

## Increasing your Success Through Commercial Loans

By: Jeff Long, CPA

I have been writing articles for the Journal since 1997. This is my inaugural column and I hope you benefit by taking the time to read this information. Throughout the last several Journal issues I have been exploring how you can earn big commissions by originating commercial loans. I would suggest that you review those articles or contact me and I will send them to you. I promise that in future columns I will provide you with marketing ideas and some more juicy topics. However, before you can earn the big money, you need to understand the foundational concepts of commercial lending. That way, meeting with a client will be more productive and profitable. One of the most important fundamentals of commercial lending is knowing how to determine what the **Net Operating Income (NOI)** is for a particular property or commercial business.

**Mastering this first concept, and other concepts in future columns, should be a goal. Fortunately, the foundations of commercial underwriting are similar to the foundations of residential underwriting. For example, the NOI on a commercial property is similar to an individual's income on a residential loan in that these figures will determine what loan amount and type the borrower will qualify for.**

**ABC Company Example:** In order to better understand the concept of NOI, we will use some key figures from a tax return on ABC Co. We will assume that ABC Co. owns a building that they think is worth \$1,200,000 and on which they currently owe \$930,000. Additionally, the owners of the company have excellent personal credit, and all other aspects of the loan are strong. The goal of ABC Co. is to refinance their existing commercial mortgage with a new \$960,000 mortgage that rolls in the closing costs, have a 20 year loan w/ no balloon, and lower their interest rate. Using the following figures we will analyze their request to see if they qualify:

*Gross Income (per tax return): \$1,000,000*

*Operating Exp.. (sum of most expenses listed on the tax return): \$880,000*

*Interest Exp. (a separate exp. item not incl. in the operating exp.): \$90,000*

*Depreciation Exp (a separate exp. item not incl. in the operating exp.): \$20,000*

*Net Income (the bottom line figure, \$1MM -\$880k -\$90k -\$20k): \$10,000*

If the Net Income is listed on a tax return or financial statement then you should begin with that figure. Using our ABC Co. example this would be \$10,000. Because Depreciation expense is only a tax related expense and not an actual hard dollar expense, commercial underwriting standards allow the figure to be added onto the Net Income figure. Additionally, since the Interest expense is going to be replaced with our new loan, we will also allow this figure to be added onto the Net Income figure. Thus, you can add back any Depreciation and Interest expense if they are specifically listed as expenses on the tax return (or financial statement) that resulted in the Net Income. Adding back the Depreciation and Interest expenses to the Net Income creates the usable Net Operating Income figure that can then be used for value determination purposes. In summary, Net Income + Depreciation expense + Interest expense = NOI. Using the figures from ABC Company: the Net Income of \$10,000 + Depreciation of \$20,000 + Interest of \$90,000 = An NOI of \$120,000 that can be used to determine the property value and loan amount.

This illustration of NOI is simplified and does not contain all of the nuances. However, understanding the basics will allow you to determine if a commercial loan request is reasonable. Prior to reading this column, if you saw a tax return that showed a \$10,000 net income do you think you would have thought this loan request was closable? Probably not! In conclusion, this loan will work out and you could earn thousands of dollars by recognizing how the figures flow. In my next columns I will explore the concept of Debt Service Coverage Ratios and how commercial property values are determined.

*Jeff Long, CPA, is the Director of Commercial Lending and Private Mortgages of Financial Resources and can help you with your commercial loan requests. He is in the main office in New Hampshire, Phone (603) 279-1133, Fax (603) 279-4278, email JLong@franh.com. If you have a residential loan request please contact Cindy Buckmaster in the Tulsa, Oklahoma branch office at (918) 307-1949 or by fax (918) 294-1913 or by email cbuckmaster@franh.com. Consultant Information packages can be obtained by mail upon a faxed request, by email or from the Web site at [www.financialresourcesinc.net](http://www.financialresourcesinc.net).*