NAI Realvest®

News & Information

July 1, 2022

CRE Terms: Financing

In this edition, we explore three financing terms: loan-to-value ratio, property equity and vendor finance.

Loan-to-Value Ratio (LTV)

Loan-to-value ratio – also commonly written as loan to value (without the hyphenation) or abbreviated to LTV – is used in both residential and commercial property financing, typically as a risk mitigation strategy by lenders. The ever-useful NAIOP Terms and Definitions document defines LTV as follows: “The ratio between a mortgage loan and the value of the property pledged as security, usually expressed as a percentage”.

Without getting too bogged down in the specifics, a ratio is an expression of the relationship between quantities – so LTV is the relationship between what loan is offered by a lender and what the property is valued at. If you got a 110% LTV, you’d have the full value of the property loaned to you, plus ten percent extra for upgrades, for example.

Another explanation from G-Maven: “Higher LTVs means more risk for the lender. Lower LTVs mean there is lower risk to the lender. If the borrower cannot meet their financial obligations, and the property has to be sold, there is a higher chance of the property being sold at a value in excess of the property’s debt value. This means that the lender has a greater chance of recovering their loan.”

CRE Terms: Financing

Property Equity

Related to the above, G-Maven offers this extra tidbit for us: “Out of interest, the property value less the loan value is known as the property equity.”

So if a buyer was offered financing at a 90% LTV, they would typically put in the 10% difference in cash, and their equity in the property would be equal to that amount. It’s what they actually have paid for (as opposed to financed), and – as NAIOP explains – it is what would be sold or liquidated in the event of recapitalization.

Vendor Finance

Vendor financing is an alternative to traditional financing from a bank or financial institution, and might take the form of debt (a loan) or equity financing. With the latter, you’d offer something like company stock to underpin the transaction or to close the gap between the cash or financing a buyer has and the asking price.

But be warned: vendor financing has a reputation for being expensive debt. Given that it is often deployed as a means to getting a loan when one doesn’t meet the criteria of more traditional lenders, most providers often “price in” the risk through higher rates or harsher conditions.