'UK Commercial Mortgage Guide'

Save money on your Commercial Mortgage

by

Commercial Lifeline
expanding your financial horizon

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Content

Introduction

Welcome to the 'UK Commercial Mortgage Guide' from Commercial Lifeline.

This guide is designed provide an overview of exactly what a commercial mortgage is, what is involved in finding and selecting a commercial mortgage and how to avoid paying over the odds.

Along the way we briefly touch on where to get a commercial mortgage, commercial mortgage types, Lender requirements and using a commercial mortgage broker.

We hope this guide proves useful in giving you a better understanding of Commercial Mortgages and ultimately we hope it saves you money.

Two other guides are also available from Commercial Lifeline, 'A Bridging Finance Guide' & 'A Guide to Buy to Let Mortgages'.

To download these guides free please visit www.commercial-lifeline.co.uk.

Chapter 1
An Overview of Commercial Mortgages

What is a Commercial Mortgage?

A commercial mortgage is a loan that uses commercial property as collateral. As with a residential mortgage, the lender holds a title in the property and may foreclose on that property if the mortgage goes into arrears.

Acceptable Commercial Mortgage Uses

A commercial mortgage may be used for purchasing a property that will be used by the business, purchasing property to let, re-mortgaging an existing commercial mortgage, or for raising capital for other business expenses.

Repayment Liability

If you are a sole trader then you will be personally liable for the repayment of the commercial mortgage. In addition to foreclosing on your business property the lender may be authorized by the court to seize your personal assets as well in order to satisfy the mortgage and the ensuing legal costs of the foreclosure. If you are operating as a partnership then these conditions extend to the partners as well.

If you operate as a limited-liability partnership, or a limited company, the primary liability belongs to the business entity itself. However, unless you are well funded and very profitable, it is likely that the lender will ask for personal guarantees as well. If you make these guarantees, then your personal assets are at risk just as if you were a sole trader or partnership.

Types of Commercial Mortgage Security

An "own use" mortgage is for a loan that will be secured by property that will actually be used by the borrower to conduct their business. This might be office space, a warehouse, or an actual business such as a petrol station.

A commercial investment mortgage is also known as a "to let" mortgage and is used for the purchase of property which will be occupied and used by tenants. The lender may require use restrictions and require more extensive documentation for this type of commercial mortgage.

Lending Criteria

Lenders will typically investigate the credit of the business entity as well as the principals who own and operate the business. In the case of a limited company they will investigate the credit of the managing directors or other top officers.

The lender wants to be assured that they will be repaid according to the terms of the commercial mortgage. Even though they hold an interest in the property, foreclosure is an expensive and uncertain process and no lender wants to end up being a property owner. They make their money with the interest that they charge.

The interest rate for your commercial mortgage will be based partially on prevailing rates and partially upon the amount of risk that they lender perceives that they are incurring. They look at your past credit history, your current and projected cash flow, and the attributes of the proposed property, including location and planned use, when determining their degree of risk. The higher the risk, the higher the interest rate.

Documentation and Due Diligence

In addition to answering the traditional questions that are on almost any type of commercial loan application, commercial mortgage lenders will usually want to see more. As a minimum, the lender will usually look at the following:

Your business history

You will usually be asked to provide your last three years of audited financial statements including a P&L statement (profit and loss), balance sheet and a cash flow forecast. All of this will have to be accompanied by your accountant's certificate stating that all of the information is true and correct. At this stage you may also be requested to submit a business plan.

Usually the lender will compare your financials against the "average" statistics for a business in your field to see how you stack up. If you are too far above or below those averages then you may be asked to supply additional information explaining the differences.

If the lender feels that you are credit worthy, but is concerned about some particular part of your financials, they may offer a commercial mortgage at a higher interest rate than normal or with some additional collateral requests or other terms and conditions.

Loan-To-Value Analysis

The next item that the lender considers is the amount of money they are lending compared to the value of the property. A typical acceptable loan-to-value for a commercial mortgage in the UK is 75% but this is a requirement that is always subject to negotiation.

When determining the loan to value maximum they will also take a look at your cash flow to determine if you have the income to pay for the higher loan. They consider a number of financial indicators including your current debt, retained profit, depreciation charges, and other profit indicators. They want to see that you have a cash buffer of at least 130% of the monthly payment.

Personal Information

The lender will also most likely want to see the personal financial statements of everyone who will be listed as co-borrowers on the commercial mortgage. You will be expected to prepare personal financial reports that show your net worth. You may be required to have your accountant certify these reports as well.

If you do not have sterling credit, but overall are still deemed to be credit worthy, the loan may be offered but at a higher interest rate.

Interest Rate Schemes

Standard Variable Rate (SVR)
This interest rate is determined by taking the Bank of England Base Rate (BOEBR), or the London Inter Bank Offer Rate (LIBOR), which is the wholesale rate that banks charge to lend money to each other.

The lender then adds their profit margin, plus an additional risk premium that they may have determined was required in order to make the loan, which then becomes the interest rate that you will be charged.

Capped Interest Rate
This is a variable interest rate which cannot rise above an agreed upon maximum for a specified period of time. When that period ends the rate usually converts to a SVR commercial mortgage although you may be able to negotiate another cap if you have performed well under the mortgage and your lender agrees.

Cap and Collar
This is a variation of the Capped Interest Rate commercial mortgage where the interest is capped at a maximum for some period but also has a floor (collar), which the rate will not fall below.

Fixed Rate
The rate that you are offered remains unchanged for a fixed period, which may be as long as the life of the loan. This type of commercial mortgage scheme usually starts out with a higher interest rate than is being charged for SVR and other mortgages.

Commercial Mortgage Loan Costs
There are a number of fees associated with receiving a commercial mortgage. Like the terms of any contract, these fees are subject to being negotiated, to some extent, but it is unlikely that you will be able to make them "go away" in their entirety.

Arrangement fee
This is a fee that is usually paid to a third party such as a commercial mortgage loan broker. Some brokers get paid directly from the lender and the fee is not made a part of your loan. Check with your broker to see whether or not you will be paying the fee out of your loan proceeds.

Lender's completion fee
This fee is paid to the lender and is usually represented as a percentage of the total advance.

Good-faith deposit
This is an amount that you pay, up front, to guarantee the lender that you will close the loan with them if you are approved. The lender will either refund this amount to you, or credit it against your closing costs when the loan closes. If you back out then the lender keeps the fee.

Survey fee
This is paid to the company that is hired to provide the appraisal on your intended property.

Legal fees
Some lenders require that you pay the costs associated with their use of their solicitors or they will insist that you hire outside solicitors to represent you throughout the process.

You may be subject to other fees, such as postal and courier fees, as well as copying charges, notary fees, etc.

Summary
Obtaining a commercial mortgage may seem like a lot of work but remember: The best way to eat an elephant is one bite at a time! Just be patient and provide all of the documentation that is requested.

You are going to have to live with the terms of your commercial mortgage for a good amount of time so make sure that you negotiate the best terms that you possibly can. For the widest range of flexible offers, from lenders who are willing to compete for your business, your best bet is to engage a commercial mortgage broker.

Chapter 2
Understanding a Commercial Mortgage

In many ways a commercial mortgage is just like a residential mortgage in that you pledge real property as collateral against a loan to either buy or refinance that property. You can also receive a commercial re-mortgage and use it as a line of credit for any business purpose.

When you use a commercial mortgage to buy property, or to raise funds for any other business purpose, the lender retains an interest in that property until the loan has been paid in full. Unlike other types of business loans, which usually have a relatively short repayment period, you can take out a loan for as long as 30 years if you like.

The lender receives repayment of the commercial mortgage principal and interest over the lifetime of the loan. If you default on the loan and go into arrears then the lender can foreclose and take possession of the property that was used as collateral.

Generally speaking, the interest on a commercial mortgage is tax deductible and the net proceeds of the loan are not considered to be taxable income. However, you should always check with your accountant to be sure because the tax consequences can be severe should it be determined that your usage of the funds was not for a qualified business purpose.

Should you be seeking a commercial mortgage for the purposes of operating your business, rather than actually buying property, then the lender will either want to re-finance your current mortgage, and include enough money to provide the amount that you are seeking, or they may arrange an equity line where they lend you the difference between the current value of your commercial property and the amount that you owe on the current mortgage.

There are generally two types of interest schemes available when you are applying for a commercial mortgage.

The fixed rate commercial mortgage establishes an interest rate that is in place either for the life of the loan or for a fixed period of time. If it is for a fixed period of time then it will normally convert over to the second type of rate, which is called a variable interest rate, after the fixed time period expires.

In some cases your lender may add a Early Redemption Charge (ERC) clause to your commercial mortgage contract which states that if you pay off the note prior to the end of the fixed rate period then the lender is entitled to a one-time lump fee to offset their loss of expected income. In some cases this ERC may extend to longer periods possibly up to the entire term of the loan. Be very sure to read your loan contract carefully to make sure that you understand the implications of the ERC if it is present.

With competition from lenders heating up you'll find that many of them are dropping ERC clauses all together. If there is one present in your loan contract you may be able to negotiate it away with little effort. It's worth trying in any case and you can always apply somewhere else if your lender is not willing to negotiate.

In the case of a variable interest rate commercial mortgage the rate is based upon those issued by Bank of England. The lender will usually state that the rate consists of the published rate, which will likely vary up and down over the life of the loan, plus some pre-determined premium that remains the same for the life of the loan. Be sure that you understand how frequently your rate will change and that you are comfortable with the amount that the lender is charging as a premium. As with any terms of your loan you can negotiate both of these factors.

A fixed rate commercial mortgage is a good choice when you feel that interest rates are headed up sharply and you want to lock in the current rates. On the other hand, if interest rates are in flux, and economic indicators point to a downtrend, then a variable rate may be your best choice.

Keep this strategy in mind during the lifetime of your commercial mortgage. If you are locked into a fixed rate, and interest rates have dropped significantly below what you are paying, you should consider applying for a re-mortgage and selecting a variable interest rate to take advantage of the lower rates. On the other hand, if you are in a variable, and all indicators are that interest rates will be skyrocketing soon, then look to move into a fixed rate so you can protect yourself against future increases.

Chapter 3
How easy is it to get a Commercial Mortgage in the UK?

As is the case when applying for any mortgage, be it a residential or a commercial mortgage, the better your credit and the better the collateral, the easier the process becomes. But that doesn't mean that if your credit is less than perfect, or you want to purchase commercial property in a less then desirable part of the city, that you are automatically locked out of getting the money you need. It just means that you need a "friend" in the business.

When you are applying for a commercial mortgage your potential lender will consider your credit rating, your business' balance sheet, the purpose of the loan, and the type and location of the proposed property as well as that property's appraised value. If every one of these items does not fall within the lender's acceptable guidelines then you may get a "no thank you" instead of a pile of money. Considering the amount of paperwork that you may have to complete in order to get a decision, be it a positive or negative one, you want to make sure that you have the best chances of securing that loan before you even start.

And that is where having a "friend" in the commercial mortgage business comes into play. If you were going duck hunting, and only had one shell with you, then you'd better be a pretty good shot. On top of that, you'd better not be planning to serve roast duck to a crowd because you're only coming home with one duck if any. Oddly enough, the same holds true when you are applying for a commercial mortgage.

Different lenders have different requirements for granting an approval. Since your goal is to make getting a commercial mortgage loan approval as easy as possible then you need to carry more than one shell with you. The best way to do that is to use the services of a commercial mortgage broker. A broker represents you and submits your commercial mortgage loan application to many lenders. Your "one shell" turns into a whole case of ammo as your application makes it across the desk of potentially hundreds of lenders. The odds are greatly in your favour that you are going to get an approval from at least one lender and, the truth is, many borrowers end up with several interested lenders and can actually negotiate the terms and conditions, which suit them exactly.

Since your commercial mortgage loan broker doesn't earn their fee unless you get approved, they work with you to make getting a commercial mortgage loan as easy as possible. And, since the broker gets paid by the lender and not you, there is absolutely no reason not to engage their services.

Even if you had access to the same quantity of lenders as a broker does, you would have to fill out a separate commercial mortgage application and submit it to each lender. That process alone would take you more time than it takes to walk from Land's End to John o' Groats. A broker uses the same application and sends it to all of their lenders. That fact alone makes it easier to get a commercial mortgage than doing it yourself does. Even better is the fact that the broker already knows the terms and conditions that each of their lenders utilize. The broker will only send your application to those lenders whose qualifications you already meet.

Just like with everything else in life, there is an easy way and a hard way. If you're looking for the easy way to get a commercial mortgage loan then I suggest finding the best broker for your needs and let them do all the work. It doesn't get any easier than that!

Chapter 4
Save Money by using an independent Commercial Mortgage Broker

Being a creature of habit can cost you plenty when it comes to applying for a commercial mortgage instead of going through an independent commercial mortgage broker. Let me tell you why. Most business people have an established relationship with their bank and take advantage of that relationship whenever they need to borrow money. However, here is the question that you should be asking yourself: "Is your bank taking advantage of you?". More and more the answer to that question is "Yes".

Once you have an established relationship with a bank they tend to start taking your business for granted. Not necessarily in a bad way, mind you, but in the way that a mutual level of comfort exists. The bank knows your reputation for keeping your word; they know how much money passes through your account and they know what your business does. You know that there is someone there that you can ring up who knows you and will work with you to get a commercial mortgage.

Seeing as how applying for a commercial mortgage can be a time consuming affair it is a natural tendency to go to the people that you already know to get the deal done with the minimum amount of red tape. The bank realizes this and it removes their incentive to cut you the most competitive deal or to negotiate on terms that you may not like. In essence you are locked into accepting whatever commercial mortgage "packages" your bank offers.

Now, on the other hand, if you take advantage of the services that are offered by an independent commercial mortgage broker then a whole world of options open up for you. Your broker is able to shop your commercial mortgage application among a large number of lenders who are hungry for new business. As a result you are often offered deals that beat your bank's best offer by a considerable latitude.

Current statistics show that only about 14% of commercial mortgage loans go through an independent commercial mortgage broker with the remainder being placed directly through the bank where that business owner has a relationship. With those kinds of statistics is it any wonder that a broker will bend over backwards to find you a good deal?

Imagine your potential savings possibilities when you engage an independent commercial mortgage broker who is able to find you two, three, four or even ten or more lending sources, who all want to compete for your business! Plus, a broker doesn't earn any fees unless a commercial mortgage loan deal closes. This gives them a strong incentive to find a deal which is tailored to your specific requirements. Even better, the broker earns their fee from the lender so it doesn't cost you anything to save all of that money.

You wouldn't buy a new car or lorry without checking out different dealers to find the best price would you? Then why in the world would you settle for a "one size fits all" commercial mortgage from your banker? It just doesn't make sense. At least not when there is an independent commercial mortgage broker who is jumping up and down for the chance to save you money. All you have to do is find the best one for you.