

## Increasing your Success Through Commercial Loans

By: Jeff Long, CPA

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 and columns or contact me and I will send them to you. Meetings with clients will be most productive and profitable if you understand the foundational concepts of commercial lending. It is important to know that your client's loan request is based upon a reasonable property value. This can be the difference between earning a commission on a closed loan and wasting time while putting the file in the dead drawer.

It is critical to the success of a loan that we make sure that a property's value is sufficient to meet the client's loan request. Thus in the initial stages of evaluating a loan request you should ask how the borrower determined the value of a property and make sure this is realistic. This problem is more common on refinances than on purchases. Sometimes borrowers overstate the value due to a poor guess or wishful thinking or for some form of a weak negotiating tactic. Let's look at the most common methods of determining the property value.

SOME LOW COST METHODS and good sources for initially determining the property value are as follows: Obtain an unbiased realtor's opinion of value based on some recent comparable sales; information from an old appraisal; evaluate the last purchase price of the property and local property appreciation rates over time. These are all low cost ways for a borrower to come up with the approximate property value.

ANOTHER METHOD of value determination at no cost to the borrower, is to determine the value based on the Net Operating Income (NOI) of the property divided by the appropriate capitalization (CAP) rate. For more information on this method and CAP rates please refer to our consultant information package.

THE BEST METHOD of property value determination is to obtain an appraisal from a licensed appraiser. On commercial loans, an appraisal may cost \$1,000 to as much as \$25,000. The cost of an appraisal depends on the property type, its location, its size, the loan amount, and several other factors. Fortunately, the foundations of commercial loans such as NOI and CAP rates contribute to what is called the *Income Approach*, one of the ways an appraiser uses to help determine the value. Additionally, an appraiser is going to evaluate the *Cost Approach*. What would it cost to rebuild the property. An appraiser also looks at the value of comparable property sales using the *Comparable Sales Approach*. The appraiser then reconciles these three approaches and reaches a conclusion on the final property value.

An example of the power of an appraisal can be seen in a loan we recently made. The buyer and seller had agreed to a purchase price of \$475,000. The appraisal came in at \$220,000. Given the dramatic discrepancy, we had to get a second appraisal that also came in at \$220,000. Thus it appeared that the seller was either over confident or trying to deceive the buyer. Once provided the proof that his property was only worth \$220,000 the seller reluctantly agreed to lower the sale price and the loan closed.

Some promised marketing ideas: (1.) Tell everyone you know that you can assist with their commercial loan needs. (2.) Look at all past, present and future private mortgages deals, factoring clients, residential loan applications and tax returns for borrowers who have ownership in commercial properties. On tax returns the Schedule "E" will show you if they own any commercial properties.

A simple inquiry asking a client if they have thought about purchasing a commercial property or refinancing an existing mortgage on a commercial property could put thousands of dollars in your pocket.

My next column will show you how to recognize a good commercial deal from a bad commercial deal by asking the right questions.

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