

Commercial Notes

THE ACHTERMANN COMMERCIAL
LENDING GROUP LLC

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What does the Gross Rent Multiplier tell me?

Last month I discussed how the "Cap Rate" can be used to figure a relative value of a commercial income properties. Another method of calculating the value is by using the "Gross Rent Multiplier" method.

The Gross Rent Multiplier or GRM is a ratio that is used to estimate the value of income producing properties. The GRM provides a rough estimate of value. Only two pieces of financial information are required to calculate the Gross Rent Multiplier for a property, the sales price and the total gross rents possible.



If this information is available for multiple sales of similar types of income properties in a particular area, it can then be used

to estimate the market value of other similar properties in that area. Some investors use a Monthly Gross Rent Multiplier and some use a Yearly GRM.

The monthly Gross Rent Multiplier is equal to the Sales Price of a property divided by the potential monthly gross income and the Yearly GRM is the Sales Price divided by the yearly potential gross income.

Example 1: If the sales price for a property is \$200,000 and the monthly potential gross rental income for a property is \$2,500, the GRM is equal to 80.

$$\text{GRM} = \frac{\text{Sale Price}}{\text{Monthly Potential Gross Income}}$$

$$\frac{\$200,000}{\$2,500} = 80 \text{ (GRM)}$$

Monthly potential gross income is equal to the full occupancy monthly rental amount, which assumes all available rental units are occupied.

Generally speaking, properties in prime locations have higher GRMs than properties in less desirable locations. When comparing similar properties in the same area or location, the lower the GRM, the more profitable the property. This statement assumes that operating expenses are proportionate for the properties being compared.

Since the GRM calculation doesn't include operating expenses, this state-
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Rates Currently Available through
The Achtermann Commercial
Lending Group, LLC

Minimum Loan \$500,000
Max \$5,000,000
NO BALLOONS!

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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6.93%	3 years	30/30
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6.73%	5 years	30/30
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6.78%	7 years	30/30
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6.83%	10 years	30/30
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7.08%	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%
12/15/06	8.25%

1 Year CMT (Treasuries)

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%
12/15/03	4.95%

5 Year CMT (Treasuries)

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%
12/13/06	4.54%

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ment might not hold true for similar properties where one of the properties has significantly higher operating expenses.

Exmample 2: We have several similar properties that have been sold recently and their average GRM is 80. We can use this information to estimate the value

of comparable properties for sale. If our monthly potential gross income for a property were equal to \$3,000, we would estimate its value in the following way.

GRM X Potential Gross Income = Estimated Market Value

$$80 \times \$3,000 = \$250,000$$

A market GRM can provide a rough estimate of value when consistent and accurate financial information is available for sales of similar types of properties in a particular market place, but it does have some limitations. Operating expenses, debt service and tax consequences are not included in the GRM calculation. We could have a situation where two properties have approximately the same potential gross income, but one property has significantly higher operating expenses. The above formula would result in a questionable estimation of the market value for these properties.



Also, the above GRM formula uses the monthly potential gross income and doesn't account for a vacancy factor, which could have an impact on the accuracy of the property value estimates. *This is why it is important to have accurate and detailed financial information for comparable sales when establishing a market GRM or Cap Rate for income producing properties. Do not rely on a crystal ball to calculate the GRM*

The GRM is sometimes calculated using the **effective gross income rather than the potential gross income** thus incorporating the vacancy factor in the GRM calculation. Effective Gross income equals potential gross income minus the vacancy amount.



When vacancy rates are a factor, using the effective gross income will produce a more reliable estimate. The capitalization rate is a more reliable tool for estimating the value of income producing properties since vacancy amount and operat-

The complete handbook on section 1031 is available by e-mail request as are any other Commercial Notes topic. Just e-mail Marvin@insight.rr.com requesting a copy and I will e-mail the entire PDF document to you.



ing expenses are included in the cap rate calculation. The GRM is useful in providing a rough estimate of value.

When using "Cap Rate" or the "Gross Rent Multiplier" in evaluating the economic value of commercial real estate both methods must be taken as relative values. The number calculated to be of true value, the properties should be similar in their usage as well as location and age.

As is true for cap rate, the gross rent multiplier is not an absolute value and must be reviewed taking into consideration the source of the information. To use an old saying, be sure you are not comparing apples to oranges.

Interest Rate Thoughts

For 2007

The major news this week is the decision from the Federal Reserve regarding interest rates. As expected, the Fed left rates unchanged. But the language the central bank used in making the decision will be closely scrutinized.

Longer term, there are many different views as to the direction of interest rates. Since there are so many conflicting economic data points, I would not be surprised if the Federal Reserve left rates unchanged for a good portion of 2007 to get a better understanding of where the U.S. economy is actually heading. If this is the case, then I would expect commercial interest rates to hold steady or drop very little.

May 2007 bring you prosperity

Sincerely — Marvin

