

A guide to commercial mortgages

Allica Bank

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If you're looking for a commercial mortgage to purchase your first trading premises or invest in property for further growth, there's a lot to get your head around. Here, we'll try and break down all you need to know about commercial mortgages.

In this guide, we'll cover:

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What is a commercial mortgage?

A commercial mortgage is a type of loan used to purchase business premises, such as factories, shops, offices, restaurants and warehouses. It differs from a residential mortgage because it is used to finance the purchase of a property for business activities, rather than for you to live in.

Before you apply for a commercial mortgage, it's important to weigh up whether a commercial mortgage is right for your business. If you do try to access a commercial mortgage, some of the things you need to consider include the types of commercial mortgages available, the commercial mortgage providers who may lend to you and the properties you can get a commercial mortgage for.

Then you will need to assess the commercial mortgage rates and fees, as well as the eligibility criteria for commercial mortgages. Along with the information that commercial mortgage lenders require, this will help you understand what is involved in the commercial mortgage process.

Although there are unique things you need to consider about accessing a commercial mortgage, the fundamental principles are similar to mortgages on a home.

Fees and lengths

Some costs and fees that you may have to pay as part of a commercial mortgage include:

- Loan arrangement fees charged on completion of the loan by the lender.
- Broker fees if you choose to have a specialist broker assist you.
- Surveys to assess the condition of a property (usually only required in a small number of cases).
- Valuation fees paid to the valuer of the property. These can vary by lender.
- Insurance, which the lender may require you to take out as part of the loan arrangement.
- Legal fees, charged for preparation of legal documents and insurance.

Repayment mortgages vs interest-only



As with residential mortgages, the amount you pay for your commercial mortgage will depend on several factors, such as how you choose to repay it. For example, you can sometimes choose between a repayment mortgage or an interest-only mortgage.

With repayment mortgages, your monthly repayments will cover both the interest owed on the loan and the loan amount itself. While, as the name suggests, repayments for an interest-only mortgage will only go towards repaying the interest on the loan. This will likely make the monthly repayments smaller, but at the end of the term you will have to pay off the full original amount you borrowed from the lender.

There are a number of factors that go into deciding which option is right for your business, including how much you can afford and how long you intend to own the property. Some lenders will only offer repayment mortgages or may restrict the types of businesses that can be offered interest-only mortgages.

At a high-level, interest-only options might offer cheaper monthly payments and give you greater flexibility but they give you less chance to increase your equity in the property. On the other hand, while repayment mortgages do allow you to increase your equity, they usually require higher monthly payments, which restricts your ability to spend that money elsewhere.

Length

Commercial mortgages can be secured for a range of term lengths, from as little as three months and up to 25 years, with some lenders able to offer term lengths that are even longer.

As with other aspects of the market, this is an area that is constantly evolving, with different lenders offering new or slightly amended products all the time. If you're unsure of your options you could speak to an advisor, such as your accountant or a commercial finance broker, to understand what is available.

Which properties can you get a commercial mortgage on?

Commercial mortgages are available on almost any type of business premises, including shops, offices, farms, care homes, restaurants, pubs, warehouses and factories.

There are also some sectors, such as social care or farming, where property plays a significant role and where there are a high proportion of specialist lenders who focus on lending to businesses in these sectors.

Types of commercial mortgage

There are lots of different commercial mortgages available, mainly because there are lots of situations in which businesses might want to purchase a property.

The main types of commercial mortgages are listed below, with a brief description of what they are. Allica doesn't offer all of these commercial mortgages but there are specialist lenders available who will.

Owner-occupied commercial

This type of mortgage can be used to finance a property where the owner uses the property in the day-to-day operations of their business. They cover a range of business premises, including offices, factories, shops and more, and are available to a range of business types, such as sole traders, limited companies, partnerships and limited liability partnerships (LLPs).

Commercial investment

This type of mortgage is used to finance a property that will be rented out to business tenants, rather than being used by the owner in their day-to-day operations. It would be available for business properties such as offices, factories, shops and more but these would be used by the business tenants rather than the owner.

In this way, it is similar to how landlords use buy-to-let mortgages for residential properties that they want to fill with rent paying tenants.

Semi-commercial

Also referred to as mixed-use mortgages, these are mortgages that finance the purchase of properties with both residential and commercial elements to them. These include properties that business owners live in and work from, as well as properties that are let out by the owners.

Limited company buy-to-let

Buy-to-let mortgages for limited companies are used by people who want to purchase residential properties to let out but want to do so with the properties held by a company, rather than any individual. There are various reasons why a landlord might choose this approach, one of which might be to receive rental income into a business for tax purposes.

Property development

As the name suggests, this type of mortgage is used to finance the building and development of residential or commercial properties. These are typically a form of relatively short-term financing, as the point of borrowing the money is to finance the building of a property that can then be sold or remortgaged at its new, fully developed price.

Commercial bridging

Commercial bridging loans are used by owners of commercial property as a short-term form of finance, which is secured against their property. As commercial bridging can be used for all sorts of reasons, it would take too long to explain them all here. However, some common ones include accessing cash to pay an unexpected bill or to cover refurbishment costs.

Opco/Propco finance

If a company wants to separate its property assets from its operating business, it might choose the 'Opco/Propco' or 'Operating Company/Property Company' structure. In this situation, it is common for the operating company to be the property company's tenant, which may enable the Propco to access better commercial mortgage terms, based on the rent the Opco pays it.



Who provides commercial mortgages?

The three main categories of commercial mortgage providers are high-street banks, specialist banks and non-bank lenders. These categories are described briefly below but there are so many different commercial mortgage lenders and the market is evolving so much that it would be impossible to list all the options here.

Therefore, to explore the mortgage market further and to understand which lender might be best for you, a good first step is to talk to your accountant or a commercial mortgage broker. If you want to speak to a broker and don't already have a contact, a good place to start is the National Association of Commercial Finance Brokers (NACFB).

High-street banks

The established high street banks are often able to offer the best prices because of their scale and ability to access funds at the best rates, which they can then pass on to customers. However, these lenders have less flexible criteria and longer turnaround times that can often become inconvenient for customers.

Specialist banks

Specialist banks, such as Allica Bank, are typically more focused on offering various commercial mortgages than the high street banks, who serve a wider range of customers. This means that specialist banks may offer a wider range of commercial mortgage products, and may be more responsive.

Non-bank lenders

If the high-street and challenger banks are not able to offer what you are looking for, another option is non-bank lenders. If your loan application has been rejected by more traditional banks, a non-bank lender could be a good alternative as they usually have less restrictive lending criteria for borrowers. However, these lenders often comes with higher costs.

Is getting a commercial mortgage right for you?

Before you start applying for a commercial mortgage, it's important to spend some time thinking about whether a property purchase is right for your business.

Buying a property requires funds for a deposit, so you should assess whether using this money might be better spent elsewhere, on areas such as plant & machinery or recruiting talent.

You should also consider the long-term costs of owning a property, such as having to pay for maintenance. In addition, think about what might happen in future if you borrow at a variable rate and interest rates rise or if property prices fall.

On the other hand, there are many potential positives to buying a property with a commercial mortgage. It can bring greater stability to your business, with each loan repayment increasing your equity stake in the property. Indeed, over time your business may end up owning the property outright, just as you can with a home mortgage. By owning the property, you can make it truly yours and no longer need to worry about monthly rent cost. It can be also cheaper to borrow for the long-term, rather than constantly lease in the short-term, and you could also benefit if the property's value increases over time. Finally, it may be the case that any rental income you receive is tax deductible.

If, after considering these factors, you decide a property purchase is the right decision, it's time to find the right one for your business. This includes assessing whether a property fits your growth ambitions, as you don't want to buy one and grow out of it soon after. You should also assess things like the transport links nearby and the pool of talent in the local area.



What is the process for getting a commercial mortgage?

It usually takes a few months to complete a commercial mortgage but, when finance is required more quickly, there are certain types of bridging products you can access. At Allica Bank, we believe an initial decision on commercial mortgages should be done in days.

In general, the stages of a commercial mortgage involve receiving an offer, having the property assessed and then confirming the details of the transaction, More specifically, the process includes the following steps.

Step 1

A credit proposal is supported - this is when the lender decides internally that a borrower's application will be 'sanctioned' or 'approved'. However, it may require more information to move forward.

Step 2

An offer is made - this includes a facility letter that is dependent on a valuation or an offer letter. Allica Bank always includes an offer letter if we have sanctioned the lending, as it allows buyers to move forward.

Step 3

A valuation takes place - undertaken by a property surveyor, who checks whether the property is structurally sound, whether any big risks (like Japanese Knotweed) exist, whether repairs are required and whether it is a good security for the lender.

Step 4

The loan request is confirmed - using the information gathered, the lender can confirm the value of the property, the deposit paid and the loan-to-value amount.

Step 5

Solicitors are engaged - they will undertake searches to ensure the lender's conditions are met and insurance requirements are in place. They will also communicate with the seller's solicitors, set a date for completion and work with the lender to transfer funds.

It's important to keep in mind that applying for a commercial mortgage can be harder than a residential mortgage because it is a more complex and less common purchase. Finding the right solicitor is crucial to ensure they have the expertise they need to deal with any complications that might come up specific to commercial mortgages, and that they negotiate terms that are favourable for your business.

What information do lenders require?

Every lender will have slightly different requirements but they will all want to answer three key questions

- Who are you? Lenders will undertake Know Your Customer (KYC) checks to confirm identities and prevent risks.
- Why are you buying a property? Lenders will want to understand what you intend to use the property for and to check whether this purpose is legitimate.
- Can you afford it? Lenders need to ensure you can pay back the money they lend you and will assess whether your business can support the mortgage debt.

To assess affordability, all lenders want to know how much of a deposit you have and see proof of this. They will also ask for information to determine how much you can borrow. As mentioned, each lender is different, but they will all want to look at the financial health of your business, its past performance and your plans for the future.



A business plan

This can take different forms depending on the type of business you run and the lender's requirements but, in general, all lenders will want to assess risks to your business, your management team and your plans for paying the commercial mortgage.

While some lenders want to see a full business plan, all lenders will want to see at least a high-level narrative that describes the business's potential. They will also want to assess current and future business risks, and be comfortable that these can be successfully mitigated.

Financial information

Lenders may want to look at your past financial accounts, the business's current performance and its forecasts for future income. To do this, they may request annual accounts or management information.

For owner-managed businesses, they may request trading information, such as revenue and income. For commercial property businesses, they may want to see rental projections, minus costs, dividends and other expenses.

In general, all lenders will be interested in the assets, liabilities, directors and shareholders of the business. It is also quite normal to be asked for a personal statement of assets and liabilities, showing what you own and what you owe.

Eligibility and criteria

As the market is constantly evolving, it's difficult to describe all the requirements here but some factors are always likely to affect your application and these are outlined below.

As with a residential mortgage, a lender will assess whether the property is sound security and whether you are able to afford the mortgage you use to pay for it. Some of the most important criteria a lender will look at are:

- Cash flow to understand the general health of your business.
- Debt to assess whether more debt, in the form of the mortgage, can be afforded.
- Income to show that interest and repayments can be paid over time.
- Deposit as agreed in principle and to be paid when the property is purchased.

In addition, lenders may also require other information to make an assessment, such as:

- Credit score to gauge a third-party agency's assessment of your creditworthiness.
- Business plan that shows how the property fits into your business's strategy.
- Other income and assets including the rent you may expect from the property.

Loan-to-value

The loan-to-value of a commercial mortgage is calculated by comparing the amount of money borrowed with the value of the property that the mortgage is for. Therefore, the deposit you pay will change the loan-to-value amount, as it reduces the amount you need to borrow.

A simple example of a loan-to value calculation would involve a property worth £100,000 and a borrower who was able to deposit £10,000. In order to buy the property, the borrower would need an extra £90,000 and therefore the loan-to-value is 90% (as £90,000 is 90% of £100,000).

How to apply

You can find out more about Allica Bank's commercial mortgage options and how to apply on our commercial mortgages page.

See our commercial mortgages

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