THE MONEY DOCTOR

With John Lowe

COMMERCIAL LOANS AND UNDERSTANDING THEM

Investors in the property market over the last 10 to 20 years have enjoyed the greatest growth in the sector that Ireland has ever known. Everything that could possibly go right has gone right while there have virtually been no downsides through this period for property owners.

Currently with residential property growth exceeding 15% for the year ending June 2003, and against all forecasts achieved similar last year, why is it then that commercial property seems to have stagnated in relation to its residential cousins ?

For one reason, **home loans** and **Residential Investment Loans** (**RIL**s) are far less complex than commercial loans

- Usually in personal names
- Dependent on individuals for rent or from borrowers' personal income
- Less risk involved
- No arrangement fees
- Only one solicitor involved (the client's – via a Certificate of Title)

Commercial loans also vary so much between

- Viability of the individual or company and if company, the net worth and reputation of the directors supported by personal guarantees.
- The covenant – to whom the commercial building is let to (whether it is an owner / occupier or a straightforward tenant) e.g. letting to a PLC with a 25 year no break clause will merit less risk than letting to a start up business with a 5 year break clause option.

- The geographic location – some areas can increase risk
- Loan to value (obviously borrowing less than 50% of the value is going to be more attractive to the lender than looking for 85%)
- Additional security on offer

Lenders will take on board all the facts that are presented to them and will either decline (usually without giving a reason) or approve by way of a letter of offer. This offer letter will outline the Prime rate, **margin** and/or arrangement fees. Maximum term is usually 20 years with the first 24 months repayable on an interest only basis. Some lenders might allow a longer period on interest only - again it is dependent on the "risk" factors of the case.

All lenders have a Treasury department who handle the millions being borrowed or millions being deposited overnight. These departments buy money at the *European Central Bank* (ECB) rate, which is currently 2%, and add a little for their own departmental annual profit - up to 0.25% and sometimes even beyond. Be aware therefore of the terms **Prime rate**, **Base rate** and the **ECB rate** – they are not necessarily all the same thing so you would need to know what "base" rate you are starting off from before the margin is struck.

After the 2.25% **Prime rate**, anything above this is called "**margin**" or the profit the lender is going to make from the deal.

A multi million euro deal with a government department on a PLC long term, no break clause covenant will attract less than 1% margin whereas funding the commercial building of a start up unproven business in a less than salubrious area could have a 3% + margin attached to the loan. Therefore the riskier the deal, the more you are going to have to pay the lender in terms of that margin.

Arrangement fees can also vary. All lenders initially look for them – anything from 0.5% to 1.5% again depending on the risk and the type of loan required. For instance, developmental funding is generally of a short term nature, perhaps up to a maximum of 12 months and therefore a margin of 2.5% interest rate on the borrowings is not really going to fully compensate a lender for all the trouble in setting up the loan and approving same. *Anglo Irish Bank plc* have an excellent reputation as a business bank – very fast, quick responses but you pay for it both in terms of margin and fees. For the "no-brainer" deals, lenders will halve or drop the arrangement fees.

In terms of **legal costs**, all lenders insist because of "investigation of title" in all commercial property deals, that the lender must be legally represented separately to the client's solicitor (remember for home loans and residential investment loans, only the client's solicitor is utilised) **They also insist that the client pays for their legal costs.** Again in some cases, this can be waived dependent on the strength of the application or the lender might allow a partner of the client's legal firm to represent their interests and in so doing reduce the overall bill through economies of scale.

Finally, in terms of **negotiation**, it can be worth your while to engage an intermediary who is fully authorized and has full choice and knowledge of the market. Some lenders have greater appetites for certain commercial deals than others. Staying with the lender that has always looked after you can have its drawbacks

- Are you getting the best deal
- Do you know what the competition is offering
- Will your lender's appetite change through economic circumstances
- Will your contact person with that lender be moved out of your jurisdiction

On the positive side,

- If your lender knows that you are being represented by an intermediary with a full range of alternative and competitive choices, will this help your lender to "sharpen his/her pencil" and give you a better deal

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