

# **MULTI-FAMILY LOAN OVERVIEW**

**A BORROWER'S GUIDE**

**BMC**  

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**CAPITAL**

## **MULTI-FAMILY LOAN OVERVIEW GUIDE**

### **Multi-Family Mortgage Underwriting Guidelines and Process**

Commercial financing for multi-family properties is underwritten on a case by case basis. Every loan application is unique and evaluated on its own merits, but there are a few common criteria lenders look for in commercial loan packages.

#### **Financial Analysis (for recourse loans)**

A key component in making an underwriting evaluation is the personal debt coverage ratio. The PDCR is defined as the monthly debt compared to the adjusted gross monthly income of the borrower in question. Using a PDCR of 1:1.50 a lender is saying that they are looking for a \$1.50 in net income for each \$1.00 mortgage payment. Typically they will determine the PDCR ratio based on monthly figures, the monthly mortgage payment compared to the monthly net borrower income. The higher the PDCR ratio the more conservative the lender. PDCR's are set by property type and what a lender perceives the risk to be. Today, apartment properties are considered to be the least risky category of investment lending. As such, lenders are more inclined to use smaller PDCR's when evaluating a loan request. Your BMC loan officer can assist you to understand the PDCR policies of each of the major multi-family lenders.

#### **Loan to Value**

Unlike residential lending, multi-family investment properties are viewed more conservatively. Many lenders will require a minimum of 20% of the purchase price to be paid by the buyer. However, some lenders will loan up to 85% of the purchase price to buyers based upon their cash flow and net assets. What a bank/lender will do is subject to their appetite and the quality of the buyer and property. Loan to value is the percentage calculation of the loan amount divided by purchase price. If you know what a lender's LTV requirements are, you can also calculate the loan amount by multiplying the purchase price by the LTV percentage. Keep in mind that the purchase price must also be supported by an appraisal. In the event that the appraisal shows a value less than the purchase price, the lender will use the lower of the two numbers to determine the loan that will be made.

#### **Credit Worthiness**

In many cases the personal credit of principals will be evaluated.

#### **Property Analysis**

Fair Market Value and Fair Market Rent will be analyzed. Special use property may require additional underwriting. Age, appearance, local market, location, and accessibility are some other factors considered.

#### **Tenant Analysis**

A thorough analysis of the current tenants will be conducted.

## MULTI-FAMILY MORTGAGE LENDING RATIOS

Most of real estate lending can be boiled down to the results of three ratios:

- Loan-To-Value Ratio (LTV)
- Personal Debt Coverage Ratio (PDCR)
- Debt Service Coverage Ratio (DSCR)

The bulk of the energy spent "processing" a loan is merely an attempt to verify the numbers that go into the numerator and denominator of these ratios.

**The Loan-To-Value Ratio** is defined as follows:

Loan-To-Value = Total loan balances (1<sup>st</sup> mtg+2<sup>nd</sup> mtg) / Fair market value (as determined by appraisal)

For multi-family mortgages, Loan-To-Value Ratios seldom exceed 80%.

**The Personal Debt Coverage Ratio** is the second ratio that lenders use when underwriting a loan. The Personal Debt Ratio compares the amount of bills that the borrower must pay each month to the amount of monthly income he earns. More precisely, the Personal Debt Coverage Ratio is defined as:

Personal Debt Coverage Ratio = Monthly Personal Debt / Monthly Personal Income

Obviously someone whose Personal Debt Coverage Ratio is 100% is in trouble. A Personal Debt Ratio of 100% would mean that a borrower's obligations are exactly the same as his income. Personal Debt Ratios seldom are allowed to exceed 50% in practice.

**Debt Service Coverage Ratio** evaluates the debt coverage of the property itself. The Debt Service Coverage Ratio is defined as:

Debt Service Coverage Ratio = Net Operating Income / Debt Service

Net Operating Income is the income from a rental property after deducting for real estate taxes, fire insurance, repairs, and all other operating expenses. Debt Service is the mortgage payment on the property. Most lenders insist that this ratio exceed 1.2. A debt service coverage ratio of less than 1.0 would mean that the property did not produce enough net rental income for the owner to make the mortgage payments without supplementing the property from his personal budget.

## **INITIATING YOUR MULTI-FAMILY LOAN PROCESS**

To initiate your commercial lending application process, the following information is required by financial institutions. Your BMC loan officer will assist you in preparing this information:

1. Marketing package or property overview
2. Copy of Purchase/Sale Agreement
3. YTD + Two most recent year-end financial statements for property
4. Background summary on tenants including rent roll and unit mix
5. Borrower's background summary or resume
6. Last two years personal federal tax returns from the principal borrower(s) – including all schedules
7. Current personal financial statement of principal borrower(s) including real estate all schedules (dated and signed with original signature)

### **Lending Institution fees**

Various lending institutions have different fee schedules for multi-family loan applications and processing. The range of fees varies widely amongst these institutions. Your BMC loan officer will be happy to provide more information on the schedule of fees for each institution. A range of potential fees for several leading institutions is as follows:

- Attorney: \$0 - \$5,000
  - Appraisal: \$1,500 - \$3,000
- \*note: some lenders may charge higher fees*

### **How to get started**

BMC specializes on providing a full service solution to customers interested in any size multi-family loan. Call us for a free consultation on initiating your loan process.

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