GUIDE TO COMMERCIAL MORTAGES

MKL COMMERCIAL LOAN OVERVIEW
A BORROWER'S GUIDE

Commercial Mortgage Underwriting Guidelines and Processing
Financing for commercial properties is underwritten on a case by case basis. Every loan application is unique and evaluated on its own merits, but there are a few common criteria that Lenders look for in a Commercial Loan package.

COMMERCIAL MORTGAGE LENDING RATIOS
Commercial Real Estate lending can be boiled down to the results of three ratios:

1. Loan-To-Value Ratio (LTV)
2. Personal Debt Coverage Ratio (PDCR)
3. Debt Service Coverage Ratio (DSCR)

1. The "Loan-To-Value Ratio" (LTV) is defined as follows: "Total Loan Balances (1st mtg+2nd mtg) / Fair Market Value" (as determined by appraisal).

Commercial Investment Properties are viewed more conservatively than residential property. Many Lenders will require a minimum of 25% to 35% of the purchase price to be paid by the buyer. However, some lenders will loan up to 80% of the purchase price to buyers based upon credit worthiness and property analysis.

What a Lender will do is subject to the quality of the buyer and property. If you know what a lender's LTV requirements are, you can also calculate the loan amount by multiplying the purchase price by the LTV percentage.

Keep in mind that the purchase price must also be supported by a property appraisal. In the event that the property appraisal shows a value less then the purchase price, the Lender will use the lower of the two numbers to determine the loan that will be made.

2. The "Personal Debt Coverage Ratio" (PDCR) is the second ratio that Lenders use when underwriting a Commercial Loan. The Personal Debt Ratio compares the amount of bills that the borrower must pay each month to the amount of monthly income he earns.

More precisely, the Personal Debt Coverage Ratio is defined as: "Monthly Personal Debt / Adjusted Gross Monthly Personal Income".

PDCR's are set by property type and what a Lender perceives the risk to be. Today, apartment properties are considered to be the least risky category of investment lending. As such, Lenders are more inclined to use smaller PDCR's when evaluating a loan request. The higher the PDCR ratio, the more conservative the Lender. Your **MKL** Loan Officer can assist you to understand the PDCR policies of each of the major commercial lenders.

3. The "Debt Service Coverage Ratio" (DSCR) evaluates the debt coverage of the property itself. The Debt Service Coverage Ratio is defined as: "Net Operating Income / Debt Service".

"Net Operating Income" is the income from a rental property after deducting for real estate taxes, fire insurance, repairs, and all other operating expenses.

"Debt Service" is the mortgage payment on the property.

Most lenders insist that this ratio “exceed 1.1”. A debt service coverage ratio of “less than 1.0” would mean that the property did not produce enough net rental income for the owner to make the mortgage payments without supplementing the property from his personal budget.

Property Analysis
Fair Market Value and Fair Market Rent will be analyzed. Special use property may require additional underwriting. Age, appearance, local market, location, and accessibility are some other factors considered.

Tenant Analysis
A thorough analysis of the current tenant(s) will be conducted. Lenders will evaluate the financial strength of the tenant(s), how many years are left on the current lease(s), and other relevant information regarding the tenant(s).

Credit Worthiness
In many cases the personal credit of principals will be evaluated. For corporations, business performance and credit ratings will also be evaluated.

INITIATING YOUR COMMERCIAL LOAN PROCESS
To initiate your commercial lending application process, the following information is required by most financial institutions and your **MKL** Loan Officer can assist you in preparing this information:

1. Property overview
2. Copy of Purchase/Sale Agreement (unless a refinance)
3. Background summary on tenants including how many units operated
4. Borrower’s background summary or resume
5. Current personal financial statement of principal borrower(s) including real estate with all schedules
6. Last two years personal federal tax returns from the principal borrower(s) – including all schedules
7. Last two years’ corporate tax returns if self-employed or own more than 25% of corporation, and year-to-date Profit and Loss statement
8. Any relevant 1031 information you have

LOAN PROCESSING

The bulk of the energy spent "processing" a loan is merely an attempt to verify the numbers that go into the numerator and denominator of these ratios.

1. Loan-To-Value Ratio (LTV)
2. Personal Debt Coverage Ratio (PDCR)
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