

The 3C'S of Credit

Some of the most important factors that any lender to consider are listed below and are commonly referred to as the “three Cs” of credit.

- ▶ **CAPACITY: the ability of the company to repay both existing and proposed debt, as well as the ability of the owners to cover their household obligations**

- ▶ **CREDITWORTHINESS: the experience of the owners of the business and their credit history**

- ▶ **COLLATERAL: assets to be pledged to secure the proposed debt**

Of course, the conditions of the economy, use of the funds you are requesting, the experience of the lending officer and the credit policies of the lending institution certainly impact the process of getting a commercial real estate loan.

Interest Rates and Fees

Interest rates vary per loan commitment because they are a function of risk. All “three Cs” are considered when pricing a commercial real estate loan. Interest rates may be fixed, variable or a combination of the two. Fixed rates may be fixed to term or fixed for a period of time then reset according to a previously agreed-upon index and margin. This type of pricing is most commonly used for financing long-term fixed assets such as owner-occupied commercial real estate and non-owner-occupied (investment) real estate. Variable rates adjust from time to time and are common for U.S. Small Business Administration (“SBA”) 7(a) guaranteed loans and in times of volatile interest rates.

Loan commitment fees and prepayment penalties are common costs associated with long-term loans, especially commercial real estate loans, and should be expected. They vary between lenders.

Commercial real estate loans are available for most properties. However, some property types are not on the “preferred” list of every lender. Some loan applications cannot be considered due to geographic boundaries of the lender, some are rejected due to industry type such as hospitality, entertainment or environmentally-sensitive loans, and some just don't make sense from a regulated lender's perspective such as loans based on fair market value rather than cost. SBA loans, including “7(a) guaranteed loans” and “504 loans,” are available for the financing of most types of commercial properties. They are available from SBA-approved lenders nationwide.

“Loan-to-Cost” or “Loan-to-Value” (Fair Market Value)

Traditional and SBA lenders base their lending decisions on “loan-to-cost” or “loan-to-value,” whichever is lower. Loan-to-value (FMV) loans are generally accepted for

lending purposes when the property is being refinanced and has been owned for at least two years. Alternatively, “hard money” loans are available based on the fair market values (loan-to-value).

The primary differences between commercial, SBA and hard money loans are loan term and down payment.

Examples of typical loan terms

Use of Funds	Typical Commercial Loan Terms	Typical SBA Loan Terms	Typical Hard Money Loan Terms
Purchase, construct, renovate or refinance owner-occupied commercial real estate	Usually 15 or 20 years with 20% - 30% down	Up to 25 years with as little as 10% down	Up to 20 years with 30% - 50% down
Build out or improve leased space	Up to 7 years	Up to 25 years	N/A
Debt refinancing	Up to 30 years, depending on debt being refinanced	Up to 25 years, depending on debt being refinanced	Up to 20 years, depending on FMV of collateral property

Down payments towards purchases are to be expected. Personal guarantees may be expected of owners of 20% or more of the business or property-again depending on the strength of the asset. They vary from lender to lender and depend on the asset being financed.

Generally, commercial lenders look for a down payment or equity contribution to the project to be financed in the 20% - 30% range whereas SBA loans require as little as 10% down for qualified applicants. In many cases, SBA loans require additional collateral beyond the commercial real estate and may even include a mortgage against your home. Hard money lenders generally require 30% - 50% down and are less concerned with the “three Cs”.