

The Next BIG Thing in Small Business: Smarter Commercial Real Estate Financing

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Small business owners all over Central Florida are finding out that it doesn't take 20% down, numerous out-of-pocket expenses, weeks or months for approvals, and large monthly payments to own or construct their commercial property. Many firms are taking advantage of a loan program that flies in the face of ordinary commercial financing and enables small business owners to preserve more of their capital while minimizing the impact to cash flow.

It's a common belief (and not off base) that all healthy small and mid-sized businesses should eventually own their real estate. For most small business owners, commercial property ownership may be one of the best investments they can make, as much for real estate expense savings as for long-term asset planning.

Because of real estate's leverage advantage, this loan program offers clients smarter, capital-preserving financing which provides the highest cash-on-cash return available. That cash-on-cash return is exactly the metric by which most real estate investors measure their success, and it also holds true for owner-occupied investors who happen to run a business as well. Maybe this is a crazy idea, but borrowers get to decide where to best use their capital, and they lower their business risk by only putting half as much equity down.

Sound too good to be true? Believe it or not, small business owners can actually enjoy these benefits with a little-known loan product called the SBA 504 loan. This program has been in existence for over twenty years and is "all the rage" in California, but only recently has it begun to gain serious momentum and popularity in Florida. SBA 504 loans finance total project costs as opposed to percentages of the appraised value or purchase price, whichever is less, like most commercial lenders. This means that things like FF&E (equipment), soft costs, and closing costs are included in the calculations of the total project.

There are at least two overt benefits that should drive small business owners to choose the 504 loan program. The first is the 90% loan-to-cost option it provides, while the second is the fact that nearly half of their loan is a government-guaranteed bond with an interest rate usually about 100 basis points lower than the market rate. For most of 2004 and 2005, the bond rate hovered around 6%, which is incredible for commercial mortgages -- especially with a true 10% equity injection.

504 lenders get to their 90% loan-to-cost amounts by providing a first mortgage (which is nearly always 50% of the total project costs) and a second mortgage (nearly always 40%). The first mortgage typically has a fully-amortizing 25-year

term at market rates, while the second mortgage has a 20-year term but with its below-market rate fixed for the entire term. 504 second mortgages really are the cheapest money available for most small business owners -- there are not many banks or private lenders that can match these rates at these terms. Many banks won't offer 504's because of the smaller loan amounts (only 50% first mortgages versus the common 80%), which means their pocketbooks take a hit. When you couple that with the fact that these loans take more effort and skill on the part of the lender, borrowers are encouraged to seek someone who has done more than just a few of these loans (and has done them well).

There are common misperceptions by some that SBA loans are too much trouble, take too long or have higher closing costs. It's also been said that SBA loans are for start-ups and borrowers that are not well-off. Fortunately, none of those myths are true about 504 loans. Some of those negative stereotypes may fit the profiles of other SBA programs that get more press, but 504 borrowers are simply utilizing a great lending program which any big business with a fleet of lobbyists wouldn't be foolish enough to ignore. People that perpetuate those old myths don't realize that the SBA has changed dramatically. Today's SBA has made sure that 504 loans are not any more complicated or require more paperwork than ordinary commercial loans, and lenders that focus on this type of financing have become known for speed and certainty in closing deals. A good 504 lender should be able to "pre-approve" a potential borrower within 24 hours after receiving as few as seven basic documents.

About the author -- Chris Hurn is the President, CEO & Cofounder of Mercantile Commercial Capital (MCC), the only company nationwide that focuses exclusively on SBA 504 loans. Founded in early 2003, MCC is now the largest originating SBA 504 lender in Central and North Florida, having closed over 100 loans. They were recently named by the U.S. Small Business Administration as winners of the 2006 Financial Services Champion of the Year for Florida (encompassing both SBA district offices) and for the twelve-state Southeast region.

Chris and his partner, Geof, not only provide the 504 loan; they use it, too. They're both minority investors in a property that was financed by a 504 loan even when competitive conventional financing was readily available. They chose a 504 loan for themselves because of the higher cash-on-cash return and the longer fixed-rate financing.