

# Apartment and Commercial Loans: How Big of a Loan Can I Get?

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REPRINTED FROM SCOTSMAN GUIDE COMMERCIAL EDITION, OCTOBER 2004

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Borrowers often ask, “What is the maximum loan-to-value (LTV) you can get for me on this (income-producing) property?” This is a valid and important question in the world of real estate finance, but an honest answer cannot be given to the borrower without more information.

The maximum LTV that lenders are willing to lend is usually based, to a significant degree, on property type. Apartment complexes, for example, are viewed as relatively safe investments and can usually support higher LTVs—perhaps 75 percent on a single loan. Land, on the other hand, usually supports an LTV of only 50 percent.

Pretty simple, eh? Well, the property type is only half of the story. The second requirement for income-producing property (when a property’s income services the property’s debt) is a little more complicated. Most lenders like to see that the income-producing property, indeed, produces income and does so in a way that can cover the expenses, the suggested loan and then some.

Establishing whether a property is

income-producing, however, requires a little math, so you might want to keep your calculator handy. As a case study, let’s take the purchase of a 10-unit apartment complex that is bringing in an average rent of \$1,000 per unit per month and has expenses of \$3,500 per month. From this, we can calculate the gross and net operating income (NOI) as follows:

- $\$1,000 \times 10 = \$10,000$  gross income per month or  $\$120,000$  gross income per year
- $\$3,500 \times 12 = \$42,000$  expenses per year

Subtracting the expenses from the gross income yields an NOI of \$78,000 per year. With the NOI calculated, we are halfway finished. This is when the debt service coverage ratio (DSCR) comes in. The DSCR is sometimes referred to by other names: debt service ratio (DSR) or debt coverage ratio (DCR). However, all these terms mean the same thing: the ratio of the NOI to the suggested loan payments (principal and interest). Many lenders use a DSCR of 1.2 for income-producing properties. This suggests that the NOI has to be 20 percent more than the carrying cost of the loan.

Returning to our apartment complex example, our \$78,000 yearly NOI is \$6,500 per month. Dividing this by 1.2, we have about \$5,417 per month for principal and interest payments. So, if we assume a loan amortized over 25 years with a 6 percent interest rate and use the “time value of money” function on the calculator, we discover

that this monthly payment can cover an \$840,000 loan. This represents the maximum sum that many conventional lenders would likely be willing to loan on a property such as this (based on the property’s income). Given this, a question still remains: What is the maximum amount that will be loaned on this property? The effective maximum loan amount is the lower of the result of the DSCR calculation previously computed and the maximum LTV on the property type.

So, the mortgage broker or lender can now ask (if he or she has not already done so), “What is the purchase price of this apartment building?” If the answer is \$1 million, most lenders would be willing to finance 75 percent (\$750,000) of that amount since it is less than the \$840,000 that the property can carry. Our buyer would need to come up with the difference between the \$1 million purchase price and the \$750,000 loan amount (\$250,000 plus closing costs).

If, instead, the purchase price was \$1.5 million, lenders would likely be willing to put up the full \$840,000—the amount the property can support. This is because this price represents a LTV of 56 percent, which is well below the desired maximum LTV of 75 percent for apartment buildings. This would require the buyer to come up with the difference between the \$1.5 million purchase price and the \$840,000 loan amount (\$660,000 plus closing costs).

Nevertheless, there is some flexibility. Although the DSCRs often hover

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around 1.2 for most lenders, some lenders use somewhat lower DSCRs, allowing the borrowing of more money; however, others do the reverse and lend less. For example, there is at least one lender that uses a 0.8 DSCR in some cases. Also, some lenders might allow more flexibility in projected vs. current rents. Some lenders are more or less lenient on the amount that should be allocated for expenses—for example, 3 percent vs. 5 percent for the management fee. Also, the program and rate for which the borrower and property might qualify could be different, resulting in a lower qualifying rate or interest-only payments that would support a higher loan amount. Lastly, there are other financing sources that might allow the effective loan amount and LTV to go higher than otherwise possible, such as seller financing, mezzanine financing and joint ventures (options usually for larger deals).

Borrowers should not be surprised when they hear a broker or lender ask, “What is the net operating income?” in response to their initial question, “What is the maximum LTV you can get for me on this property?” Consequently, if a borrower is looking for financing for an income-producing property and wants to know what the maximum LTV on a conventional buy-and-hold loan would be, he or she should expect this to be based largely on the ability of the property to carry it.

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