



## June 2009 Market Perspective: Capital for Owner Occupied Real Estate

In a tough economy and difficult financing environment, many business owners are looking closer at their deployment of capital. In many cases, they may have a significant amount of money tied-up in the real estate component of their business. However, many businesses generate a higher return in their core business than they do in the real estate that they own.



In addition to benefiting from the greater profit potential that their business presents, the company may require additional funds for new equipment, employees, marketing or other core business needs. At the same time, conventional financing may be difficult to obtain or simply may not be the best option. In some cases, the business owner may wish to sell their business but, they know that it will be difficult to get strong values for both the real estate and their business

from a single purchaser (making a pre-emptive sale of the real estate desirable). In these situations, one option that many prudent business leaders are considering is a "sale and leaseback" of their business's real estate.

A sale and leaseback is a real estate transaction whereby a business owner sells their facility to an investor and leases it back, usually on a long-term lease. The value of the real estate is greatly influenced by the lease rate and terms offered by the business owner (the more attractive the terms of the lease, the more valuable the real estate). The lease is typically a triple net lease meaning the former owner, now tenant, continues to pay for the property taxes, insurance, maintenance, and utilities for the property. The seller / tenant also pays the new owner an agreed to rent based on a reasonable return on the purchase price. In return for that rent, the seller receives the net equity they put into and have accumulated in the real estate over their period of ownership (in the form of proceeds from the sale of the real estate). The business owner can then redeploy this capital into the needs of their business or otherwise distribute it.

In a time period when commercial real estate values are at best flat or in some cases declining and when traditional financing is hard to come by, many business owners could benefit from a sale and leaseback. Capital obtained from this transaction can then be used to better position their business for growth as the economy rebounds. In addition to freeing-up the equity in their real estate, they also are able to pay-off any debt on the property; thus, potentially, strengthening their financial statement and borrowing capacity.

Please consult your tax advisor, attorney and a qualified commercial broker before implementing a sale and leaseback. Should a sale and leaseback be something that you are interested in investigating further, our experienced real estate advisors at Chrisland Commercial would be pleased to provide a no obligation initial consultation to discuss this process, potential sale terms, and an appropriate value at which to market the property.

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### Alternate Source of Capital:

Recent changes to the U.S. Small Business Administration's 504 Loan Program, within the American Investment and Recovery Act of 2009, have reduced the upfront cost of this financing mechanism for business owner occupied real estate.



The 504 Program provides owner occupants long-term, fixed-rate financing for land and buildings. These loans can be used for new buildings or refinancing.

The above referenced change within the stimulus bill reduces the upfront fees from 3% of the debt amount to 1.5%. Costs totaling approximately \$10,000 remain for an appraisal, a phase I environmental report, closings costs, and loan packaging.

The upfront savings resulting from this reduced upfront fee structure could amount to \$60,000 on a \$4 million loan to a small manufacturer. As of this point in time, the other terms of that same loan could be a term of 20 years with a fixed rate of around 5.50% and a 90% Loan to Value Ratio.

Many banks in northern Colorado are active in 504 SBA lending. In general, banks have remained active in SBA 504 lending, despite pulling back in other areas, as these loans represent less risk to the bank (given the SBA's participation).

Under a typical SBA 504 loan, the bank would hold a 1st deed of trust position at 50% loan to value, the SBA / 504 would take a junior lien at 40% (backed by a 100% SBA-guaranteed debenture) and the owner would have 10% cash into the project. In some cases the owner may have to put in more cash (i.e. new business or special purpose real estate).

As with most things, restrictions do apply. In this case some of the restrictions included a job creation requirement, the business must be operated for profit, and the business must fall within the size standards set by the SBA (tangible net worth less than or equal to \$7.5 million and average net income less than or equal to \$2.5 million after taxes for the preceding two years). Loans cannot be made to businesses engaged in speculation or investment in rental real estate. Although, there are some exceptions where a majority of the property is owner occupied.

Chrisland Commercial is not a mortgage broker or lender and advises that interested parties contact their tax advisor, attorney, and a lender with SBA loan experience. Should you wish, one of Chrisland Commercial's real estate advisors can provide contact information for such lenders. Christian Bordewick, a Branch President with Bank of Colorado, is one such lender. Christian served as an information resource for this summary. He can be reached at (970) 663-7600 or via email at [christian.bordewick@bankofcolorado.com](mailto:christian.bordewick@bankofcolorado.com).