TauroAdvisor

Weekly Bulletin

A Quick Guide to Assumable Loans

Curated by Andy Evans

When evaluating prospective Commercial Real Estate opportunities, investors initially look at location, physical asset, and rents. If everything pencils, financing assumptions are the next step in making or breaking a deal.

When considering debt, the investor has two options:

1. Secure new debt
2. Assume the existing debt

If the seller of the property has a pre-negotiated loan assumption right or the lender agrees to add one, potential buyers have the option to assume that loan. In this scenario, the buyer steps into the shoes of the seller and assumes all loan obligations.

Several types of loans are assumable, including most Fannie Mae, Freddie Mac, HUD multifamily, and CMBS loans. Some bank and life company loans may also be assumable, depending on the individual lender.

With lender originations down and high interest rates, loan assumptions are a creative way to get a deal across the finish line. Below is a list of potential benefits for the buyer and seller respectively:

Seller:

1. Attract more buyers with better terms
2. Lower cost of sale; avoid prepayment penalties associated with current loan

Buyer:

1. Lower interest rate than the current market rates
2. Fewer lender fees
3. Fewer third-party report costs

Once the assumable loan has been determined to make sense for the transaction, it is crucial for the buyer to perform their due diligence and identify any existing loan covenants that could impact them moving forward.

Two potential covenants to look out for:

1. Servicer may require the LTV ratio of the property to remain the same as it was at the origination of the loan. This covenant will prompt the lender to require a new appraisal. If the value of the property has dropped, the borrower may have to place a sizable amount of money in a reserve account that artificially lowers the LTV for the duration of the loan (This locks up additional buyer equity and can hurt the deals IRR).
2. Servicer may have the right to take over property cash flow if the debt-service-coverage ratio falls below a stated l level, or if a major tenant ends a lease (Roughly 70% of CMBS loans have this covenant).

At Tauro, we have seen numerous assumable loan opportunities this past year and can attribute a number of our successful closes to this creative strategy during a turbulent time in the capital markets.

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