

# Commercial Notes

THE ACHTERMANN COMMERCIAL  
LENDING GROUP LLC

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## What is the Capitalization rate? more commonly known as "CAP RATE"

The following information is being presented to complement the outstanding presentation of Furmon Tinon at a recent CRRE Thursday morning meeting.

The **Capitalization Rate** or **Cap Rate** is a ratio used to estimate the value of income producing properties. Put simply, the cap rate is the net operating income divided by the sales price or value of a property expressed as a percentage.



Investors, lenders and appraisers use the cap rate to estimate the purchase price for different types of income producing properties. A market cap rate is determined by evaluating the financial data

of similar properties, which have recently sold in a specific market. It provides a more reliable estimate of value than a market Gross Rent Multiplier (GRM) since the cap rate calculation utilizes more of a property's financial detail. **The GRM calculation only considers a property's selling price and gross rents.**

The Cap Rate calculation incorporates a property's selling price, gross rents, non-rental income, vacancy amount and operating expenses thus providing a more reliable estimate of value.



If we have a seller and an interested buyer for particular piece of income property, the seller is trying to get the highest price for the property or sell at the lowest cap rate possible. The buyer is trying to purchase the property at the lowest price possible that translates into a higher cap rate. The lower the selling price the higher the cap rate.

In summary, from a buyer's perspective, the higher the cap rate, the better.

Investors expect a larger return when investing in high-risk income properties. The Cap Rate may

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Rates Currently Available through  
The Achtermann Commercial  
Lending Group, LLC

Minimum Loan \$500,000  
Max \$5,000,000  
NO BALLOONSI

25 - 30 years amortization and term.

80% MAX Loan-to-Value,  
with Fixed period options  
from 1 to 15 years.

(Add 0.15% to loans over 75% LTV)

DSC ratio 1.20 times

Rate	Fixed Period	Am/Term
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6.97%	3 years	30/30
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6.78%	5 years	30/30
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6.83%	7 years	30/30
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6.88%	10 years	30/30
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7.14%	15 years	15/15
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Call for rates on loan amounts greater  
than \$2million.

## MARKET INTEREST RATES

### Bank Prime Rate

11/01/05	7.00%
12/13/05	7.25%
01/31/06	7.50%
03/28/06	7.75%
05/10/06	8.00%
09/29/06	8.25%
11/10/06	8.25%

### 1 Year CMT (Treasuries)

06/23/06	5.27%
07/05/06	5.29%
07/20/06	5.28%
08/16/06	5.06%
09/18/06	5.04%
10/16/06	5.01%
11/10/06	5.20%

### 5 Year CMT (Treasuries)

06/23/06	5.21%
07/05/06	5.19%
07/20/06	5.13%
08/16/06	4.81%
09/18/06	4.77%
10/16/06	4.76%
11/10/06	4.57%

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vary in different areas of a city for many reasons such as desirability of location, level of crime and general condition of an area. You would expect lower capitalization rates in newer or more desirable areas of a city and higher cap rates in less desirable areas to compensate for the added risk. In a real estate market where net operating incomes are increasing and cap rates are declining over time for a given type of investment property such as office buildings, values will be generally increasing. If net operating incomes are decreasing and capitalization rates are increasing over time in a given market place, property values will be declining.

If you would like to find out what the cap rate is for a particular type of property in a given market place, check with an appraiser. Be aware that the frequency of sales for commercial income properties in a given market place may be low and reliable capitalization rate data may not be available. If you are able to obtain a market cap rate from an appraiser for the type of property you are evaluating, **check to see if the cap rate value was determined with recent sales of comparable properties or if the Cap Rate was constructed.** When adequate financial data is **unavailable**, appraisers may construct a cap rate through analysis of its component parts thus reducing the credibility of the results. Cap Rates, which are determined by evaluating the recent actions of buyers and sellers in a particular market place, will produce the best market value estimate for a property.

If you are able to obtain a market cap rate, you can then use this information to estimate what similar income properties should sell for. This will help you to gauge whether or not the asking price for a particular piece of property is over or under priced.

$$\text{Cap Rate} = \frac{\text{NOI}}{\text{Value}}$$

$$\text{Estimated Value} = \frac{\text{NOI}}{\text{Cap Rate}}$$

Example 1: A property has a NOI of \$155,000 and the asking price is \$1,200,000. What is the Cap Rate?

$$\text{Cap Rate} = \frac{\$155,000}{\$1,200,000} \times 100 = 12.9 \text{ rounded}$$

The complete handbook on section 1031 is available by e-mail request. Just e-mail [Machtermann@insight.rr.com](mailto:Machtermann@insight.rr.com) requesting a copy and I will e-mail the entire PDF document to you.



The Cap rate is 12.9%

Example 2: A property has a NOI of \$120,000 and Cap Rates in the area for this type of property average about 12%. What is the Estimated Market Value?

$$\text{Estimated Market Value} = \frac{\$120,000}{.12} = \$1,000,000$$

The Estimated Market Value is \$1,000,000.

Net operating income is determined by subtracting vacancy amount and operating expenses from a property's gross income. Operating expenses include the following items: advertising, insurance, maintenance, property taxes, property management, repairs, supplies, utilities, etc. Operating expenses do not include the following items; Improvements such as a new roof, personal property such as a lawn mower, mortgage payments, income and capital gains taxes, loan origination fees, etc.

Appraisers use the Income Approach, Cost Replacement and Market Comparison methods to estimate the value of property. The Income Approach utilizes the theory of capitalization.

What is a good Cap Rate is not an absolute percentage and must be reviewed taking into consideration of the source information. Cap Rate is a "relative value" compared to other type of property in the same region or area based upon the same assumptions.

I hope this finds you and your families enjoying the many wonders of our county as we enter in to the holiday seasons.



HAPPY THANKSGIVING TO ALL.

US Treasury 5yr CMT

