

# **HRC**

## **The High-Risers Club**

**9.24.2024 – The Language of Commercial Real Estate: Definitions  
We All Need to Know - Part 3**

# Coach Jeff Wright

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# Welcome

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Does anyone have anything great to share personally or professionally?



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# Greatness is Within



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# Terms You Need to Know

**Valuation  
Terms You  
Need to  
Know**

# Terms You Need to Know

## IRV Formula

$$I \div R = V$$

I = Net Operating Income

R = Cap Rate

V = Value

# Terms You Need to Know

## Net Operating Income (NOI)

NOI is the income available to pay the mortgage (debt service) after all operating expenses have been paid.

$$\text{Value} \times \text{Capitalization Rate} = \text{Net Operating Income}$$



# Terms You Need to Know

## Cap Rate (Capitalization Rate)

The capitalization rate is the rate of return on a real estate investment property based on the income that the property is expected to generate.

$$\frac{\text{Net Operating Income}}{\text{Sales Price (Value)}} = \text{Cap Rate}$$

# Terms You Need to Know

## Market Value

This method is based on the IRV formula: converting a one-year stabilized net operating income (NOI) into the market value of the property. If the property is not yet built or fully occupied (has not reached its full potential NOI), the appraiser will put together a value they feel reflects the true marketplace.

# Terms You Need to Know

## Total Income

$$\begin{aligned} & \textit{Total Rental Income} + \textit{Total Reimbursements} \\ & \qquad \qquad \qquad = \textit{Total Income} \end{aligned}$$

# Terms You Need to Know

## Reimbursements

The additional rent expenses above the base rent the tenant is responsible for.

As an example, if the property is for a single tenant, the lease could stipulate that the tenant is obligated to reimburse the owner for all the property taxes.

If the taxes were \$20,000 per year, the tenant would be responsible for the \$20,000 in addition to their base rent.

# Terms You Need to Know

## Management Fee

Fee paid to a management company to conduct daily oversight of the property and take responsibility for repairs, maintenance, security and upkeep.

This fee is usually 3-5% of the EGI (Effective Gross Income) of the property.

# Terms You Need to Know

## Vacancy and Credit Loss

Used by a purchaser and lender to get a feel for the vacancy history of a given property type in said property's market area. It is used to measure risk and create an appropriate cash flow plan.

When calculating the NOI of a property to determine value and financing, vacancy and credit loss should be included, as most properties will have a vacancy and/or credit loss during the year or over several years. If data is available for the specific market area from an appraiser or a published source, use that percentage. If not available, use 3-5% of the potential gross income.

$$\frac{\text{Gross Scheduled Income} \times \text{Estimated Percentage of Vacancy and Credit Loss}}{\text{= Vacancy and Credit Loss}}$$

# Terms You Need to Know

## Lease Rate per Square Foot

$$\frac{\text{Annual Lease Rent}}{\text{Square Footage}} = \text{Lease Rate per Square Foot}$$

# Terms You Need to Know

## Loan-to-Value Ratio

$$\frac{\text{Loan Amount}}{\text{Sale Price}} = \text{Loan-to-Value}$$



# Terms You Need to Know

## Loan Term

Commercial mortgage terms are typically 5, 7, or 10 years in length. Most have a balloon payment at the end of the term and are refinanced at that point.

# Terms You Need to Know

## Amortization

Paying off a debt through scheduled, pre-determined installments that include principal and interest. Amortizations vary but most often the length of the time is 15, 20, 25 or 30-years.

# Terms You Need to Know

## Debt Service Coverage Ratio (DSCR)

DSCR is one of the underwriting standards a commercial lender uses to determine if they will offer an applicant financing. Different types of real estate have different minimum debt service coverage ratio standards.

$$\frac{\text{Net Operating Income}}{\text{Annual Debt Service}} = \text{Debt Service Coverage Ratio (DSCR)}$$

# Terms You Need to Know

## Net Cash Flow

Net Cash Flow are the funds received after all expenses are paid during a specified period.

	Rental Income	
+	Other Income	
=	<b>Potential Gross Income</b>	
-	Vacancy and Credit Loss	
=	<b>Effective Gross Income</b>	
-	Operating Expenses	
=	<b>Net Operating Income</b>	
-	Annual Debt Service	
-	Tenant Incentives	
-	Leasing Commissions	
-	Capital Improvements	
=	<b>Net Cash Flow</b>	

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<https://www.facebook.com/groups/commercialrealestateforresidentialrealtors>



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# Next Session

## The Language of Commercial Real Estate: Definitions We All Need to Know Part 4

Tuesday, October 1<sup>st</sup>, 2024  
@ Noon Eastern

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