Commercial Real Estate (CRE)
Glossary for Investing & Syndications

Accredited Investor
An investor whose net worth is $1 million *excluding* personal residence OR $200,000 of income in each of the last two years (single) OR $300,000 of income in each of the last two years (married), and a reasonable expectation of the same income level in the current year.

Agency Debt/Agency Loan
A loan that is backed, but not guaranteed, by the US government. Fannie Mae, Freddie Mac, and HUD are examples of agency debt. These loans are generally 65%-85% Loan to Value, amortized over 30 years, and often have a 5, 7, or 10 year term, and generally requiring a prepayment penalty when. Normally Agency will only lend on apartment communities that are stabilized above 90% economic occupancy. Minimum loan

Apartment Community
Refers to a single building or group of buildings, usually on one parcel of land, generally managed by one property management team. It's the preferred terminology instead of "apartment complex".

Apartment Home
Refers to a single occupiable rental unit, generally consisting of a kitchen, bedroom(s), and bathroom(s). An apartment home would be occupied by a resident who signed a lease and paid monthly rent. It's the preferred terminology instead of "apartment unit".

Appraisal
Real estate Appraisal is an opinion of value, for real property (usually market value). There are multiple valuation methods (Income Approach, Sales Approach and Cost Approach) where as a residential appraisal only uses the Sales Comparison Approach. Commercial appraisal reports feature detailed site and building improvements, sales history & ownership, zoning, flood plain analysis, age/life analysis, market analysis (supply, demand, vacancy, absorption and etc, detailed highest & best use as vacant and improved, detailed valuation analysis, rent and sale, expense and cap rate comparables, and more.

Assessed value

This is how much a property is worth according to a public tax assessor who makes that determination in order to figure out how much city or state tax the owner owes.

ARV

After repair value. The estimated value of a property after rehabilitation. This term is more commonly used in single family house flipping but can apply to multifamily as well.

Bridge Loan

A bridge loan is a short-term form of financing that is used between two transactions before securing permanent financing. Bridge Loans, like hard money loans, allow a multifamily investment team to purchase an apartment community that does not immediately fit the criteria of a commercial loan or agency loan. A bridge loan typically has a higher interest rate and shorter term than agency debt.

CapEx (capital expenditure)

CapEx refers to investment in improvements that have a time horizon of more than one year. For example, building a new tennis court or retrofitting the electrical system both have useful lives of 10+ years.

Cap rate (capitalization rate)

A simple percentage metric of how a property is valued. It consists of dividing the most recent 12 month period of net operating income (sometimes called the T-12) by the purchase price. The result is a percentage number of usually 5-15%. Sometimes industry professionals will leave out the percent and just say “five cap” instead of 5%. A property with a lower cap rate more expensive than one with a higher cap rate. Higher cap rate investments are usually riskier.

Cash Flow

Sometimes called gross spendable income (GSI). Cash flow is the net operating income (NOI) minus cap ex and debt service, but not including depreciation.

Cash on cash return (COC)

Percentage return on an investor receives from the cash in the deal, usually expressed as an annual number. For example, suppose an investor buys a property for $1 million using a $200,000 down payment ("cash in") and $800,000 loan. Also suppose that the property produces $24,000 in cash flow ("cash out") after expenses and debt service. Divide $24,000 by $200,000 to get .12. This is a 12% COC.

Cash reserves

Refer to the money a company or individual keeps on hand to meet emergency funding needs. Lenders will generally require at least 6 months cash reserves for each property being held.

Commercial mortgage-backed securities (CMBS)

Also known as a conduit loan, a CMBS is a commercial real estate loan that is secured by a first-position mortgage on a commercial property. These loans are packaged and sold by conduit lenders, commercial banks, investment banks, and syndicates of banks.

Commercial Real Estate (CRE)

Also known as commercial property, investment real estate, or income property. CRE refers to buildings or land intended to generate a profit, either from capital gain or rental income.

Commercial Loan

Debt-based funding from a financial lending institution, typically used at purchase or to fund major capital expenditures and or cover operational costs.

Commitment letter

It is a lender's promise to offer a loan or credit of a specified amount to a borrower. Also called a Loan commitment, it includes all of the terms and conditions of the **loan**.

Concessions

A negotiated amount that the seller will pay or reduce the purchase price by depending on the situation. For example, a seller may offer a $20,000 concession for a property that needs critical maintenance before the lender will approve the loan.

Contingencies

This term refers to conditions that have to occur in order for the purchase of a property to be finalized. For example, financial contingency, appraisal contingency, inspection contingency, sale of another property contingency, etc.

Contract Services

Services on a property that typically are performed by outside contractors rather than on-site personnel. Examples include waste removal, pool maintenance and pest control.

Due Diligence

Duty of the investor to gather necessary information on actual or potential risks involved in an investment. Check out our Due diligence Checklist.

Debt Service Coverage Ratio (DSCR, or sometimes DCR)

A measure of the cash flow available to pay current debt obligations. The ratio states net operating income as a multiple of debt obligations due within one year, including interest, principal, sinking-fund and lease payments. Most commercial lenders require a DSCR of 1.2, meaning the asset generates at least 20% more cash than the cost to service the debt.

Economic Vacancy

Refers to units that are occupied but producing little or no income. The most common example is discounted rent granted to management personnel.

Equity

Equity refers to the ownership interest net of any liabilities. The owner of a $300,000 property that has an $150,000 mortgage loan is said to have $150,000 of equity in the property.

Equity Partner

Refers to as Limited Partner or Passive Investor. Equity partners invest their own money to buy shares (AKA units) in the LLC or LP that purchases the property. The equity partner(s) receives cash flow from operations and/or capital gain on sale.

Family Office

Family offices are private wealth management advisory firms that serve ultra-high-net-worth investors. They are different from traditional wealth management shops in that they offer a total outsourced solution to managing the financial and investment side of an affluent individual or family. For example, many family offices offer budgeting, insurance, charitable giving, family-owned businesses, wealth transfer and tax services.

Financing Contingencies

Refers to a clause that expresses that the offer is contingent on the buyer securing financing for the property. A financing contingency provides the buyer with protection from potential legal ramifications in case the deal fails to close.

General Partner (GP)

A general partner (GP) is the operator and part owner of a partnership (LP) or limited liability company (LLC) . Typically the GP has rights and obligations that are different from the limited partners.

Gross Operating Income (GOI)

Equals the Gross Scheduled Income minus a designated vacancy allowance and plus any ancillary income from services such as laundry. Depending on the size of the property, vacancy allowances typically run from 3.0-10.0% of the GOI.

Gross Operating Expense

The total of all operating expenses related to the property. Does not include the monthly payment or interest expense associated with any loans or mortgages against the property.

Gross Potential Rent

The total amount of income that potentially could be generated if all the units remained rented for an entire year. This refers to rental income only and does not include ancillary income from laundry and other services.

Gross Scheduled Income (GSI)

The total amount of income that potentially could be generated if all the units remained rented for an entire year. This income could include other ancillary income generated from laundry, storage rental, garages, etc.

Insurance

Provides protection against most risks to property, such as fire, theft and some weather damage. This includes specialized forms of insurance such as flood insurance, earthquake insurance, home insurance, or boiler insurance. Property is insured in two main ways: open perils and named perils.

Internal Rate of Return (IRR)

Internal rate of return (IRR) is a metric used in investing to estimate the profitability of investments over time, taking into account cash distributions and capital gains. This is useful when comparing different types of investments with different payout schedules.

Letter of Intent (LOI)

A non-binding letter spelling out the offer and terms of purchase for a property. If accepted, the seller signs the LOI and begins drafting a purchase and sale contract.

Key Principal

Sometimes called a sponsor, a key principal is one more people that puts their names on the loan. Typically their combined net worth must be larger than the loan amount, and they must have liquid assets equivalent to 10% of the loan amount. Any person who owns more than 15-20% of the equity also must go on the loan (exact percentage varies by lender).

Leverage

Financial leverage (AKA "loan" or "Debt") as it relates to Real Estate is the ability to own property that is worth an amount usually much greater than the amount actually invested.

Limited Partner

A partner in a company or venture who receives limited profits from the business and whose liability toward its debts is legally limited to the extent of his or her investment.

Loan To Cost (LTC)

The loan-to-cost (LTC) ratio is a metric used in commercial real estate construction to compare the financing of a project (as offered by a loan) with the cost of building the project. The LTC ratio allows commercial real estate lenders to determine the risk of offering a construction loan. Similar to the LTC ratio, the loan-to-value (LTV) ratio compares the construction loan amount with the fair-market value of the project.

Loan To Value (LTV)

The loan-to-value (LTV) ratio is a financial term used by lenders to express the ratio of a loan to the value of an asset purchased. The term is commonly used by banks and other lenders to represent the ratio of the first mortgage as a percentage of the total appraised value of real property.

Loss to Lease

A charge taken against Gross Potential Rent (GPR) for leases signed on apartment units after their initial lease-up term has expired to simulate when the leases are either renewed, or a new tenant moves in (in either case, leased), at a rent below the then-Gross Potential Rent.

Master Lease

Master lease is a lease that controls subsequent leases or subleases. It is a lease that allows an existing lessee to lease additional assets under similar terms and conditions without negotiating a new contract to the current lease.

Master Metered Building

A building that has only one meter for all of the gas and/or electric utilities associated with the property. Generally this means that the owner of the property pays for all of the gas or electricity used by the tenants. Many buildings have a central hot water heater, thereby causing the owner to be responsible for the cost of heating the water as well. In the case of properties having separate hot water heaters, gas meters, and electric meters, the expense charged to the owner of the property is typically less than in the case of master metered buildings.

MSA

Metropolitan statistical area, an aggregation of demographics and other indicators gathered by the US Census Bureau

Net Operating Income (NOI)

The net income for the property after property taxes, insurance, maintenance and other operating expenses. It does not include debt service or CapEx and therefore is not equivalent to cash flow.

Net Profit or Loss

For IRS and tax purposes (i.e., Schedule E), this is the amount of money remaining after deducting from the Gross Scheduled Income all expenses of the property including, but not limited to, property taxes, insurance, utilities, contract services, maintenance, mortgage interest, management, advertising etc.

Operating Expense (OPEX)

An operating expense is an expense a business incurs through its normal business operations. Often abbreviated as OPEX, operating expenses include rent, equipment, inventory costs, marketing, payroll, insurance, and funds allocated for research and development. One of the typical responsibilities that management must contend with is determining how to reduce operating expenses without significantly affecting a firm's ability to compete with its competitors.

Other Income

Income from revenue generating activities outside of rental income (storage, laundry, parking, etc)

Profit and Loss (P&L)

A financial statement showing how a property has performed over time. It includes all revenue and expenses, but not debt service or capital expenditures.

Preferred return

The threshold return that investors must receive before the general partner receives compensation. In the case that the preferred return is not met, it usually accrues and must be repaid in the future. For example, if there is a 7% preferred return, but the project only returns 6% to investors in the 1st year, then in the following year the investors are entitled to 8%.

Prepayment Penalty

A prepayment penalty is a clause in a mortgage contract stating that a penalty will be assessed if the mortgage is paid down or paid off within a certain time period. The penalty is based on a percentage of the remaining mortgage balance or a certain number of months' worth of interest

Price per Unit (PPU)

The Purchase Price divided by the number of Units to be purchased.

Private placement memorandum (PPM)

A private placement memorandum is a legal document used in syndications. Investors in a syndication typically have very little operational control, but receive cash distributions (dividends) on a regular basis, usually quarterly. The private placement memorandum spells out how returns are calculated, the rights of the investor, and the obligations of the management. The private placement memorandum is informational. In order to invest, an investor must fill out a subscription agreement.

Recourse/Non-recourse Loan

In the case of default and foreclosure, a non-recourse loan is one in which the collateral is the only method by which the lender can seek repayment. A recourse loan is one in which the lender can seek repayment from the borrower's assets above and beyond the value of the collateral (in the case that the collateral is now worth less than at the time the loan was made).

Regulation D Offering

A securities offering that is exempt from registration with the SEC, but which must follow the rules and regulations outlined in rules 504 and/or 506. The vast majority of real estate syndications are known as 506(b) offerings, which allows both Accredited Investors and up to 35 Sophisticated Investors. 506(c) offerings can only accept Accredited Investors, and accreditation must be verified (letter from the investor's CPA or RIA). General solicitation (advertising) is allowed for 506(c) offerings, but not 506(b).

Retrade

The practice of renegotiating the purchase price of real property by the buyer after initially agreeing to purchase at a higher price. Typically this occurs after the buyer gets the property under contract and during the period that it is performing due diligence.

Return on Investment (ROI)

This is the total investment return on a property taking into account the portion of any mortgage payment that is applied to reducing the loan principal. This percentage is calculated by adding the net cash flow together with any principal reduction and then dividing by the total cash necessary to close.

Securities and Exchange Commision (SEC)

US Government agency, with the purpose of protecting investors from dangerous or illegal financial practices or fraud, by requiring full and accurate financial disclosure by companies offering stocks, bonds, mutual funds, and other securities to the public.

Sophisticated Investor

An unaccredited investor (see Accredited Investor) who is considered to have a depth of experience and market knowledge that makes them eligible for certain types of investments. For example, a real estate professional who is not accredited may nonetheless be considered sophisticated by nature of the work they do.

Sponsor

Sometimes called a Key Principal, a sponsor is one more person that puts their names on the loan. Typically, their combined net worth must be larger than the loan amount, and they must have liquid assets equivalent to 10% of the loan amount. Any person who owns more than 15-20% of the equity also must go on the loan (exact percentage varies by lender).

Stabilized Property

A term used by lenders and agency debt providers that means the property has been at least 90% occupied for at least 90 days in a row.

Subscription agreement

If an investor decides to invest in a syndication, s/he fills out a subscription agreement (sometimes called a “booklet”) that contains information such as how much money the investor is putting into the deal, the investor’s name, contact information, and whether the investor is accredited.

Syndication

A syndication is a group of investors who are collectively buying a property. Typically, there is a Manager or General Partner (depending on the entity) who makes all decisions about the property and handles the administrative overhead. Investors receive passive income from the property and typically have very little input to management decisions.

T-12

The trailing 12 months of profit and loss statements, broken out by month. Lenders require this as well at least two years of annualized operating history. Some sellers and brokers will not provide this until the property is under contract, but at a bare minimum they should provide a T-3 before you send a letter of intent.

Term Sheet

Summarizes the primary terms and options, identifying the prospective borrower and the lender, and listing terms that start with the loan amount and include the interest rate, maturity, collateral and fee. The term sheet is written in specific non-binding language. That language state that after undertaking due diligence, the lender can turn down the loan request. However, a term sheet is often a positive indication the loan will be granted.

Unit Mix

Unit mix is simply the different number of bedroom apartments in a property. Apartments range in sizes from efficiency to 5 bedrooms. An efficiency apartment is usually occupied by a single person and combines the sleeping, living, and kitchen areas.

Vacancy

The vacancy rate is the percentage of all available units in a rental property that are vacant or unoccupied at a particular time. It is the opposite of the occupancy rate, which is the percentage of units in a rental property that are occupied.

Value Add / Value Play

Value-add commercial real estate investments typically target properties that have in-place cash flow but seek to increase that cash flow over time by making improvements to or repositioning the property. This could include making physical improvements to the asset that will allow it to command higher rents, increasing efforts to lease vacant space at the property to quality tenants, or improving the management of the property and thereby increasing customer satisfaction or lowering operating expenses where possible.

Wholesaler

A wholesaler is similar to a real estate agent in that they find properties for sale. However, instead of listing the property for sale, they put the property under contract themselves, then turn around and find a new buyer before the contract closes. They are compensated through an assignment fee paid at closing.

Waterfall

The order of distributions and capital payback in a syndication. Typically, the Class A investors receive distributions first, Class B second, and so on. However, this can vary widely from deal to deal so make sure you read the operating agreement and private placement memorandum closely

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