business far more valuable over the years than if it had rented them

This is particularly the case if you can use a recession such as the one we are experiencing at present to buy a property cheaply if you know that your Business will weather the storm and thrive whatever the economic conditions. Then when we come to a recovery you will have an even more valuable asset.

Inflation (which for the first time for some years seems to be surging again) can be another strong reason to buy because it may mean that in 20 years time rents will have rocketed simply due to inflation whereas if you purchased your debt is minimal and your asset is in money terms worth much more

### Summary

If you want a Commercial Mortgage you have to be realistic about your prospects. If you have no deposit, have only just started trading then ask yourself would you lend to yourself if you were a lender?

However if you think you might qualify and would benefit from a mortgage then contact us at [www.JustCommercialMortgages.com](http://www.JustCommercialMortgages.com) and let us see if we can help you or contact the writer of this guide at [marcus@justcommercialmortgages.com](mailto:marcus@justcommercialmortgages.com) and I will be glad to try and answer our questions.