

SECTION THREE:

TYPES AND EXAMPLES OF LOANS

This Section on types of loans, provides the opportunity to begin calculating actual loan payments. A basic understanding of the use of a financial calculator is necessary. Included in this Section are examples of several types of Income Property loans and a brief explanation of each loan with the payment and balloon payment calculated. Then the student has an opportunity to calculate a payment on a similar loan.

This Workbook requires a mortgage calculator in order to solve all the loan calculations in this Workbook. These examples can be referred to whenever there are questions on the calculations. You may also download a mortgage calculator application such as PowerOne FE.

Fully Amortized Loan: Fixed Rate

This loan is the easiest payment to calculate since the payment stays the same throughout the term of the loan.

Example 1:

\$2,500,000. 25 Year Amortization @ 4.75%:
Monthly Payments = \$ _____

Partially Amortized Loan: Bullet Loan

These loans have many names, including Bullet Loans, Partially Amortized Loans, and Balloon Payment Loans. Other times they are simply referred to as Stops, Calls and Pops. The Amortization Term can be from 15-30 Years, but the remaining balance (balloon payment) is due before the loan is fully paid out.

Example 2:

\$2,500,000, 30 Year Amortization @ 4.75% with the balloon payment due in 5 Years.
Monthly Payments=\$ _____
Balloon Payment due in 5 Years=\$ _____

PROBLEM #2:

Calculate the Balloon Payment due in 5 years for a \$2,000,000 Loan amount, 25 Year Amortization 5% with the balloon payment due in 5 Years.

Monthly Payments = \$ _____.
Balloon Payment due in 5 Years = \$ _____.

BRIDGE LOANS WIKIPEDIA

Description

A bridge loan is interim financing for an individual or business until permanent financing or the next stage of financing is obtained. Money from the new financing is generally used to "take out" (i.e. to pay back) the bridge loan, as well as other needs.

Bridge loans are typically more expensive than conventional financing, to compensate for the additional risk. Bridge loans typically have a higher interest rate and points (points are essentially fees, 1 point equals 1% of loan amount), and other costs that are amortized over a shorter period, and various fees and other "sweeteners" (such as equity participation by the lender in some loans). The lender also may require [cross-collateralization](#) and a lower [loan-to-value ratio](#). On the other hand they are typically arranged quickly with relatively little documentation.

In real estate

Use

Bridge loans are often used for commercial real estate purchases to quickly close on a property, retrieve real estate from foreclosure, or take advantage of a short-term opportunity in order to secure long-term financing. Bridge loans on a property are typically paid back when the property is sold, refinanced with a traditional lender, the borrower's creditworthiness improves, the property is improved or completed, or there is a specific improvement or change that allows a permanent or subsequent round of mortgage financing to occur. The timing issue may arise from project phases with different cash needs and risk profiles as much as ability to secure funding.

A bridge loan is similar to and overlaps with a [hard money loan](#). Both are non-standard loans obtained due to short-term, or unusual, circumstances. The difference is that hard money refers to the lending source, usually an individual, investment pool, or private company that is not a bank in the business of making high risk, high interest loans, whereas a bridge loan refers to the duration of the loan.

Characteristics

For typical terms of up to 12 months 2–4 point may be charged. Loan-to-value (LTV) ratios generally do not exceed 70% for commercial properties, or 80% for residential properties, based on appraised value. Although there are more aggressive lenders for added value loans.

A bridge loan may be closed, meaning it is available for a predetermined timeframe, or open in that there is no fixed payoff date (although there may be a required payoff after a certain time).

A first charge bridging loan is generally available at a higher LTV than a second charge bridging loan due to the lower level of risk involved, many UK lenders will steer clear of second charge lending altogether.

Lower LTV's may also attract lower rates again representing the lower level of underwriting risk although front-end fees, lenders legal fees, and valuation payments may remain fixed.

Examples

- A bridge loan is often obtained by developers to carry a project while permit approval is sought. Because there is no guarantee the project will happen, the loan might be at a high interest rate and from a specialized lending source that will accept the risk. Once the project is fully entitled, it becomes eligible for loans from more conventional sources that are at lower-interest, for a longer term, and in a greater amount. A. Construction would then be obtained to take out the bridge loan and fund completion of the project.

- **Bridge Loan (Gap Financing):**

In Income Property lending there are three basic types of loan. The first is a Construction Loan for the actual building of the property. This loan is then paid off by a "Bridge" or "Gap Loan", an interim loan for a term of 1-3 Years until the property generates enough income to get the third type of loan, a "Permanent Loan" which has a 25-30 year Amortization.

Calculate payments on the following example;

\$2,000,000 Loan Amount, 30 Year Amortization @ 200 Basis Points (2%) above Prime Rate. The payments are adjusted every six months, with a balloon payment due in 5 years. Assume a Prime Rate of 8.25%, so 200 Basis Points (2%) above this rate would be a 10.25% interest rate for the first 6 months of the loan.

PROBLEM #3:

\$2,000,000.30 Years @ 10.25% = Monthly Payments of \$ _____.
For the first 6 Months.

At the end of six months the rate will be adjusted by the lender. For example if the Prime Rate increased 100 basis points (1%) to 9.25%, then 200 Basis Points above Prime Rate would be a new interest rate for 6 months of 11.25%

- First calculate the balance on the loan at the end of the first 6 months
- A borrower is in need of funds to lease up the property or rehab the property in which he can then roll it into a permanent loan. In this instance bridge lenders are more aggressive.
- A lender may offer the borrower a discount on the loan if he can pay them off in a short period of time. The property value may be worth less today as the loan may have been taken out during the height of the market.
- A property may be offered at a discount if the purchaser can complete quickly with the discount offsetting the costs of the short term bridging loan used to complete. In auction property purchases where the purchaser has only 30 days to complete long term lending such as may not be viable in that time frame whereas a bridging loan would be.

PROBLEM #4

Loan Balance at 6 month anniversary date = \$_____

Calculate the new payment amount on this balance.

(Remember there are now 354 months remaining on the loan.)

Loan Payments for 6 months @ 11.50% = \$_____.

A loan of this nature gives the lender the flexibility to pass on any changes in rate to the borrower. Prime Rate is used mainly by Banks and Credit Companies. They adjust the rate from monthly to semi-annual periods. On most loans using Treasury Bills and other Indexes the rates are adjusted less frequently, usually from 1-5 year periods. However the longer the adjustment period, the higher the initial interest rate on the loan.

In the following examples, if the borrower is willing to take a higher initial rate in the beginning of the loan, the lender will consider longer periods between rate adjustments. These examples are the same loan, the only difference is the initial beginning interest rate and the rate adjustment period.

Example:

Interest Reserve Loan:

This loan is used for construction loans, while the building is leasing up, or for renovation loans. An Interest Reserve is set up to cover the payments on the loan for the months during the construction of the building and the lease up period or while the building renovation is being completed. The lender carefully projects the estimated time before the property's income is adequate to service the loan payments. If the interest reserve is depleted before the property generates enough income to make the loan payments then both the lender and borrower must renegotiate the loan terms.

Example of an Interest Reserve loan:

\$2,000,000, 30 Year Amortization with a 3 Year Call Date. The rate is 200 Basis Point (2%) over Prime Rate (Assume 8.25%) adjusted semi-annually. Included in this loan is an Interest Reserve of \$100,000 for the cash flow shortfall until the building is renovated and leased up. The project has a Net Operating Income of \$8,000 a month during this period.

\$2,000,000, 30 Years @ 10.25%	= \$17,922 Monthly Payments
Cash Flow from Building	= \$8,000 Monthly Income
Difference from Interest Reserve	= \$ 9,922 Taken from Reserve

The lender and owner project the time period before adequate income is available to service the debt is ten months. The property should generate increased income each month to not deplete the full interest reserve. This example shows how important it is to realistically project the time period necessary before the cash flow is adequate to service the debt.

Try this problem on Interest Reserve loans:

The loan amount requested is \$3,000,000, for 30 Years, with a 3 Year Due Date. The index used is Prime Rate, and the lender must have a spread of 200 Basis Points over this Index. Assume Prime Rate in this example is 8% and the rate is adjusted semi-annually. One half of the building is being renovated during each six month period. During this period the net income from the building is reduced by 50%. The building when fully occupied, has a net monthly income of \$34,000. Calculate the payments and Interest Reserve necessary to cover the shortfall during renovation. Assume; the building will have full occupancy and at its normal income at the end of the 12 month period (13th Month).

PROBLEM # 4:

\$3,000,000, 30 Years@10%	= \$ _____ Monthly
Building Income	= \$ _____ @50%Occupancy
Difference from Reserve	= \$ _____ Monthly Shortfall I

How much interest reserve will this borrower need for a full year to cover the shortfall in income?

Interest Reserve for one year \$ _____ (12 Month Reserve)

In this example if the lender and borrower miscalculate the effect of the renovation, or the time it takes, the interest reserve is quickly depleted. Any shortfall in the Interest Reserve is either paid by the borrower or the lender must rewrite the entire loan.

An Interest Reserve loan is frequently used as part of a construction loan to cover the lease up period. As you can see the amount of the Interest Reserve must be carefully calculated and the lender certain the cash flow projections are realistic.

These previous examples of loans are the most common loan types now in Income Property lending. Lenders do many different variations on these type of loans. The first examples are the most popular and common. Interest Reserve loans are primarily for construction loans, until the building leases up, or renovation. An Accrual Loan is used primarily by Lenders willing to take more risk until the project has adequate income to service the loan payment amount.

These are the primary loans we will work with throughout the Workbook. All of the examples used in the Narrative Case Studies are about one of these types of loans.

There are many other loans presently in use by Income Property lenders. However they are more specialized and require lengthy calculations considering various other factors, such as the property's Internal Rate of Return (IRR), costs of funds, projected inflation, and tax concerns. However it is important to be aware and understand all the different loans presently available. The next part of this Section briefly covers several other loan types occasionally used by Income Property lenders.

Joint Ventures and Equity Participations:

The lender may be willing to give interest rate concessions if the borrower, usually a developer, gives the lender a percentage of both the annual income of the project and the proceeds from the sale or refinance of the project. Certain lending institutions see these loans as an opportunity to make substantial profits in addition to the interest rate. In some cases the lender may advance up to 90% financing of the property's appraised value with flexible payments and terms.

These loans are often called Equity Kickers and may make this loan a more acceptable risk for the lender. Present lender attitudes about these type of loans is very cautious and they only consider very financially sound properties with experienced borrowers. The borrower gets the advantage of a lower interest rate and an equity partner" with large financial reserves.

SUMMARY: The recent trend in Income Property Lending is a more conservative approach to loan transactions with lenders preferring properties with proven cash flow. This Workbook concentrates on the most frequently used loan types, Fixed Rate Loans, partially Amortized Loans (Bullet Loans) and Adjustable Rate Mortgages using different Indexes. Experience in calculating and presenting these loan types forms the foundation of Income Property Lending. A lenders willingness to do more creative loans such as Accrual Loans (Bow Ties), and Equity Participations depends on their attitude about the future cash flow of the property and the strength of the borrowers. These loan types offer more flexibility in structuring loans and large profits. However the opportunity for profits must be weighed carefully against any increased risk.

Points and Fees

In the Section on Lenders the trend of Income Property Lenders seeking additional fee income in the form of loan points and fees was discussed. All lenders charge the Income Property borrower loan fees called Points. One point is one percent of the loan amount.

For example:

A lender charges the borrower One Point (1%) on a \$1,000,000. Loan.
The lender collects \$10,000 or 1% of the total loan amount at the close of the loan.
($\$1,000,000 \times .01 = \$10,000$)

These initial loan fees defray some of the lender's expenses in processing and closing the loan. Points also increase the lenders yield on the loan by raising the effective interest rate. Actual interest yield can be calculated on any financial calculator. The following example illustrates how a one point fee (1%) increases the lender's yield:

\$2,000,000, 30 year Loan, 3 Year Due Date @ 10%, with One Point to the Lender.

The Lender collects \$20,000 (1 Point) at the close of the loan. The Actual Yield to the Lender is; 10.39%

In this same example if the lender wished to increase the yield further, then 2 Points could be charged to the borrower. This would increase the true interest rate to 10.79%

An additional way for the lender to increase the yield on a loan is to shorten the loan maturity date. A due date of 2 years in this example would increase the lender yield even further to 11.13%.

Lender concern about increasing profitability forces them to require the borrower to pay much of the cost involved in closing the loan. Lenders have some flexibility on the amount of expenses they pass on to the borrower. However the recent trend is for the borrower to pay most of the loan costs.

The following example illustrates some of the borrower and lender costs in processing and closing a commercial real estate loan. Before submitting a loan request to a lender, the borrower may have to have an appraisal done by an MAI or SRPA designated appraiser. Depending on the type of property, location and time involved, the appraisal expense can be substantial. Each appraisal is unique and the fee is dependent on the time and work involved.

Now most lenders have a list of "Approved Appraisers": so the borrower may wait until the lender expresses an interest before hiring an appraiser. Either way the borrower pays the initial expense of a detailed appraisal to determine the value of the property.

To make a decision the lender needs up to date financial information, including Actual and Projected Income on the property. Also required are up to date financial statements and tax returns on the borrowing entity (individual, partnership or corporate financial statements). Some

lenders may require audited statements to be provided by the borrower. All these prepared statements are an additional up front cost to the borrower.

If the borrower's preliminary loan information interests the lender, a loan application fee may be required. This in the form of a Good Faith Deposit or a fee for a Letter of Intent from the lender. Collection of this fee assures the lender the borrower is serious about the loan request and not just "shopping". The lender needs to know once the loan process is started the borrower is more likely to accept the requested loan.

Lenders deduct any costs or expenses they incur processing the application from the deposit fee. For example the lender may require an employee or a representative of the lender to inspect the property, its books and records. There may be fees for a review appraiser plus additional costs for credit reports, corporate searches and title reports.

At this point if the lender is seriously interested in the loan request a Commitment Letter is issued to the borrower. The **Commitment Letter** outlines the proposed terms and amount of loan, plus any additional terms or lender requirements. The borrower should review the Commitment Letter carefully and negotiate any changes in the terms before signing. If the borrower backs out during this process the lender will keep an amount of the application fee to cover any costs and expenses incurred. The remainder is returned to the borrower.

When the borrower accepts and signs the Letter of Commitment, then an additional fee is required by the lender. This is the Good Faith deposit for the loan commitment, authorizing the lender to proceed with the necessary work to close the loan. Each lenders requirement is different and negotiable, however they almost universally require a Good Faith deposit from the borrower before proceeding.

There is a tremendous amount of time and expense involved in processing and closing a commercial real estate transaction. The lender absorbs some of these costs simply as overhead expense. Other expenses are either shared with the borrower or totally paid by the borrower. Included below are some of the major expenses incurred while closing a large Income Property loan:

Attorney Fees: As large commercial real estate loan transactions become more complicated and the possibility of losses greater, lenders must seek the assistance of attorneys. Most lenders have an attorney review all pertinent documents, including loan documents, title insurance policies, corporate or partnership agreements, and other data. Some lending institutions have their own corporate counsel assist in the closing of loan. Because of escalating costs of legal representation the borrower pays substantial attorney and legal fees to close these loans.

Title Insurance Policies: All lenders require a Title Insurance Policy which is extremely expensive on loan amounts of several million dollars or more. There may also be escrow costs, and title review fees, depending on the type of Title Insurance Policy the lender requires.

Closing Costs: Other costs incurred include recording fees (state, county and municipal), searches on the corporation and partnerships and other expenses incurred for the searching, recording and closing of the loan.

This illustrates some of the costs incurred by both the lender and the borrower in this type of transaction. As mentioned earlier lenders are trying to control their overhead and costs so they pass much of the expenses to the borrower.

In later Sections are assignments requiring the completion of Executive loan Summaries and submissions. These Case Studies will illustrate the tremendous amount of time and expense involved in processing loan requests and loan closings.

Summary: One of the keys to success in Income Property lending is a thorough understanding of the different types of loans available. The purpose of this Section is to introduce the student to the most frequently used loan types. It also gives the student practice in calculating loan amounts, payments, points, fees and net loan amounts. Working with these calculations provides the experience and confidence needed to begin using net income of the property to determine loan amounts.

Before proceeding with the next Section on Income and Expenses, please complete all of the following problems:

Workbook Additional Questions:

5: Calculate the following amounts: Loan request amount of \$5,000,000, 30 Year Amortization, 10.5% Fixed Rate Interest with a 5 Year Due Date. 1 Point to the Lender and 1/2 % for Attorney Fees and Closing Costs.

Interest Rate:	_____ %	
Payments:		\$ _____.
Balloon Payment (5 Years):		\$ _____.
Gross Amount of Loan:		\$ _____.
Less:		
Loan Fee to Lender (1 Point):		\$ _____.
Attorney Fees and Costs (1/2 Point):		\$ _____.
Net Proceeds of the Loan:		\$ _____.

- 6: Which is not a bridge loan
- a. Long term fixed rate
 - b. Used to quickly close the loan
 - c. Used for "added value" financing
 - d. Have higher interest rates

7: True or False

On Joint Ventures or Equity Kickers lender may give up to 90% financing in return for an equity kicker

ANSWERS TO SECTION 3

SECTION #3: TYPES OF LOANS, LOAN FEES AND EXPENSES:

PROBLEMS:

1: \$2,500,000, 30 year amortization @ 4.75%
Monthly Payments=\$13,041.18

2: Monthly Payment=\$13,041.18
Balloon Payment in 5 years=\$2,287,456.15

3: \$2,000,000, 30 year amortization @ 10.25%
Monthly Payment=\$17,922.03
for the first 6 months.

4: \$3,000,000, 30 year amortization @10%: \$26,327.15 month
Monthly Income of building -= (\$17,000.00)
taken from Interest reserve monthly =\$(9,327.15) Shortfall

Interest Reserve for full year=\$111,925.80
(12 payments @ \$9,327.15)

5: \$5,000,000 Loan @10.5%, 1 Lender Point, 30 year
amortization.

Payments =\$45,736.96
Gross Loan =\$5,000,000
Less:
Lender Points =\$50,000 1 Point
Closing Costs =\$15,000 1/2 Point
Net Amount to Borrower =\$4,935,000

6: Which is not a bridge loan

a. Long term fixed rate

7: True or False: **True**

On Joint Ventures or Equity Kickers lender may give up to 90% financing in return for an equity kicker