

BANKING & FINANCE

BY JAMES BAIRD, BAY AREA DEVELOPMENT COMPANY

Two excellent financing choices for buying business real estate

When the time comes to purchase commercial real estate to house your business, it is important to know that you have a number of very good financing programs to choose from.

Your first three options are simple: You can pay cash, get a seller to carry the financing on reasonable terms, or finance the property conventionally. These are good choices, provided they can be done without putting too much of a dent in your personal or company cash reserves, and particularly if you have 25% or more to put down.

However, many growing independently owned companies want to leverage their real estate investment by making a smaller down payment. This helps them maintain liquidity and preserve their cash reserves needed for contingencies and financing future growth. This is when the two most active financing programs of the Small Business Administration, 7a financing and 504 financing, shine.

Note that this applies to most "independently owned" companies rather than what are typically considered "small businesses." This is because SBA's financing programs are available to almost all companies that are not publicly held, including some with up to 1,000 employees and millions of dollars in annual revenue.

In spite of the relative simplicity of SBA financing programs, there tends to be a lot of confusion about them. To many people, the tendency to think that financing is too complicated to fully understand (it isn't) combined with the mystique of "government" involvement is intimidating. Throw in a good measure of TLAs — three-letter acronyms — and the eyes glaze over.

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The plain truth is that SBA financing, just like any reputable financing, is not that complicated. Simply have your lender answer all your questions to your complete satisfaction, or talk to another lender.

7A AND 504 COMPARED

When comparing 7a and 504 financing options for your company's real estate needs, you need to know that the two programs are almost identical in their ability to provide up to 90% financing on a long-term basis. Also, both financing programs charge similar loan fees and offer fully amortizing term loans without balloon payments or negative amortization.

The main difference is that whereas 7a financing is a variable-rate loan, priced as a spread over the prime rate, and typically adjusted quarterly, 504 financing is 20-year fixed-rate loan priced at approximately 2% over the 10-year Treasury rate at the time of loan funding.

7a loans also apply to a broader range of uses. For example, if you wanted to consolidate and refinance company debt and finance a building with the same loan, 7a would likely be your better choice. 504 focuses on financing real estate, which can include new construction, remodeling, or acquisition, and purchasing machinery or equipment. Like the loan on your home, if you are in it for the long term and don't want to worry about changes in your mortgage payment, then 504 is your better choice.

WIDELY AVAILABLE LOCALLY

In some markets in which the banking community either doesn't offer or doesn't adequately promote SBA financing, the availability of 7a or 504 financing is severely limited. In the North Bay, we are blessed and enjoy significant participation in both programs from almost every commercial bank, whether local, regional, or national. The importance of this in providing North Bay companies with the best commercial real estate financing options can't be overstated.

When it comes to buying real estate for your business, you have very good financing choices, including the two major SBA financing programs, 7a and 504. All in all, the main difference between these programs is having the choice between a fixed or variable interest rate — just like the choice you have with the financing of your home.

To get more information on the 7a and 504 programs, talk to your banker. Additional information is also available at www.SBA.gov.

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James Baird is CEO of Bay Area Development Company in Walnut Creek; 925-926-1020; www.bayarea504.com.

Things to consider when buying a home for your business

Over the last decade, thousands of independently owned companies in the Bay Area have successfully made the transition from startup to established business. This stage is when companies most often consider buying a facility rather than renting.

But even for the owners of very successful companies, buying a commercial property can be daunting. For most, this will be the first commercial property they will ever purchase. Even though successful business owners are masters at making, distributing, or selling widgets, the issues involved in purchasing commercial property can be so overwhelming that they lock themselves into yet another multiyear cycle of renting space.

TO BUY OR NOT TO BUY?

Even when looking in just one part of the Bay Area, there are substantial market differences — different cities and towns, different types of commercial properties, etc. The best way to focus on this most basic issue is to speak with a local experienced commercial real estate broker who specializes in selling (not leasing) commercial properties in your target area. Have the broker prepare a lease-versus-buy analysis, even on hypothetical typical market properties. Most brokers will do it for you free of charge. This type of analysis is the best way to cut to the chase to see if a building purchase looks right for you.

DECIDING WHAT TO BUY

If the lease-versus-buy analysis points toward a purchase, the next step is the decision of what to buy. A good rule of thumb is to look at your historical company growth rate for the last three to five years, taking into account recent and anticipated changes in your market. Then buy enough space for your company for the next five to ten years.

Buying a building for your business is not rocket science. You want to consider buying one for the same reasons you'd buy rather than rent your own home.

Make sure the neighboring space is easily divisible into additional spaces, so you can take over additional space only as you need it. Beware of considering "strip center" properties or those with a multitude of tenants. While the rental income may look enticing, you probably spend more than enough time running your own company and don't need to spend even more time being a landlord.

TIMING THE MARKET

In addition, consider expected future conditions such as the outlook for interest rates, expected building values, and the health of the economy in general. In spite of the inherent uncertainty in this, history can provide useful guidance.

For example, it is no secret that interest rates are at 40-year lows, but it is easy to forget that commercial rates were generally more than 50% higher just two years ago. For buyers of commercial property, this means that the monthly payments on a \$1 million loan at today's rates would be 25% less than on the same loan two years ago. This amounts to a 25% sale on the same property offered at the same price.

FINDING THE BEST

WAY TO FINANCE

Conventional financing can be a good option for very strong companies wishing

to put 35% to 40% down on a building purchase. However, owners of even the most successful companies almost never want to tie up that much in business or personal reserves in buying a commercial building. Other financing issues include the term of the loan and whether the interest rate is fixed or variable.

Because of these factors, most growing successful companies choose SBA financing when acquiring a commercial building. With an SBA loan, businesses can buy a building with up to 90% financing fully amortized over a 20- or 25-year term at either fixed or variable rates. Variable rate SBA financing is available from most local banks using the SBA's 7a program. Through 7a, businesses obtain long-term low down payment financing, but the interest rate typically varies with the prime rate.

The option most companies choose for real estate purchases is the SBA's 504 program. Through 504, businesses obtain all of the benefits of 7a financing as well as a below-market interest rate, currently under 6%, fixed for 20 years. 504 loans are made jointly by local banks and SBA licensed lenders known as CDCs. Interested companies can contact their local bank or a CDC such as Bay Area Development Company, the North Bay's leading 504 lender.

Overall, buying a building for your business is not rocket science. You want to consider buying one for the same reasons you'd buy rather than rent your own home. The combination of tax benefits, control of your company's occupancy costs and destiny, benefits to your long-term financial plan, and the preferential financing available all make purchase the best choice for most successful companies.

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Jim Baird is CEO of Bay Area Development Company; www.bayarea504.com.