Commercial Mortgages Simplified

Subhead: Get the facts on loans for Commercial Real Estate

by Jacob Yadegar

While a multitude of options exist for a loan secured by a residential property, very few options exist for loans on commercial property. To begin with a loan on a commercial property consists of all property types except one to four family dwellings. Some examples of commercial properties are apartments that have more than four units, office buildings, shopping centers, industrial buildings etc.

There are three fundamental reasons why there is such a large difference between residential loans and commercial loans. Firstly, residential loans are primarily based on the credit worthiness of the borrower while commercial loans are predominately underwritten based on the property income itself. The actual borrower is given very little consideration.

Secondly, the value of a residential property is fairly easy to ascertain while commercial properties are not. For example, homes in a given neighborhood are generally valued in a similar range as other homes because there have many common amenities such as bedrooms and bathroom counts. Commercial properties on the other hand can vary widely. A shopping center can be 3,000 sq ft in size and may not be compared to another shopping center a block away that is 300,000 sq ft.

Lastly, 95% of residential loans are sold on the open market because they adhere to a specific set of guidelines. As a result, many investors can buy and sell residential mortgages making them very efficient and easy to trade. This open trading, ultimately reduces the rates to the customer as more people compete to create, buy and sell residential mortgages.

Unlike residential loans, which are bought and sold on the open market, most commercial loans are held by Institutional investors such as banks or pension funds. These loans are primarily created and underwritten to meet the investors own investment objectives and underwritten to a less structured set of rules. Because of this, there is no single source that dominates the commercial loan market like Fannie Mae does the residential loan markets.

As a result of this structure, a lot more negotiation and expertise goes in to getting the right commercial mortgage loan. While some attempts have been made to streamline commercial loans, only a small portion of commercial mortgages make their way to the open market. These loans primarily consist of loans on large apartment buildings often times consisting of more than 100 units, which generally will not have variances in income from year to year. Apartment rental rates for example can easily be compared to other similar rental apartments in a given market.

With no set standard, commercial lenders create rules for the types of loans they desire to make. Underwriting rules or conditions often times limit the owners ability to effectively manage their property and their assets to best serve their own needs.

Finding the right investor to match the objectives of the owner, let alone the property type, income and quality is no easy task. While there are many commercial lenders in the market, the rules and pricing vary widely from lender to lender. Unlike residential loans, terms on commercial mortgages can also be widely negotiated with the lender directly.

Jacob Yadegar is CEO of Empyrean Funding, Specializing in residential and commercial real estate loans. He can be reached at (310) 571-3672, jyadegar@empyreanfunding.com or you can stop by the Brentwood Gardens at 11677 San Vicente, #206.