

Underwriting Investor Commercial Real Estate 101



**"The loan for an Investor
Commercial Real Estate
transaction is based on the
loan amount supported
by the property's Net
Operating Income!"**



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Collect the info you will need

- **Property tax returns or P&L**
- **Rent roll**
- **Copies of leases**
- **Estimated property value**
- **Vacancy factor**
 - ask credit team or CRE broker
- **Property management fee**
 - ask credit team or CRE broker
- **Replacement reserves**
 - ask credit team or CRE broker

Calculate Effective Gross Income

Gross Rents

less: Vacancy Factor*

Effective Gross Income

* Vacancy factor: is based on market vacancy & stated as a percent (i.e. 5%). Multiply gross rents by vacancy factor.

Calculate Total Rental Expenses

Advertising

...

Insurance

Property management fee*

Repairs

Taxes

Utilities

Other expenses

Total Rental Expenses**

*Property management fee: is based on going market rates & is stated as a percent (i.e. 5%). Multiply effective gross income by property management fee %.

**Don't include depreciation & interest expense.

Calculate Net Operating Income

Effective Gross Income

less: Total Rental Expenses

Operating Income

less: Replacement reserves*

Net Operating Income

*Replacement reserves: is based on going market rates & is either a fee per unit or fee per square foot. If the subject property is an apartment building, the reserve is a dollar amount per unit. Multiply the number of units by the reserve dollar amount (i.e. \$300 * 12 units). The reserve is a dollar amount per square foot for any other property type (i.e. \$0.25 * 9800 square feet).

Calculate Debt Service Coverage

$$\text{DSC}^* = \frac{\text{Net Operating Income}}{\text{Annual Loan Payment}}$$

*DSC: you want DSC to be equal to or greater than 1.25. If you are falling short, there are a few strings you can pull:

1. Rent increases: determine if there are scheduled rent increases that are not yet reflected on property P&L.
2. One-time expenses: determine if there were one-time expenses that can be backed out.
3. Lower the loan amount: decrease the loan amount until you meet the minimum DSC.

Additional Considerations

- **Rent Roll:**

- **Maturing leases:** review rent roll for leases that are maturing in the near future & discuss with your credit team.
- **High Risk Tenants:** identify any high risk tenants (dry cleaners, dispensaries, etc.) & discuss with your credit team.

- **Leases:**

- Ensure that tenants, dollar amounts & maturity dates foot to the rent roll.
- Ensure that tenants with maturing leases have extensions or are going to sign extensions.

- **Building Type & Tenants:**

- Is the building type acceptable?
- Are the tenants acceptable?

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approved & funded fast!

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