Commercial Lending Glossary

Acre: Unit of land measure equal to 43,560 square feet.

Amortization (To Amortize): The act of paying off a debt through scheduled periodic payments. Example: A 20 year amortization means that the payments are evenly distributed monthly over the course of 20 years, so that the final payment on the last month of the 20th year will have paid the entire principal balance of the loan.

Appraisal: A document prepared by a professional, licensed appraiser that determines the monetary value of commercial real estate. Most commercial appraisals have three approaches to determining the value of a property. These three approaches are: income approach, cost approach and fair market value. An appraisal of the subject property is needed on all commercial real estate loans with Mission Oaks National Bank.

Assumability: A loan that is capable of being transferred to a new borrower with no change in rate or terms of the loan. It also allows a borrower to sell a property and avoid paying a prepayment penalty because the loan is being transferred and not paid off.

ADR (Average Daily Rate): A unit of statistics used to determine a hotel or motel's pricing scale. The statistic is determined by dividing the room revenue by the total number of rooms sold.

Balloon Loan: A loan with a term shorter than its amortization therefore requiring a final loan payment significantly larger than the payments preceding.

Basis Point (BP): A basis point is 1/100th of 1%. Example: 25 basis points is equal to 0.25%.

Bridge Loan: Short term financing designed to be paid off after a designated period of time. A common form of bridge loans is construction loans.

CAM (Common Area Maintenance): Common Area Maintenance describes the act of maintaining areas which are used by one or more of the tenants in a building or their customers. Common areas can be as simple as a picnic table in the quad of an office complex to the entire interior corridor of a shopping mall and the parking lot. Many times these expenses are passed on to the tenants as part of their base rent or as a direct expense of a tenant in a triple net lease (NNN).

Cap Rate: Capitalization Rate: a capitalization rate is used to measure how quickly an investment will pay for itself based on the income that it produces. The Cap Rate is calculated by dividing the Net Operating Income (NOI) by the purchase price of the property. If the purchase price of the property is $1,000,000 and the most recent annual NOI for that property is $120,000 then (120,000/1,000,000 = 0.12 or 12%) the property has a Cap Rate of 12%. The property could pay for itself in 8.33 years (100/12 = 8.33).

Cash Flow: Cash flow is a measure of financial strength for a company. Cash flow is equal to cash receipts minus cash payments over a certain period of time. In order to determine the cash flow of a business based on tax returns, non-cash expenses such as depreciation and amortization are added to the net income. Cash flow is used by lenders to determine the amount of cash available to service the debt of a loan. Cash flow is used to derive the DCR (Debt Coverage Ratio) of a business.

Closing Costs: Any fees or costs that are incorporated into the transfer of real property applied at the closing of a loan (not including the cost of the actual property).

Construction Loans: A loan where the funds are used for ground-up construction, renovation or expansion of a building on real property. Generally construction loans are short term loans designed to be taken out by permanent financing. The Construction Loan Program with Mission Oaks National Bank includes the construction loan and permanent financing in a single closing.

Contingency: Any condition of a contract that must be satisfied before the contract can be consummated.

Cost Approach to Value: The cost approach in determining the value of a property is simply determining how much it would cost to construct the permanent improvements at the subject property plus the cost of the unimproved land.

Credit Tenant: Credit tenants are tenants that are usually publicly traded or large private entities with a strong S&P rating.

DCR (DSCR), Debt Coverage Ratio (Debt Service Coverage Ratio): DCR is a calculation that banks use to determine the capability of a income producing property or business to pay its debt obligations. DCR is calculated by dividing the Net Operating Income (NOI) by the annual debt payments. Example: NOI = $120,000. Annual debt payments= $100,000. $120,000/$100,000 = 1.20. This means that the property or business would have a DCR of 1.20x or 120% of the annual principal and interest cost of their debt. A DCR below 1 would mean that the property or business is not producing enough income to meet its debt obligations or proposed debt obligations.

Discount Rate: The Federal Reserve Board defines the discount rate as "...the interest rate charged to commercial banks and other depository institutions on loans they receive from their regional Federal Reserve Bank's lending facility..."

Default: When a borrower does not meet his/her obligation to pay their debt as prescribed in the loan documents, their loan is in default. When a loan is in default, if not made current, the property secured by the mortgage is in danger of being foreclosed upon.

Depreciation: Depreciation is an accounting method that provides a way for businesses to expense assets over time, rather than only at the time that they purchased it. Depreciation is a non-cash expense, letting businesses report lower earnings, but higher Net Operating Income and Cash Flow.

DTI (Debt to Income Ratio): The debt to income ratio is used to determine the percentage of gross monthly income going to pay debts. The calculation used to determine DTI is monthly debt payments divided by gross monthly income. For example: If someone makes $10,000 per month and their debt payments (including mortgages, credit cards, car payments, etc.) total $3,000 per month, then they have a debt to income ratio of 30% (3,000/10,000 =0.30 or 30%). That is to say that 30% of their gross personal income goes to pay debt. Although DTI does play a role in qualifying a commercial loan, DCR plays a much more important role in commercial lending than does DTI.

Environmental Report: Many banks and lenders require a subject property to be proven environmentally clean prior to committing to fund a loan with the subject property as collateral. This report discusses the actual or potential environmental hazards related to the property.

Equity: The monetary value of a property beyond the amount leveraged.

Escrow: Escrow is a third party that will hold funds in trust until all contingencies are fulfilled and then will distribute the funds according to the instructions of the parties involved.

Fair Market Value: The US Supreme Court defines Fair Market Value as "...the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts."

Federal Funds Rate (Fed Funds Rate): The Fed Funds rate is the rate at which banks lend to each other for overnight money. It is the interest rate on which the Prime Rate Index is based. The nominal Federal Funds Rate is controlled by the Board of Governors of the Federal Reserve.

FF&E (Furniture, Fixtures and Equipment): FF&E or Furniture, Fixtures and Equipment is a term used to describe the non-permanent assets that are necessary to perform the business being operated on the property. For example: FF&E for a restaurant would include stoves, ovens, tables, booths, chairs, light fixtures, etc. Sometimes the FF&E of a property can be financed, especially when using SBA financing.

Foreclosure: Foreclosure is the legal process of seizing the collateral that secured a loan that has been defaulted.

Fully Amortizing Loan: A loan that has an amortization schedule the same length as its term. It is a loan that has no balloon payment.

Hectare: A unit of land measure equal to 2.47 acres or 107,639 square feet.

Hospitality Property: A property designed for the specific purpose of providing guests with overnight accommodations. Hospitality properties include: hotel properties, motel properties, and bed and breakfast properties.

Income Approach to Value: Also known as the "Income Capitalization Approach," is a method appraisers use to determine the value of commercial real estate based on income derived from the property. The value is determined using capitalization rates of the net operating income.

Index: An economic indicator in the form of an interest rate on which other interest rates are based. Examples: The Wall Street Journal Prime Rate, The Federal Home Loan Bank (FHLB) of Seattle indices, Treasury SWAP indices.

Interest Rate: The percentage of a sum of money that is charged by a lender to a borrower for the use of said sum.

Interest Only: A loan where the borrowers pay interest on the principal balance and no amount of the payment goes towards reducing the principal balance.

Lease: A contract renting land and/or buildings to another. A lease identifies the amount of rent to be paid, the responsibilities of both the property owner (lessor) and lessee (tenant), and sets a start and expiration date.

Limited Service (Hotel): A hotel that offers only lodging services and does not offer special services such as a full scale restaurant or a spa. Many limited services hotels offer a free continental breakfast to guests and some have a pool and small gym.

LTV (Loan to Value Ratio): LTV is a ratio expressed as a percentage and is the calculation of debt over equity. It is used to express the amount of debt owed on real property as a percentage of its total appraised value. For example, if someone wishes to purchase a property for $1,000,000 and they have $250,000 cash to put down on the property, they would need a loan of $750,000 to complete the purchase. The loan ($750,000) to value ($1,000,000) ratio is 75% (750,000/1,000,000 = 0.75).

Lock-Out Period: The period following the closing of a loan in which the loan may not be prepaid.

Mixed Use Property: A mixed use property is a property that has both residential and commercial uses. A typical example of this would be a building with one or more office or retail units on the first floor and one or more apartments above.

Multifamily Property: Multi-family property is a property that can house more than one family; an apartment building.

Multi-Use Property: A multi-use property is a property that can easily be converted for multiple purposes. Examples of multi-use property are: office, retail, warehouse, light industrial, and general use commercial.

NOI (Net Operating Income): The gross annual income of a property minus its operating expenses. Mission Oaks National Bank uses the NOI of a property to determine the debt serviceability of said property. The NOI of a property is used to determine the DSCR of a property.

Origination (fee): Origination is the process of pre-screening, Prequalification, due diligence, underwriting and funding/recording. An Origination fee is the fee for this service.

Permanent Financing: As opposed to a bridge loan or construction financing, permanent financing is the long term financing of commercial real estate. Permanent financing usually has a term longer than 10 years and has an amortization schedule of at least 15 years. With MONB you will typically find loans with terms and amortization schedules of 20 or 25 years.

Pre-Leased: Pre-leased it a term used when a landlord leases property to tenants before the construction of the property is completed. Sometimes borrowers need to pre-lease a portion of their property in order to qualify for a commercial construction loan.

Prepayment Penalty: A prepayment penalty is a fee charged to a borrower if he/she pays off their loan prior to the end of the prepayment penalty term. Sometimes these penalties are based on a percentage of the amount prepaid, and sometimes they are based on the amount that the borrower would have paid in interest payments had the note not been prepaid. A prepayment penalty is not a lock-out.

Prime Rate - The Prime Rate is defined as the interest rate charged by banks to their most creditworthy borrowers. The Prime Rate varies little throughout the country. The most commonly accepted publisher of the Prime Rate is the Wall Street Journal. That is why the index is often referred to as the Wall Street Journal Prime Rate (WSJ Prime Rate). Although the Board of Governors of the Federal Reserve does not directly control the Prime rate, the open market generally calculates the Prime Rate to be the Fed Funds Rate + 3.00%.

Principal: Principal refers to the outstanding debt of an entity without including interest costs.

Profit and Loss Statement: A statement that details the income and expense for a business or commercial real estate for a given period.

Pro Forma: Pro forma, when translated form Latin, literally means “matter of form.” In commercial real estate financing it simply means projected or expected and usually refers to income, expense, or cash flow.

Recourse: Recourse refers to a lender's ability to hold a personal guarantor personally liable for a loan. There are some commercial loan programs available that do not require a personal guarantor and thus are "non-recourse."

Refinance: To replace securitized debt with new debt, secured by the same collateral.

Rent Roll: A list of tenants in a commercial or multi-family property that includes some detail of the lease agreement between tenant and landlord (i.e. tenant name, base rent, length of contract, area or unit description).

SBA (U.S. Small Business Administration): The SBA website states: *The U.S. Small Business Administration (SBA) was created in 1953 as an independent agency of the federal government to aid, counsel, assist and protect the interests of small business concerns, to preserve free competitive enterprise and to maintain and strengthen the overall economy of our nation. We recognize that small business is critical to our economic recovery and strength, to building America's future, and to helping the United States compete in today's global marketplace. Although SBA has grown and evolved in the years since it was established in 1953, the bottom line mission remains the same. The SBA helps Americans start, build and grow businesses. Through an extensive network of field offices and partnerships with public and private organizations, SBA delivers its services to people throughout the United States, Puerto Rico, the U. S. Virgin Islands and Guam.* For more information about the SBA visit: Overview & History of the SBA.

Second Trust Deed (Second Mortgage): A second trust deed (also written 2nd TD) or a second mortgage (also referred to simply as "a second") is a loan in a subordinate position to a first trust deed loan secured by the same collateral.

Special Use Property: A commercial property type that cannot be easily converted into many different uses. Examples of Special Use Property are: gas stations, most restaurants, automotive service facilities, assisted living facilities, marinas, carwashes and hospitality properties (motels/hotels).

Square Foot: A unit of measure usually used to describe the size of a building or lot of land smaller than one acre. A square foot is the area of a square with sides equal to one foot in length. Also equal to 144 square inches.

Tenant: A tenant occupies and uses a property according to terms outlined in a lease or rental agreement signed by both tenant and landlord.

Term: The term of a loan identifies how many years until full repayment is required.

Title: The legal document that provides evidence of ownership of a piece of real estate.

Triple Net Lease (NNN Lease): (Also referred to as Net-Net-Net). A triple net lease is a lease agreement where the tenant pays all real estate taxes, property insurance, common operating expenses (utilities) and Common Area Maintenance (CAM) in addition to the base rent.

Unanchored: Unanchored usually refers to small retail centers with no major credit tenant in the center. Major credit tenants are usually very large regional, national or international companies.

Underwriting: The process of due diligence performed by a lender in preparation of final approval to fund a loan.

Vacancy: A vacancy is an unoccupied unit in a commercial or multi-family building.

Vacancy Percentage: The percentage of available rentable space that is not occupied by a tenant.

Yield Maintenance: A type of prepayment penalty designed to allow investors to attain a similar yield as if the borrower made all scheduled mortgage payments until maturity.