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Smart Answers**An Office Space of One's Own**

John Sauro of North Atlantic Mortgage discusses the pros and cons of buying business property -- and how to finance it

Many -- if not most -- small-business owners rent or lease their office, manufacturing, or retail space. As home equity escalates, however, another option is becoming popular : purchasing business property. Some do it as an investment, others to add value to their company, or to boost cash flow with sublease or rental income. Smart Answers columnist [Karen E. Klein](#) spoke recently with John Sauro, president of Stamford (Conn.)-based North Atlantic Mortgage, about the world of commercial mortgages and how entrepreneurs can navigate it. Edited excerpts of their conversation follow:

What are the reasons that some entrepreneurs choose to purchase their business property, rather than lease or rent?

There are several benefits to owning commercial property. First, you can build equity, so the property is an investment as well as the business. As your property goes up in value, you gain that appreciation and can add it to your nest egg. If you want to make improvements to the property, your business will reap the benefits of those improvements, and you'll benefit from them also when you sell.

Second, when you own your property, you're more likely to have relatively fixed expenses; whereas, if you lease, you'll have to renegotiate the terms of that lease after a certain number of years, and you may find those expenses escalating.

A third factor is that when you sell the business, you'll also be selling the building, so you'll have a bit more to offer the person who comes in to buy your business. Finally, there's the potential that your building can bring in rental or lease income that will help your cash flow. You may own a two-story strip center, for instance, with your business located on the ground floor and several apartments or offices upstairs.

What's the downside to owning rather than leasing?

Depending on the property, commercial mortgages typically carry higher interest rates than do other mortgages. Commercial mortgages are also structured differently than home mortgages. Some come with very short terms, for instance. And, of course, owning your company's property makes you responsible for the upkeep, renovations, municipal requirements, and other headaches that come with being a landlord.

How does one go about qualifying for a commercial mortgage?

When someone applies for a commercial loan, the decision tends to be based on the viability of the business, along with the experience and track record of the individual who's applying. If the commercial property has the ability to generate extensive income -- such as an apartment building -- the personal aspect is not as critical as it might be in other kinds of loans. As with any loan, of course, they'll want to know that you're a good credit risk and that your company has good financials.

But the reality is, the small-business failure rate is high, and lenders already have a matrix laid out that shows them which kinds of businesses fail faster than others. Gas stations, for instance, have a failure rate that's lower than average, because they usually have large oil companies behind them. So, the decisions are often based on industry demographics and the lenders' comfort level. If you want to purchase property for a business that has a high likelihood of failure, you'll hear, "We don't have experience with that industry," or "It's not our cup of tea."

Say someone is opening a small retail business, like a hair salon, and wants to purchase the property where the business will operate. What would a banker ask that entrepreneur?

Have you ever owned a salon before? What kind of experience have you had in this industry? If you have not had any experience, the banks will start to wonder how they can lend money to you for this property.

If you come in and you can show that you've cut hair for 10 years, and you've got a client following that will bring in a certain amount of income every month -- and if you can prove it -- you'll have a much better chance of qualifying. Generally, you'll need to be in business two to three years minimum before a lender will consider you, and you'll need to

provide the documents that allow the lender to verify your financials.

Do all lending institutions make commercial loans?

No, they actually don't. And not every institution does the same types of commercial mortgages. Each has its preferences. Some prefer to deal with industrial property, others like to do golf courses or storage units or gas stations. You would think you could go to one large institution that would cover the gamut of commercial mortgages, but you can't.

Why don't they do all kinds of commercial mortgages?

They tend to choose niches based on their secondary market, which is their investors. Each of these institutional investors has a matrix in place for the loans they're willing to buy from the primary lender.

Are there other options for small-business owners who don't qualify for commercial mortgages, but would still like to purchase their business property?

Sure. The most common strategy we employ is to investigate whether the business owner owns a primary residence or some investment property. If so, we look at the possibility of tapping the equity in those properties and using it to fund their business purchase. The equity that so many of us have built up in our homes these days can be used to buy commercial property, put a down payment of 20% or 30% on commercial property, or to pay off an existing mortgage on a business property.

You mentioned home equity. Do you recommend home-equity loans or lines of credit?

Well, you are risking your home, and you want to be sure anytime you do that that you know what the payments will be, and make sure that you can afford them. Definitely speak to a financial adviser or accountant first. But as home prices have escalated, more people are seeing appreciation in their homes, and more people are able to do this.

What's nice is if you can do a cash-out refinance, where you take out some of the equity that you've built up in the process of getting a first mortgage on your home, either fixed or adjustable. There are plenty of them out there, and some people find that they can get \$400,000 or \$500,000 for their business that way -- either for operations or to purchase commercial property.

If you choose to do an equity loan or an equity line of credit, we recommend that you set up a time horizon of no more than one to two years. Equity loans are not mortgages: They're revolving credit tied to the volatile prime rate, sort of like a giant credit card. So they're not good for long-term financing. For the long-term, you want an amortized mortgage that runs 15 or 30 years, and that will pay itself down over that time.

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