

## Increasing your Success Through Commercial Loans (Grade “B-C” type loans)

By: Jeff Long, CPA

Throughout the last several Journal issues we have been exploring how to earn serious commissions by originating commercial loans. I suggest that you review those articles and columns. If you need copies, contact me and I will send them to you. Here is a quick review of what I have addressed: (1) Commercial loans to purchase a property or to refinance an existing mortgage, (2) The three main types of commercial mortgages, (3) Grade “A” mortgages, (4) Quick evaluation techniques (5) Commonly asked commercial loan questions (6) The items needed to submit a quality commercial loan package (7) Underwriting fundamentals such as Net Operating Income (NOI) and Debt Service Coverage Ratios (DSCR), (8) How a commercial property value is determined (9) Interview questions to ask a borrower when discussing a deal. Here we’ll explore one of the more exciting and profitable loan types, Grade “B-C” loans.

In explaining a Grade “B-C” loan, we see a deal with weaknesses enough to fall outside the standards of a Grade “A” (strong credit) loan. However, the loan is not bad enough to fall into Grade “D” (hard money) loan programs. All of our parameters such as DSCR, LTV, CAP rates, and NOI calculations apply to this loan type as well, but we have looser standards.

Grade “B-C” loans can be for either purchases or refinances. Grade “B-C” purchasers should have at least a 10% down payment, but the seller must be willing to hold back a second mortgage for between 10% and 40% of the sale price. The ideal would be for the borrower to have their own 20%-50% down payment eliminating any need for a seller held second mortgage (the flexibility of our program allowing the seller to hold a second mortgage has saved many loans when the borrower only had the minimum 10% down payment). The debt service coverage ratio should be in the 1.00-1.25 range. The terms on purchases and refinances are typically: LTV 50-80%, interest rates that are higher than Grade “A” rates, 15-30 yr amortizations, a possible prepayment penalty, and a possible balloon.

**Stated Income Grade “B-C” loans:** This loan type is used when the property’s Net Operating Income cannot be proven through tax returns and that income needs to be “stated” by the borrower. The word “property” is emphasized because it is the property’s income that is the focus of a commercial loan. If a property is an income type property such as an office building or a business property such as a restaurant then the tax returns should reflect the true income made through the property. When the seller of a property is unwilling or unable to show appropriately profitable tax returns, the stated income loan can solve the problem. In cases where a borrower wishes to refinance his existing mortgage but his previous two years tax returns do not reflect a strong enough NOI, the stated income loan can be the answer as well.

The key to our stated income loan is that we will allow the borrower to “state” their income for loan purposes. Of course the “stated” income must make sense. We ideally

would still like to see the tax returns in case we can make the loan fit our full income verification standards. If the tax returns will not work, then we will ignore the tax returns and typically not require any additional proof of income. By allowing the borrower to “state” the property income, we in effect are trusting the borrower’s ability to make the monthly mortgage payments. Due to the added risk of the “stated” income, the interest rates are higher than for a standard Grade “A” loan. The Loan-to-Values can range from 55% to 80%. But we can handle just about any type of property under this loan with the exception of raw land and gas stations.

**Credit Requirements.** Most Grade “A” loans require at least a middle credit score of 620. Thus, a credit score between approximately 570 and 620, will typically not fit into the Grade “A” loan category.

Our Grade “B-C” loan programs can than make the difference between a loan turndown and a successful closing. Take a look at some of your old deals; some may be able to be revived with this new valuable information.

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