

**Project Atlas Sponsor  
(PAS)**

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**Conduit Origination Manual**

**(Core Manual)**

# PROJECT ATLAS SPONSOR (PAS)

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## Conduit Origination Manual

Prepared For:

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### ***PROJECT ATLAS SPONSOR*** ***Incorporated***

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**INTRODUCTION**

Thank you for choosing to place your loan with Project Atlas Sponsor (“PAS”). This manual has been designed to aid PAS Correspondents in producing high quality, fixed rate, mortgage loans for securitization.

The sections herein provide an introduction to Project Atlas Sponsor and its conduit program; an outline to our origination process; underwriting criteria; and closing requirements. Additionally the Appendix section provides useful resources such as scopes of work; approved third party vendor lists; and PAS standard forms, documents, and checklists.

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# SECTION 1

## INTRODUCTION TO PROJECT ATLAS SPONSOR

### 1.1 Corporate Overview

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**Project Atlas Sponsor:** Project Atlas Sponsor (“PAS”) is a preeminent global financial services firm with a current market capitalization in excess of \$\_\_\_\_\_. The firm has three primary businesses that provide unrivaled products, services and execution for our clients.

**Project Atlas Team:** The commercial mortgage lending and securitization function is handled by the Project Atlas Team (“PAT”). PAT integrates the banking, capital markets, and investments within one group. PAT purchases, originates and sells conduit, large and bridge loans for the firm. With a dedicated balance sheet and over \_\_ professionals, the group acts as a principal and aggressively makes a market in securities backed by these loans.

**Project Atlas Mortgage Capital:** Project Atlas Sponsor (“PAS”) is the conduit lending subsidiary of PAS. The group is responsible for the origination of high quality mortgage loans for securitization.

## 1.2 Contact Information

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The management team for the PAS conduit is listed below. The management team is responsible for the overall strategy and administration of the conduit lending operation.

<b><u>Management</u></b>	<b><u>Contact Information</u></b>	<b><u>Responsibility</u></b>
	Phone: Fax:	Program Management
	Phone: Fax:	Chief Credit Officer
	Phone: Fax:	Business Development

The PAS bankers serve as the Correspondents' primary contact at PAS, and as the team leaders for deal management. Their main responsibility is for the underwriting and structuring of commercial mortgage loans. The bankers remain involved after commitment to ensure a smooth closing process. To provide consistent service to our Correspondents, each account is serviced by an individual banker, analyst and Contract Finance Coordinator team.

<b><u>Bankers</u></b>	<b><u>Contact Information</u></b>
	Phone: Fax:
	Phone: Fax:
	Phone: Fax:
	Phone: Fax:
	Phone: Fax:
	Phone: Fax:
	Phone: Fax:

<b><u>Analysts</u></b>	<b><u>Contact Information</u></b>
	Phone: Fax:
	Phone: Fax:
	Phone: Fax:
	Phone: Fax:

The PAS Contract Finance Coordinators and support staff are integral to the operation of the conduit. In addition to administering the closing of all loans, these individuals are responsible for structuring input, servicing issues, and data maintenance.

<u>Closers &amp; Support</u>	<u>Contact Information</u>	<u>Responsibility</u>
	Phone: Fax:	Closing Group Team Leader
	Phone: Fax:	Post Closing Coordinator
	Phone: Fax:	Contract Finance Coordinator
	Phone: Fax:	Contract Finance Coordinator
	Phone: Fax:	Contract Finance Coordinator
	Phone: Fax:	Technical Support/Data Management Coordinator

The mailing address for all members of the PAS Conduit is...

**Project Atlas Sponsor**  
 \_\_\_\_\_, \_\_\_\_\_<sup>th</sup> Floor  
 New York, NY \_\_\_\_\_

### 1.3 Program Summary

Project Atlas Sponsor's conduit program provides first mortgage loans on many commercial property types within the United States. All loans will be securitized and, therefore, must meet certain financial and industry-specific criteria. Loans appropriate for securitization have the following characteristics...

- Existing properties with two or more years of operation
- Consistent financial performance - no huge deviations in income or expenses
- Locations in established markets with populations of at least 25,000 and diverse employment bases
- No substantial future turnover without appropriate reserves
- Occupancy at or above local market
- Properties with no functional obsolescence
- Borrowers with good credit histories and strong management skills

The basic loan parameters for the PAS conduit program have been outlined below. Loans that do not meet the established criteria may still fit the program on a case-by-case basis and should be discussed with a PAS banker.

<b>Loan Parameters</b>	
<b>Security:</b>	First Mortgage on underlying property
<b>Loan Amount:</b>	\$3 - 30 million
<b>Interest Rate:</b>	Fixed Rate (spread over corresponding maturity of U.S. Treasury Rate). Early Rate Locks available.
<b>Term:</b>	10 years
<b>Amortization:</b>	20-30 years
<b>Origination Fee:</b>	Par
<b>Borrowing Entity:</b>	a) < \$5 million: Single Asset Entity ("SAE") desired but not required b) \$5 - 10 million: SAE required c) \$10 - 15 million: Single Purpose Entity ("SPE") required d) > \$15 million: SPE and bankruptcy remote required
<b>Prepayment:</b>	Defeasance with a lockout at the lesser of 5 years or 2 years after securitization and the last 3 months of the Loan open at par
<b>Assumability:</b>	One-time, subject to PAS approval and a 1% fee plus costs
<b>Escrows Required:</b>	Taxes, Insurance, Recurring Capital Replacements, and on a case-by-case basis, TI and Leasing Commissions
<b>Secondary Financing:</b>	Not permitted
<b>Financial Reporting Requirement:</b>	Monthly through securitization. Quarterly thereafter.
<b>Recourse:</b>	Non-recourse except for fraud, misrepresentation and environmental violations

PAS provides first mortgages greater than \$30 million through its Large Loan Conduit Program. Loans less than \$3 million can be accommodated on a case-by-case basis. As defined below,

PAS lends on a wide range of commercial property types. Please consult the PAS banker for particular underwriting guidelines.

<b>Multi-Family</b>	
<b>General</b>	<ul style="list-style-type: none"> <li>— 100+ unit complexes</li> <li>— &gt;90% leased</li> <li>— First, second, and third tier markets</li> <li>— Minimum B-quality</li> <li>— Well maintained</li> <li>— Garden style preferred</li> <li>— Well located</li> <li>— Good amenity package</li> <li>— Less than 25 years old</li> <li>— Student housing</li> </ul>

<b>Office</b>	
<b>General</b>	<ul style="list-style-type: none"> <li>— 30,000+ SF</li> <li>— Suburban or downtown locations</li> <li>— Limited rollover first three years</li> <li>— First and second tier markets</li> <li>— Limited above market lease terms</li> <li>— Good physical layout (e.g., efficient floor plans)</li> <li>— Multi-tenant</li> <li>— &gt;75% leased</li> <li>— Minimum B-quality</li> </ul>
<b>Class A</b>	<ul style="list-style-type: none"> <li>— Mid and High-rise buildings in superior CBD or major suburban areas</li> <li>— Post-1980 construction of high quality design and material</li> <li>— Superior replacement/maintenance programs in order to maintain rental rates</li> <li>— Nationally recognized tenancy</li> <li>— 100,000 sq. ft. minimum size</li> </ul>
<b>Class B</b>	<ul style="list-style-type: none"> <li>— Mid and High-rise buildings in good CBD and suburban locations</li> <li>— Post-1970 construction or quality design and material with at least one major renovation in the past 10-15 years</li> <li>— 30,000 sq. ft. minimum size</li> </ul>

<b>Industrial</b>	
<b>General</b>	<ul style="list-style-type: none"> <li>— 50,000+ SF</li> <li>— Major distribution markets, good access</li> <li>— Bulk distribution, Showroom, R &amp; D</li> <li>— Clear heights, turn ratios and delivery access commensurate with market</li> <li>— Limited rollover</li> <li>— Minimum B-quality</li> <li>— &gt;75% leased</li> </ul>
<b>Flex/Multi-Tenant</b>	<ul style="list-style-type: none"> <li>— Industrial properties with no more than 30% office finish</li> <li>— Mid-size warehouse buildings in floor area with ceiling heights of not less than 12'</li> </ul>
<b>Bulk Distribution</b>	<ul style="list-style-type: none"> <li>— Single story “box”, “high-cube”, or “bulk” buildings used primarily for storage and distribution</li> <li>— Office finish not to exceed 15% of net rentable area</li> <li>— 50,000 SF minimum size</li> <li>— 18' minimum clear height</li> </ul>

<b>Retail</b>	
<b>Community</b>	<ul style="list-style-type: none"> <li>— 60,000+ SF</li> <li>— &gt;85% leased</li> </ul>

<p><b><i>Center/Power Center</i></b></p>	<ul style="list-style-type: none"> <li>— First, second, and third tier markets</li> <li>— Infill location with good access</li> <li>— &gt;50% of GLA devoted to anchors preferred</li> <li>— Grocery/drug anchored, discount (e.g. Target)</li> <li>— Strong sales volume</li> <li>— Minimum B-quality</li> <li>— Long term anchor leases</li> </ul>
<p><b><i>Outlet Center</i></b></p>	<ul style="list-style-type: none"> <li>— 50,000+ SF</li> <li>— Strong sales volume</li> <li>— Manufacturer retailers</li> <li>— Destination/leisure oriented markets (e.g. Orlando)</li> <li>— Quality tenant mix</li> <li>— Several years' sales history</li> </ul>
<p><b><i>Unanchored Center</i></b></p>	<ul style="list-style-type: none"> <li>— 30,000+ SF</li> <li>— Infill location</li> <li>— First, second tier markets</li> <li>— Easy retrofit for new tenants</li> <li>— &gt;85% leased</li> <li>— Minimum B-quality</li> <li>— Stable cash flow</li> </ul>
<p><b><i>Regional Mall</i></b></p>	<ul style="list-style-type: none"> <li>— Anchored by at least three anchor tenants which are major regional or national operators. Anchors will either have long-term leases with solid sales histories or will own their own store and have a long term operating agreement.</li> <li>— Typical size range is 300,000 to 750,000 SF</li> </ul>
<p><b><i>Grocery and Drug Anchored</i></b></p>	<ul style="list-style-type: none"> <li>— Anchored by a major supermarket chain and drug store which provides convenience goods and personal services for the day-to-day living needs of the immediate neighborhood.</li> <li>— Typical size range is 50,000 to 100,000 SF</li> </ul>
<p><b><i>Shadow Anchored Retail</i></b></p>	<ul style="list-style-type: none"> <li>— Anchored by at least one Anchor Tenant which is not a part of the collateral, but provides a stable draw to the property. The in-line space, the collateral, will have a complementary tenant mix and will provide convenience goods and personal services for the day-to-day living needs of the immediate neighborhood.</li> <li>— Typical size range is 25,000 to 50,000 SF</li> </ul>

<b>Hotels</b>	Selected assets on a case-by-case basis
<b>General</b>	<ul style="list-style-type: none"> <li>— 100+ rooms</li> <li>— First and second tier markets</li> <li>— Quality franchise reservation system</li> <li>— "Flag" franchise extends beyond loan term</li> <li>— Limited reliance on food/beverage or other non-room revenue</li> </ul>
<b>Full Service</b>	— Hotels which provide a full range of services and amenities including restaurant, meeting rooms, ballroom, health clubs, pool, retailers, etc.
<b>Limited Service Class A</b>	<ul style="list-style-type: none"> <li>— Limited service hotels which offer limited food services (i.e., continental breakfast) and are primarily post-1980 construction</li> <li>— ADRs are below rates for full service hotels</li> <li>— Typical franchise affiliates include Marriott Courtyard and Hampton Inn</li> </ul>

<b>Manufactured Housing Communities</b>	
<b>General</b>	<ul style="list-style-type: none"> <li>— &gt;200 pad complexes</li> <li>— Well located</li> <li>— Minimum 3 star park - well maintained</li> <li>— Good amenity package</li> <li>— &gt;90% leased</li> <li>— Less than 25 years old</li> </ul>
<b>5 Star</b>	<ul style="list-style-type: none"> <li>— 5 Star parks have excellent and deluxe accommodations including a wide range of amenities and services. Homes are usually set back from curbed, paved streets, enhanced with sidewalks, street lights and signs, and landscaping</li> <li>— Well located in a desirable neighborhood and accessible to retail and community services</li> <li>— Quality location and amenities are typically located in the best developments in Florida and California</li> </ul>
<b>4 Star</b>	<ul style="list-style-type: none"> <li>— 4 Star parks have high quality of accommodations, amenities and services and located in good neighborhoods</li> <li>— Occupied primarily by double-wide homes in good condition, skirted and have concrete patios or raised porches with commercial steps, along paved streets</li> <li>— If older, these parks may have been regarded as 5 Star parks at one time</li> </ul>
<b>3 Star</b>	<ul style="list-style-type: none"> <li>— 3 Start Parks have attractive accommodations and offer some amenities and services</li> <li>— Occupied by a mix of double-wide and single-wide units in good condition</li> </ul>

<b>Self Storage Facilities</b>		
<i>General</i>	<ul style="list-style-type: none"> <li>— 60,000+ SF</li> <li>— On-site management office</li> <li>— &gt;80% occupied</li> </ul>	<ul style="list-style-type: none"> <li>— Concrete construction</li> <li>— Secured access</li> <li>— Less than 20 years old</li> </ul>

<b>Congregate Care</b>		
<i>General</i>	<ul style="list-style-type: none"> <li>— 100+ room facilities</li> <li>— Professional management</li> </ul>	<ul style="list-style-type: none"> <li>— First and second tier markets</li> <li>— Limited medical services</li> </ul>

# SECTION 2

## PROCESS AND RESPONSIBILITIES

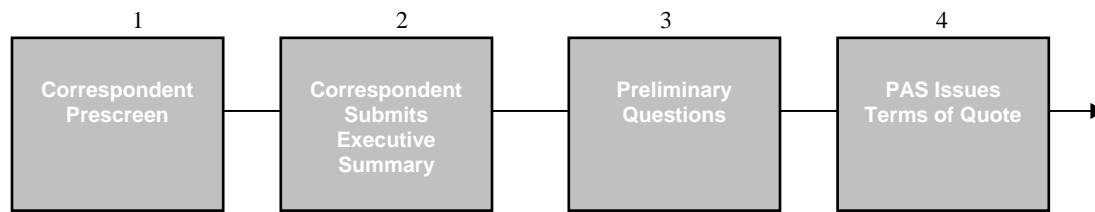
### 2.1 Process Overview

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Step 1	Quote Process
Step 2	Application Process
Step 3	Commitment Process
Step 4	Closing Process

## 2.2 Quote Process

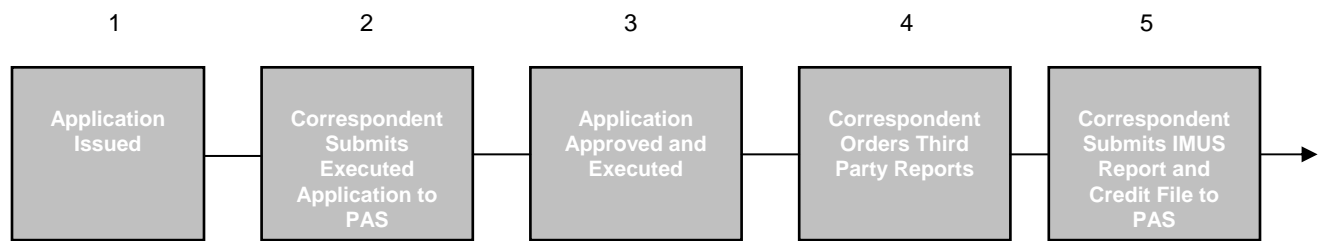
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1. Correspondent Prescreen: The Correspondent does preliminary due diligence structuring in order to determine if the investment meets the PAS loan parameters.
2. Submission of an Executive Summary: The Correspondent prepares a summary of the deal's salient facts in order for PAS to properly size and structure the loan. The executive summary should include:
  - A summary of the loan terms requested
  - Property and location description including map
  - Photos of the property
  - Property operating statements including the trailing 12 months, prior 3 years, budgets, and current year to date
  - Current rent roll
  - Market analyses such as average rental rates and market occupancy
  - Principal resume with note of any credit deficiencies
  - Deal Issues - a summary of deal points and terms which may require additional structuring, i.e. abnormally large single year rollover, unsubordinated ground lease, etc.
3. Questions: Based on the Executive Summary and preliminary discussions, the PAS banker will have follow-up questions answered before a thorough quote can be issued
4. Quote: Once preliminary due diligence is complete, PAS will issue a quote. Quotes can be in verbal or written form, and are subject to changing underwriting and market conditions.

## 2.3 Application Process

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1. Application Issued: Once a quote is accepted by the Borrower, PAS will issue a formal application to the Correspondent. The Correspondent will review the application and deliver it to the Borrower (See Appendix H for boiler plate application terms). With the application, an introduction package will be sent to the Correspondent. The package will contain a Borrower questionnaire and relevant information to begin the loan process.
2. Application Submitted: Once the Application is accepted and signed by the Borrower, the Correspondent should forward the signed Application with the application fee to PAS before the expiration date which is usually within 5 business days of issuance. For PAS acceptance, the application must be submitted with \$15,000 fee to cover the cost of third party reports. Any remaining funds once the loan closes will be returned to the Borrower.
3. Application Approved and Executed: PAS's acceptance of the Application is evidenced by the signature of a PAS Officer. Upon PAS's counter-signature, PAS will instruct the Correspondent to commence due diligence, engage the third party reports from approved vendors, and start the Credit File.
4. Third Party Reports: The Correspondent is responsible for the engagement and management of the third party reports. Correspondent should select an appraiser with the PAS banker. Environmental, engineering, and appraisal reports must be completed for all loans according to PAS's guidelines and ordered from party from PAS approved vendor list. At this time PAS will initiate borrower due diligence and order credit checks.

Existing reports may be used subject to PAS's review and approval. The existing reports shall not be dated more than 180 days prior to closing and may be subject to update as deemed necessary by PAS. All existing reports must be assigned to PAS, follow the standard scopes of work (see Appendices P, Q, and R), and be reviewed at a cost of \$500-\$750 per report. All reports should be addressed to PAS and should include standard reliance language. Experience indicates that the use of existing reports often costs more than the preparation of new reports due to the cost of review and follow-up work needed if/when the reports do not conform to PAS's Scope of Work.

The Environmental Phase I and Property Condition Reports will be ordered from an PAS approved vendor and will be due within a pre-agreed three-week time period. Appendix G lists all third party reports requirements by property type.

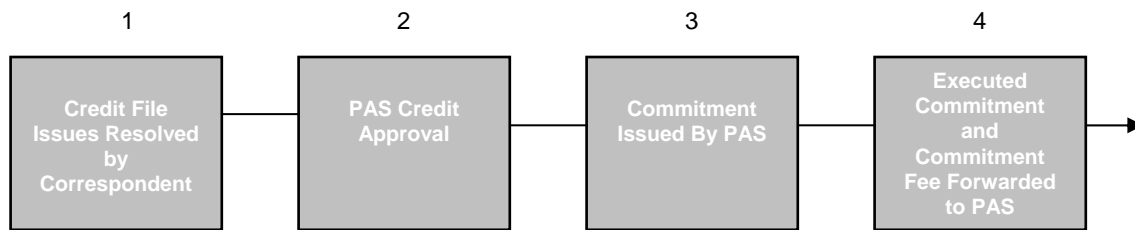
The appraisal will be completed by a national or regional MAI, subject to PAS's approved provider list, and according to PAS's scope of work. (See Appendix R)

On certain transactions additional third party reports may be required. Such reports include but are not limited to:

- Cash Procedures Audit (Hotels, Self Storage properties, Multifamily with significant month-to-month occupancy, and Mobile Home Parks). See Appendix G for details.
  - Phase II Environmental (if required)
  - PML (all zone 3 and zone 4 seismic areas) – Which include all of CA, parts of WA, OR, etc. See Appendix G for seismic zone map.
5. IMUS Report /Executive Summary and Credit File Submission: PAS's decision to issue a commitment is based upon the IMUS Report/Executive Summary Submission and credit file. PAS must receive a completed IMUS Report Submission and credit file (which includes final third party reports) before a Loan can be presented for approval. The IMUS Report Submission is primarily comprised of information presented in the initial submission along with a more detailed and in-depth analysis of the property, competition, market, and borrower.

## 2.4 Commitment Process

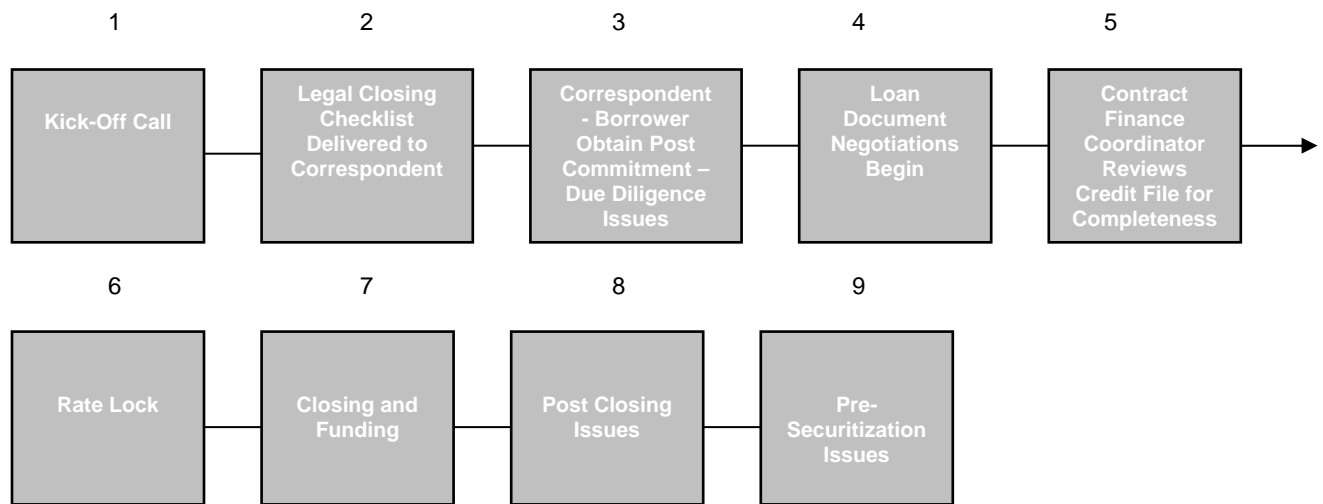
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1. Resolution of Credit File Issues: The Correspondent is responsible for obtaining all items necessary for a complete Credit File and resolving all Credit File issues. It is important to remember that all PAS loans will be securitized and therefore, it is imperative that a complete Final Credit File is delivered to PAS prior to closing.
2. Credit Approval: The IMUS Report/Executive Summary Submission must be complete and satisfactory to PAS prior to presentation for approval. PAS will respond with its approval decision within a week's time of the receipt of a complete submission.
3. Commitment Issued: Following approval by PAS, the Commitment will be issued to the Borrower via the Correspondent. The Commitment must be executed by the Borrower and forwarded to PAS by the date set forth in the Commitment. Standard PAS boiler plate terms can be found in Appendix I.
4. Executed Commitment: The correspondent must forward Borrower-signed Commitment and Commitment Fee of 3% to PAS. The Commitment Fee is returned upon closing of the loan.

## 2.5 Loan Closing Process

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During the Loan Closing process, the loan documents will be finalized along with any other outstanding due diligence items. At the commencement of the closing process, a representative from PAS’s Contract Finance Coordinator (“Contract Finance Coordinator”) will be assigned as the primary contact on the loan. The closing process will be managed by the Contract Finance Coordinator.

The closing and funding of the loan is anticipated to take place approximately three to four weeks following the issuance of the Commitment. Each Commitment will have an Outside Closing Date by which the loan must close. Because timing is critical for successful loan securitization, PAS will only consider requests for commitment extensions under special circumstances.

During the closing process, the correspondent will be responsible for the following:

- Completion of all post-commitment due diligence, including obtaining and delivering all outstanding items necessary for a complete Credit File
- Communication with Borrower regarding the loan status and outstanding issues
- Apprising the Contract Finance Coordinator of any issues to ensure no time delays in the closing process. PAS Bankers and Contract Finance Coordinators remain available to speak with the Borrower on any key issues or program requirements
- Completion of follow up on any outstanding engineering, environmental, seismic, or other property issues that must be resolved prior to closing
- Working with PAS designated Servicer and Contract Finance Coordinator to set up servicing account and all necessary escrows

1. Kick-Off Call: Within 3 business days of an accepted commitment, the PAS Banker and the Correspondent will schedule a Working Group Kickoff Call to coordinate the closing process and highlight any nonstandard issues. The telephone conference will include the PAS banker, Contract Finance Coordinator, PAS Counsel, the Correspondent, the Borrower, and Borrower's counsel. During this telephone call, the Banker will:
  - Introduce all the parties
  - Discuss their individual responsibilities
  - Discuss the time frame for getting the documents to the appropriate parties
  - Confirm and reiterate all issues that have been previously agreed to. The Correspondent should bring any issues or agreements to the attention of the Contract Finance Coordinator at this time
2. Legal Closing Checklist: After the Kick-Off Call and receipt of the Working Group List, PAS Counsel will forward to the correspondent a Counsel's Closing Checklist of items. The items on the Closing Checklist are to be received prior to the funding of the loan by PAS including all due diligence items and legal documentation.
3. Post-Commitment Due Diligence Items are Obtained and Delivered to PAS: Once the executed commitment is forwarded to PAS, correspondent must forward to Counsel all relevant portions of the Credit File. The correspondent, with the Borrower, is required to provide all the information as set forth in the commitment no less than five days prior to the Outside Closing Date. Counsel will provide periodic checklists to the correspondent and Borrower's counsel during the closing process. It is the correspondent's responsibility to work with Borrower to deliver any outstanding items as soon as possible.

The Credit File items that must be obtained post-commitment include, but are not limited to, the following:

- *Subordination and Non-Disturbance Agreements (“SNDAs”) and Tenant Estoppel Certificates (“Estoppels”)*: As soon as possible after the Commitment is issued, the Correspondent must send PAS standard form SNDAs and Estoppels (see Appendix J and K) to each tenant for execution. Correspondent will forward all SNDA’s and Estoppels to both the Contract Finance Coordinator and PAS Counsel for review. If a SNDA or Estoppel cannot be obtained from a particular tenant, the Correspondent must inform the Contract Finance Coordinator or PAS Counsel immediately. The correspondent must check each Estoppel to ensure it does not conflict with the rent roll or lease agreements. If any conflicts arise, explanations must be provided to PAS.

A SNDA is required for all tenants to ensure that all leases are subordinate to the lien of the mortgage granted by PAS. A SNDA is generally not required if:

- ◆ the terms of the lease agreement make it subordinate to the mortgage granted by PAS
- ◆ the lease agreement does not contain provisions entitling the tenant to casualty process or condemnation awards
- ◆ the lease agreement does not contain constructive or other monetary obligations from the landlord to the tenant

Final determination will be made by PAS Closing Counsel.

Tenant Estoppels are required to verify the Borrower’s representations in the rent roll, operating statements, and lease agreements. In the Estoppel, the tenant must confirm the terms of its lease including:

- ◆ Monthly rent
  - ◆ Any Monies Owed To and From Tenant
  - ◆ Size of the Leased Space
  - ◆ Lease Commencement Date
  - ◆ Lease Expiration Date
  - ◆ Renewal or Expansion Options
  - ◆ Condition of the Property and Improvements
  - ◆ Landlord Obligations and Defaults
- *Title and Survey*: The Borrower must deliver a title commitment and survey that comply with PAS requirements as set forth in Appendix M. The correspondent must confirm that Borrower’s Counsel has ordered an acceptable title and survey within three days of the issuance of the Commitment. Any delays in ordering Title and Survey will result in a delay of closing.

- *Operating Statements and Rent Roll:* The Correspondent must obtain and deliver to the Contract Finance Coordinator an updated income and expense statement for the property and a certified current rent roll. These must be:
  - ◆ signed, dated, and certified to be true and correct by the Borrower as outlined below.
  - ◆ no more than 30 days old at the time of funding
  - ◆ provided no later than the end of the month preceding closing

### **Borrower Certification**

I \_\_\_\_\_, hereby certify that the attached (rent roll/operating statement) dated \_\_\_\_\_, 199\_, is true and correct.

Signed: \_\_\_\_\_

Date: \_\_\_\_\_

- *Zoning Letter:* Borrower must deliver to PAS Counsel a letter from the applicable municipal authority stating that the property complies with all applicable zoning law. If Borrower and its Counsel are unable to obtain a zoning letter, the Correspondent should make sure that they contact PAS Counsel and discuss alternatives.
- *Certificate of Occupancy:* A Certificate of Occupancy must issued by the appropriate local government permitting the structure to be occupied by members of the public.
- *Organizational Documents:* Borrower must deliver to PAS Counsel evidence that title to the property is held by an entity which:
  - ◆ has been properly formed
  - ◆ has the power to execute and deliver all the various documents in connection with the loan
  - ◆ complies with the special purpose entity and bankruptcy remote requirements of the loan commitment. See Exhibit 2.1 for Borrowing Entity Requirements.

4. Loan Document Negotiations Begin: Prior to closing, PAS counsel and PAS prepare and forward loan documents to Borrower's Counsel to commence the negotiation process. All PAS standard loan documents reflect years of experience in the market, yet are intended to be user friendly. In order for loans to be eligible in a possible securitization pool, the loan documents must be consistent, without substantial changes to PAS's standard loan documents, which have been carefully drafted to meet the expectations of investors and the rating agencies.

The Correspondent is responsible for conveying the importance of the use of our standard form documents to the Borrower. The consistency of our documents and the ability to securitize enables PAS to offer competitive spreads and to keep legal fees charged by counsel at a minimum.

The scope of the comments PAS will accept is very narrow. Substantive comments should be limited to one round, which is contemplated in PAS's Counsel's fee schedule. More than one round of comments will cause delays in the closing process and an increase in PAS Counsel fees.

Loan Document Negotiation usually proceeds as follows:

- Closing Counsel will distribute the loan documents to Borrower's Counsel, with a copy to the Correspondent and PAS
- Borrower's Counsel will review the legal issues with PAS Counsel
- Correspondent or PAS Counsel will communicate business issues to Contract Finance Coordinator for resolution
- PAS will communicate the resolution of any business issues to PAS Counsel
- PAS Counsel will then revise and distribute the loan documents to Borrower's Counsel, with a copy to the Correspondent and PAS

5. Review by Contract Finance Coordinator prior to Closing: Prior to closing, the Contract Finance Coordinator will review the following:

- Credit File Review: The Contract Finance Coordinator will review the Credit File for completeness.
- Pre-Closing Calculation: Prior to locking rate on a loan, the Contract Finance Coordinator will calculate the DSCR at the current Treasury Rate to ensure that the Loan still meets the minimum DSCR requirements. In addition, the Contract Finance Coordinator will calculate the maximum rate the Treasury Rate can be for the Loan to meet the minimum DSCR restriction. If rates are above the maximum Treasury Rates as determined by the calculation, the loan will not have adequate coverage. Correspondents should bear in mind that the final loan amount may be reduced upon rate lock depending upon market conditions at the time of closing, final actual LTV, Agency DSCR, and Agency LTV.
- Insurance Review: Prior to closing, the Contract Finance Coordinator will put the Correspondent in contact with an Insurance Consultant approved by PAS who will determine the amount of property insurance required to adequately protect both the Lender and Borrower's interests. The Correspondent must provide the Insurance Consultant with all necessary information to complete the analysis.

The amount of required insurance will be determined solely by the Insurance Consultant, however, insurance cannot be less than the greater of (i) the outstanding principal balance of the loan; or (ii) the amount necessary to prevent the borrower from becoming a co-insurer. The Correspondent should ensure prompt delivery of the policy to PAS's Insurance Consultant.

The insurance certificate must:

- ◆ be issued on an Accord Form 27
- ◆ Identify as the mortgagee, the originating lender and its successors and assigns as their interests may appear; and
- ◆ indicate all applicable deductibles, sublimits, and replacement cost valuations

PAS coverage requirements are:

- ◆ Casualty insurance against building loss and damage by fire, lightning, and other such perils must equal at least 100% of the replacement cost of existing or future improvements on the property
- ◆ Comprehensive public liability insurance against death, personal bodily injury, and property damage in a total amount of not less than \$5,000,000
- ◆ Business interruption/loss of income insurance equal to at least 12 months gross income of the property
- ◆ Boiler and Machinery insurance covering all boilers or other pressure vessels, elevators, air conditioning equipment, etc. This must include repair and replacement costs.
- ◆ Flood insurance, if any part of the property or any improvement thereon is located in an area identified by the Federal Environmental Management Agency as being a special flood hazard area. The amount of insurance must equal at least the principal balance of the loan.
- ◆ Earthquake insurance is required for properties with a Probable Maximum Loss (“PML”) assessment (contained in the Seismic Report) of 20% or more. The PML study measures the percentage of the property that will be lost or damaged by an earthquake and is conducted if the property is located in earthquake zones 3 or 4. Earthquake zones are addressed in both the Appraisal and Property Condition Report.
- ◆ Special Hazard insurance. Earthquake and sinkhole insurance, hurricane and windstorm insurance, and mine subsidence insurance, if required in amounts, form and substance satisfactory to PAS provided that any such insurance coverage shall be on terms consistent with the all risks insurance policy required.
- ◆ Builder’s Risk insurance. At all times during which structural construction, repairs or alterations are being made with respect to the improvements, the following coverages must be obtained:
  - A. Owner’s contingent or protective liability insurance covering claims not covered by or under the terms or provisions of the above-mentioned comprehensive general liability insurance; and
  - B. Property insurance written in a builder’s risk completed value form.

#### Collection of Reserves:

Per the terms of the commitment letter, insurance premium holdbacks and reserves are paid by the Borrower to the Servicer either at closing or on a monthly basis depending on when premiums are due and the amount of premiums due. (See “CALCULATION OF RESERVES” section for how insurance reserves and holdbacks are calculated).

If a property is insured under a blanket policy, PAS may elect not to collect any reserves at closing to cover the cost of insurance premiums. However, PAS reserves the right at a later time to require the borrower to make monthly or one-time payments to the Servicer.

6. Rate Lock: The interest rate on a loan is finalized (“locked”) either the day prior to or the day of funding unless the Early Rate Lock Option has been elected. At this time, the closing process is near completion and all closing conditions have been satisfied. At a predetermined time, PAS’s Closer, with the Borrower and the Correspondent on a conference call, will contact Project Atlas Sponsor’s pricing desk in order to lock the interest rate. The coordination of the phone call is important since the interest rate is based on live Treasury Rates which change regularly during the course of the day.

At PAS’s sole discretion, a Borrower can lock the interest rate on a loan prior to closing. For Borrowers who elect this option, the interest rate may be locked the day after PAS is in receipt of the following:

- a complete Loan Application;
- an Early Rate Lock Good Faith Deposit from Borrower equal to 3% of the loan amount; and
- an executed Early Rate Lock Agreement. See Appendix L.
- A substantial portion of the Credit File.

7. Closing and Funding: At closing, all funds will be wired by PAS to the title company’s account with instructions regarding the disbursement of monies. The title company will be responsible for withholding all required and necessary escrow amounts and will forward all remaining funds to the borrower’s legal counsel.

As additional security for PAS, recurring escrows for real estate taxes, insurance, replacement reserves, tenant improvements, and leasing commissions will be set-up at closing as set forth in the loan documents. The Borrower will be required to make deposits at closing and/or monthly deposits with the Servicer (along with regular debt service) equal to one-twelfth of the annual amounts for each of the escrowed items. See Exhibit 2.2 for Standard Escrow Deposits.

These funds will be held and administered by the Servicer. All accounts must be maintained with a depository institution whose unsecured debt obligations (or those of its parent holding company) are rated “A” or better by Standard & Poor’s Ratings Group or Fitch IBCA, Inc. The accounts should be designated as “(To Be Named Servicer), in trust for Purchaser under Master Mortgage Loan Purchase and Service Agreement dated (month and day), 199\_ with Project Atlas Sponsor”

8. Servicing and Post Closing Issues:

Post Closing Issues - If any Post Closing issues exist, the issues will be managed by PAS's third-party legal Closing Counsel and assisted by the Contract Finance Coordinator. All post-closing documents will be forwarded to the custodian via Closing Counsel.

Servicing - After closing, the collection, disbursement, monitoring and reporting of the loan becomes the responsibility of the PAS-designated loan servicer (the "Servicer"). The Servicer (or Subservicer) will collect monthly P&I payments, maintain escrow accounts pursuant to the Loan Documents, and provide monthly reports.

The following items must be delivered to the Servicer as soon as possible after closing (within one week):

- The Correspondent completes and delivers a loan set-up sheet. If Correspondent does not complete the loan set up sheet, all pertinent information must be provided to Contract Finance Coordinator.
- PAS Counsel delivers loan documents to the Servicer.
- All third party reports are delivered to Servicer by PAS.
- All initial escrow deposits are wired to the Servicer at closing.

If the Correspondent is also the Subservicer of the Loan, an executed Master Purchase and Servicing Agreement or the Correspondent Agreement will govern its responsibilities. The Subservicer will provide:

- Monthly escrow balance reports (See Appendix N)
- Remittance reports should be submitted to PAS Controller. (See Appendix N)
- Updated financial statements and rent rolls must be obtained from Borrower as required by Loan Documents.

9. Pre-Securitization Issues: All PAS loans will be securitized and therefore must meet standards set forth in this manual. As such, PAS may require a follow-up information and documentation from the Correspondent and Borrower during the securitization process.

## 2.6 Responsibility Matrix

In order to simplify the loan origination process, PAS has developed a program which involves the efficient exchange of information between the Correspondent and PAS. Both the Correspondent and PAS share the responsibility for advancing the loan throughout the process. Outlined below is a responsibility flow chart that tracks the respective role, responsibility, and necessary documentation for each stage of the loan process:

Process	Stage	Document	Responsible Party
Quote Process (Pre-Application)	1. <u>Correspondent Prescreen</u> : Correspondent does preliminary due diligence screening in order to determine if the investment is appropriate for PAS .	-----	Correspondent
	2. Executive Summary Submission to PAS	IMUS Report or Equivalent Executive Summary	Correspondent
	3. <u>Questions</u> : Based on the IMUS Report/Executive Summary and preliminary discussions, the PAS Banker will have follow-up questions answered before a thorough quote can be issued.	-----	PAS
	4. <u>Quote</u> : Once preliminary due diligence is complete, PAS will issue a quote. Quotes can be in verbal or written form, but are valid for only 5 days. PAS quote is only an expression of its level of interest.	Quote	PAS
Application Process	1. <u>Application Issued</u> : Once the quote is accepted by the Borrower, PAS will issue a formal application and application package to the Correspondent. The Correspondent will forward it to the Borrower.	Loan Application	PAS
	2. <u>Application Submitted</u> : Once the Application is accepted and signed by the Borrower, the Correspondent should forward the signed Application with the application fee to PAS before the expiration date.	Signed Loan Application Receipt of Application Fee	Correspondent
	3. <u>Application Approved and Executed</u> : Acceptance of the Application will be finalized upon PAS's receipt of the signed Application and the \$15,000 application fee from the Borrower. Upon PAS's counter-signature, PAS will instruct the Correspondent to commence due diligence through engaging the third party reports and starting the Credit File.	Credit File Initiated	Correspondent
	4. <u>Third Party Reports</u> : The Correspondent is responsible for the engagement and management of the third party reports. Environmental, engineering, and appraisal reports must be completed for all loans according to PAS's guidelines.	Environmental Report Property Condition Report Appraisal Report	Correspondent

<b>Process</b>	<b>Stage</b>	<b>Document</b>	<b>Responsible Party</b>
Application Process Continued	5. <u>IMUS Report/Executive Summary and Credit File Submission</u> : One of the required elements PAS bases its decision to issue a commitment is the IMUS Report Submission. PAS will review and revise accordingly the IMUS Report Submission before a loan can be presented for approval.	IMUS Report or Equivalent Executive Summary Final Credit File	Correspondent
Commitment Process	1. <u>Resolution of Credit File Issues</u> : The Correspondent is responsible for resolving all Credit File issues and completing a Final Credit File for delivery to PAS 5 business days before closing.	Final/Complete Credit File	Correspondent
	2. <u>Credit Approval</u> : The IMUS Report Submission must be complete and satisfactory to PAS prior to presentation for approval. PAS will respond with its approval decision within a week's time of the receipt of a complete submission.	-----	PAS
	3. <u>Commitment Issued</u> : Following approval by PAS, the Commitment will be issued to the Borrower via the Correspondent. The Commitment must be executed by the Borrower and forwarded to PAS.	Commitment	PAS
	4. <u>Executed Commitment</u> : The legal documentation process will commence upon the receipt of the Borrower-signed Commitment and Commitment Fee.	Signed Commitment Commitment Fee	Correspondent
Closing Process (Post-Commitment)	1. <u>Kick-Off Call</u> : A Working Group Kickoff Conference Call will be scheduled by the Correspondent. The closing and funding of the loan is anticipated to take place approximately three to four weeks following the issuance of the Commitment.	-----	Correspondent
	2. <u>Legal Closing Checklist</u> : The PAS Counsel will forward the Correspondent a Legal closing Checklist of items to be received prior to the funding.	Legal Closing Checklist	PAS Counsel
	3. <u>Post Commitment Due Diligence Items</u> : Correspondent must forward to Counsel all relevant portions of the Credit File.	-----	Correspondent
	4. <u>Loan Document Negotiations</u> : PAS Counsel and PAS prepare and forward loan documents to Borrower's Counsel to commence negotiation process.	-----	PAS Counsel

<b>Process</b>	<b>Stage</b>	<b>Document</b>	<b>Responsible Party</b>
Closing Process (Post-Commitment) Continued	5. <u>Review by Contract Finance Coordinator prior to Closing</u> : Contract Finance Coordinator will complete a Credit File Review, Pre-Closing Calculation, Insurance Review, and Collection of Reserves.	-----	PAS Counsel
	6. <u>Rate Lock</u> : The Interest Rate on the Loan will be set the day prior to or the day of funding unless the Early Rate Lock Option has been elected.	-----	PAS
	7. <u>Closing and Funding</u> : At the closing, all funds will be wired by PAS to the title company's account with instructions regarding the disbursement of monies. The title company will be responsible for withholding all required and necessary escrow amounts and will forward all remaining funds to the Borrower's Legal Counsel.	-----	PAS
	8. <u>Servicing and Post Closing Issues</u> : If any post-closing issues exist, the issues will be managed by PAS's third-party legal Closing Counsel and assisted by PAS's Contract Finance Coordinator. All post-closing documents will be forwarded to the Custodian via Closing Counsel. After closing, the collection, disbursement, monitoring and reporting of the loan becomes the responsibility of the PAS-designated loan servicer.	Post-Closing Documents	PAS, Correspondent, and Counsel
	9. <u>Pre-Securitization Issues</u> : All PAS loans will be securitized and therefore must meet standards set forth in this manual. As such, PAS may require a follow-up from the Correspondent during the securitization process.	-----	Correspondent

**Exhibit 2.1**  
**PAS Borrowing Entity Structure Requirements**

Single Purpose Entity and Single Asset Entity: Rating agencies base their ratings on the payment capability of the Borrower’s assets. These assets must therefore be shielded from the consequences of the bankruptcy of any affiliate of the Borrower. This process allows the rating agencies to safely assume that only the quality of the underlying asset affects the value of the securities and that the borrower has no other obligations and liabilities that might increase the risk of insolvency.

PAS has developed a number of standards and legal structure for attaining this goal, many of which are mandated by the rating agencies. The most common form of Borrower structures is described below.

<b>Loan Amount</b>	<b>Borrowing Entity Requirement</b>
Under \$5 Million	Single Asset Entity is Desired.
\$5 Million to \$10 Million	Single Asset Entity is Required.
\$10 Million to \$15 Million	Single Purpose Entity is Required
\$15 Million or More	Bankruptcy Remote, Single Purpose Entity is Required.

A Single Asset Entity (“SAE”) is an entity which

- Is a limited partnership, corporation, or limited liability company; and
- Owns only one asset.

In the case of our Borrowers, the only asset will be the real estate mortgaged by PAS and incidental personal property. The PAS mortgage is the Borrower’s only debt and the Borrower agrees to the separateness covenants outlined in PAS standard mortgage and has incorporated the same into its formation documents.

In a Single Purpose Entity (“SPE”), also known as a Two-Level SAE, the Borrower must meet the same requirements as above, but will have the following structure:

- A limited partnership Borrower with a sole corporate general partner; or a limited liability company Borrower with a sole corporate managing member.
- The formation documents of the corporate managing member or general partner restricts its activities to the management of the Borrower.
- Consists of newly formed entities.

A Bankruptcy Remote, Single Purpose Entity (“SPE”) meets all the requirements of a two-level SAE above, but meets the two additional requirements:

- The corporate managing member or general partner must have one independent director.
- Borrower’s counsel delivers a substantive non-consolidation opinion acceptable to PAS.
- The unanimous consent of the directors is required for certain decisions such as consent for filing bankruptcy, appointment of receiver, assignment for the benefit of creditors of the general partner/managing member or the Borrower, or to take any action in furtherance of any of the foregoing.

The creation of these entities requires the inclusion of certain provisions in the Borrower's, General Partner's, or Managing Member's organizational documents. The Contract Finance Coordinator and PAS Counsel will be available to work with the Borrower, Borrower's Counsel, and the Correspondent to ensure the organizational documents meet PAS's specific requirements. It is the Correspondent's responsibility to discuss the entity requirements with the Borrower and make them understand the necessity.

## **EXHIBIT 2.2 STANDARD ESCROW ACCOUNTS**

The standard deposits required by PAS are as follows:

Immediate Repair Reserves: PAS holds back from the loan amount 125% of the estimated cost of the *immediate repairs* set forth by the engineer in the Property Condition Report. These repairs must be completed within the next 12 months of closing or per the engineer's recommendations. Disbursements of the escrowed funds by the Servicer will be governed by the Completion Repair Escrow Agreement.

Replacement/Capital Expenditure Reserves: PAS requires the borrower to make monthly deposits (along with debt service payments) equal to one-twelfth the greater of

- amount recommended by the engineer in the Property Condition Report for annual replacement reserves and
- PAS's minimum requirement set forth in the Commitment.

Property Tax Reserves: PAS will require the Borrower to escrow at closing and on a monthly basis sums determined by PAS to be sufficient to pay real estate taxes on the Property at least one full calendar month prior to the date when due. If the actual tax bill for the upcoming year is not available, the tax amount escrowed by the Borrower will be 103% of the preceding year's taxes for the Property.

### **Example**

1998 taxes = \$45,000.00

Amount required to be deposited = \$45,000.00 x 103% = \$46,350.00

Monthly amount required to be deposited = \$46,350.00/12 = \$3,862.50

The date property taxes are due determines whether or not and how much is escrowed at closing. At closing, the amount held back should equal the total monthly payments for those months the borrower would not have made any payments to PAS or the Servicer because the loan has not closed and monthly payments are not yet collected from the borrower.

OR

The amount escrowed at closing is calculated by taking the amount of the next tax payment due and subtracting the amount of monthly tax reserve payments that will be collected monthly from closing until the month prior to the date when due. The difference between the two is held back from the loan proceeds at closing.

## **Example**

Loan closes April 10, 1998

Taxes are due November 1998

Servicer begins collecting monthly payments and reserves June 1, 1998

Monthly tax reserves for 7 months will be held back at closing so that the Servicer has received 12 months tax payments by October 1998.

Note: Taxes that are due the month of closing or a month after closing will be collected in full from the borrower at closing.

Insurance: Upon confirmation by PAS's insurance consultant of the insurance premium amount and when it is payable, insurance reserves are calculated. PAS requires that there are sufficient funds available to pay for insurance a month before insurance fall due. To ensure this, reserves are taken from the borrower at closing and monthly, depending on when insurance payments are to be made. To calculate the total amount PAS requires the borrower to deposit for insurance reserves, PAS multiplies the latest insurance amount by 3%. This ensures that even if insurance is increased, a sufficient amount of money is reserved/deposited by the borrower to pay for the higher insurance.

Tenant Improvement/Leasing Commission Reserve ("TI/LCs"): PAS requires the borrower to make monthly deposits (along with debt service payments) equal to one-twelfth of the annual TI/LC reserve previously agreed upon in the Commitment. The reserve amounts will be based on PAS minimum requirements, rollover risks and current leases at the property, and historical TI/LC's.

Furniture, Fixture & Equipment Reserve: ("FF&E"): PAS will take monthly deposits for FF&E as previously agreed upon in the commitment. Calculation of this amount is property specific.

# SECTION 3

## UNDERWRITING

### 3.1 Introduction

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The key component of the PAS Underwriting Standards is the determination of Underwritten Cash Flow (UCF). UCF is determined by the following equation:

$$\text{Underwritten Cash Flow (UCF)} = \text{Net Cash Flow} = \text{NOI} - \text{Total Capital Costs}$$

In generating UCF, PAS puts tremendous focus on historical operating statements. As a result, details of the Trailing 12 month period and most recent year end are critical. For effective securitization, strict adherence to PAS guidelines and standards are necessary. Any deviations from these standards must be fully explained along with all significant trends, spikes, and changes in income and expense levels. Supporting documentation and approval by the PAS Banker is required. In preparing the IMUS Report underwriting, the Correspondent must use the PAS Chart of Accounts (See Appendix C).

### 3.2 Specific Underwriting Guidelines

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**3.2.1 Effective Gross Income (EGI)** – EGI represents the total cash expected to be generated from the property during the period. The components of EGI are as follows:

$$\text{Effective Gross Income (EGI)} = \text{Gross Potential Rent} - \text{Vacancy} - \text{Discounts \& Concessions} + \text{Other Income} + \text{Reimbursements}$$

- **Gross Potential Rent (GPR)** – GPR is based on income in place from the Trailing 12 months base rent or current rent roll with the following adjustments:
  - ◆ Vacant space and management space marked to market rent
  - ◆ Mark to market tenants with above-market rents
  - ◆ Do not include rent from tenants more than 60 days delinquent
  - ◆ Consider tenants expiring within next four months as vacant
  - ◆ Include contractual step-ups within next four months
  - ◆ Do not include dark tenants (still paying rent)
  - ◆ Current rent roll should be constrained by Trailing 12 months

The market rent used for grossing up the vacant space and management space must be an appraiser's estimate. Market rent used must be appraiser's estimate for marking above-market rents down.

Any significant increases in GPR from the previous full year financials must be explained.

For Hotels, Total Departmental Revenue is calculated instead of EGI. The components of Total Departmental Revenue are as follows:

$$\boxed{\text{Total Departmental Revenue} = \text{Rooms} + \text{Food and Beverage} + \text{Telephone} + \text{Other Income}}$$

In the case of rooms revenue for hotels the Average Daily Rate (ADR) or REVPAR is used based on the Trailing 12 months. Food and Beverage Revenue and Telephone Revenue should be based on the Trailing 12 months % of Total Revenue ratio (see Case 3 for an example).

- **Vacancy** – Vacancy should be taken as the greater of actual, market, or PAS standard. Vacancy should always be economic vacancy (as opposed to physical vacancy). In cases where the local market is higher than both the standard and actual vacancy, an explanation as to why the subject performs superior to the market must be provided. This can be done by demonstrating:
  - ◆ Certain advantages the subject has versus the market;
  - ◆ The strong contractual nature of the current leases/rents; or
  - ◆ The inappropriateness of the market as a benchmark for the subject.

All vacancy adjustments should include an adjustment for reimbursements.

- **Discounts / Concessions** – Items deducted from GPR include, but are not limited to:
  - ◆ Rent reductions
  - ◆ Free rent periods
  - ◆ Rent from units/suites occupied by management offices
  - ◆ Rent from multifamily units occupied by on-site managers

Rent reductions and free rent periods should be based on the recent historical level. Units/suites occupied by management offices and/or on-site managers can be based on the appraiser's estimate, the figures for the last two or three leases, or the average income in place.

- **Other Income** – Other income should be based on the recent historical level, as long as it is consistent with the income generated by the property over the last three years, and is common in the market. All sources for other income should be footnoted. All interest income, late fees, and other non-recurring income should be excluded from EGI. Such income is not contractual nor can it be relied upon as future income generated by the property.
  - ◆ For retail properties, sources of other income may include percentage rent. Percentage rent should be included as the average collection over a three-year period for those tenants who have a contractual lease obligation to pay such rent. In order to include a tenant's percentage rent, historical sales figures for each tenant must be broken out and documented. Tenants paying a percentage

rent plus base rent that is above current market rent should be constrained by the current market rent.

- ◆ For office properties, sources of other income may include parking and storage income, if collected historically.
  - ◆ For multifamily properties, sources of other income may include laundry, vending machine, and storage income. Other income should be based on the recent historical level.
  - ◆ For hotels, other income should be based on the Trailing 12 months % of Total Revenue ratio. Sources of other income may include income from no-shows, gift shop, and valet.
- **Reimbursements** – Reimbursements should be based on the recent historical level. All reimbursements should be grossed up to 100% occupancy. The appropriate vacancy adjustment for reimbursements should then be made in the vacancy line item. Attention should be paid to the terms of the leases as presented in the rent roll. It is inappropriate to have leases noted as NNN, Net, or Modified Gross on the rent roll and no reimbursements noted in the cash flow (without adequate explanation). Any adjustments made to expense levels should trigger a corresponding adjustment in reimbursement levels.

Estimating EGI is the first step to determine UCF. The next step is defining total expenses.

**3.2.2 Total Expenses** – Total expenses can be further broken down to Management Fee & Franchise Fee, General Operating Expenses and Total Fixed Expenses. In the case of hotels, Departmental Expenses should also be included in Total Expenses. PAS's Chart of Accounts is located in Appendix C.

$$\text{Total Expenses} = \text{Total Operating Expenses} + \text{Total Fixed Expenses}$$

- **Total Operating Expenses** – Operating expenses include Management Fee & Franchise Fee and General Operating Expenses.

$$\text{Total Operating Expenses} = \text{Management Fee \& Franchise Fee} + \text{Marketing} + \text{Legal \& Professional} + \text{Payroll} + \text{Other Administrative Expenses} + \text{Utilities} + \text{Repairs} + \text{Cleaning/Decorating} + \text{Other Operating Expenses}$$

- ◆ **Management Fee & Franchise Fee** – Management and Franchise Fees should be entered as the greater of actual, market, or the PAS standard. Should, however, the subject be managed by the borrower/sponsor or a firm associated with the borrower/sponsor, the PAS standard fee must be used.
- ◆ **General Operating Expenses** - All general expenses should be based on the recent historical level. General operating expenses include but are not limited to marketing, legal and professional, payroll, other administrative expenses, utilities, repairs, cleaning/decorating, and other operating expenses. These

expenses do not include averages, approximations or figures adjusted for inflation. All trends, spikes, and noteworthy changes in expense levels should be addressed in detail in the footnotes. Operating expenses exclude non-recurring or extraordinary expenses. These expenses should be dropped below the line and footnoted as Recurring Replacements, Capital Improvements, Tenant Improvements, Leasing Commissions or Other.

- ◆ **Total Departmental Expenses** (hotel properties only) – Rooms, Food and Beverage, Telephone, and Other Departmental Expenses should be based on the Trailing 12 months % of Total Revenue ratio (see Case 3 for an example).

$$\text{Total Departmental Expenses} = \text{Rooms} + \text{Food and Beverage} + \text{Telephone} + \text{Other Expenses}$$

- **Total Fixed Expenses** – Fixed expenses do not change with the level of occupancy of the property and include such items as Real Estate Taxes, Insurance, and Ground Lease Payments.

$$\text{Total Fixed Expenses} = \text{Real Estate Tax} + \text{Insurance} + \text{Other Fixed Expenses}$$

Real estate taxes and insurance expense should be based on the current level and supported by the actual bill for the current operating year. Ground leases should be based on current contractual ground lease payments. Abnormal future increases (over 5%) in ground lease payments should be included in stabilized numbers. Ground leases must have pre-determined steps. Ground leases with fair market value steps during the term of the loan are not securitizable.

**Note (For California Properties):** For properties located in California, a transfer of a property triggers a reassessment of the property taxes. For this reason, taxes for properties located in California must be underwritten at the greater of the current taxes or the estimated taxes after the property is transferred.

The estimated tax after the property is transferred must be calculated by taking the loan amount and multiplying it by the tax rate and then add the assessment. For newly acquired properties which have not yet been reassessed, the below calculation should be used by substituting purchase price for loan amount.

$$(\text{Loan amount} * \text{Tax Rate}) + \text{Assessment} = \text{Estimated Tax}$$

**Example**

A loan of \$5,000,000 is borrowed and the current tax on the property is \$53,000. The tax rate is 1.0558% and the assessment is \$5,400. The estimated tax after the property is transferred is calculated as follows:

$$(\$5,000,000 * 1.0558\%) + \$5,400 = \$58,190$$

The real estate tax would be underwritten at \$58,190.

Estimating Total Expenses was the second step to determine UCF. The final step is defining Total Capital Costs.

**3.2.3 Total Capital Costs** – Capital expenditures such as tenant improvements or major repairs and replacements are not operating expenses and should be underwritten after NOI.

**Total Capital Costs = CAPEX or FF&E + Tenant Improvements and Leasing Commissions**

- **Replacement Reserves (“CAPEX”) or FF&E** – Reserves are the estimated costs to maintain the property and improvements to its current standard. The cost should be taken as the greater of the recent historical level, the figure provided by the Engineer’s Report or the PAS standard. All trends, spikes, and noteworthy changes in CAPEX/FF&E levels should be addressed in detail in the footnotes.
- **Tenant Improvements & Leasing Commissions (TI/LC)** – TI/LC reserves are the calculated costs to renew or replace tenants to maintain the underwritten occupancy at the property. TI/LC should be taken as the greater of the recent historical level or the PAS standard. In cases where the local market figures (as shown in the appraisal or market study) works out to be higher than both the standard and actual, an explanation should be provided why the subject performs superior to the market. Properties may have different TI/LC costs for different tenant spaces. For example, costs for anchor tenants will vary from costs for in-line space in a retail center. For those properties where TI/LC differ for different tenant types, a weighted average TI/LC is calculated by the IMUS Report TI/LC Calculator.

TI/LC reserves are always included in the UCF calculation but are escrowed on a case-by-case basis. Properties located in strong or intermediate markets and meet the standards outlined below may not require escrows. Properties located in weak markets will require escrows for TI/LC.

Strong Market – A property located in a market with a vacancy rate less than or equal to 5% and where no new near term construction is projected. Escrows may be waived by PAS if:

- ◆ DSCR remains substantially greater than 1.25x if any single tenant’s rent is not included in the calculation of UCF;
- ◆ The anchor leases have renewal options with below market rental rates and current store sales are solid and trending upward; or

- ◆ The DSCR for each year is greater than 1.0x after deducting the derived TI/LC calculation for tenants rolling within any given year.

The data needed to calculate TI and LC costs is as follows:

1. square feet rolling
2. tenant retention rate
3. \$/sf cost for new tenant TI's
4. \$/sf cost for renewal tenant TI's
5. average rent for new tenants
6. average rent for renewal tenants
7. leasing commission for new tenants
8. leasing commission for renewal tenants
9. average lease term
10. loan term

### 3.3 Summary

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To accurately estimate UCF for a property, follow these steps:

1. Using either Trailing 12 months or current rent roll, project the GPR. Mark to market rents above the market and gross up vacant space and management space. Current rent roll should be constrained by Trailing 12 months. For Hotels, use the Trailing 12 months ADR for rooms revenue. All other departmental income should be based on the Trailing 12 months % of Total Revenue ratio.
2. Analyze historical, actual, and market vacancy rates. Take the greater of actual or PAS standard. If market vacancy is greater than actual and no explanation is given, take the greater of actual, market, or PAS standard. Use recent historical levels of Discounts & Concessions.
3. Reimbursements should be based on the recent historical level grossed up to full occupancy.
4. Consider any additional sources of income. Other income should be based on the recent historical level as long as it is consistent with the income generated by the property over the last three years.
5. Carefully analyze all historical operating expenses.
6. Estimate appropriate Capital Costs, then perform the following calculation:

$$[(\text{GPR} - \text{Vacancy} - \text{Discount \& Concessions} + \text{Other Income} + \text{Reimbursements}) = \text{EGI} - \text{Total Expenses} - \text{Capital Costs}] = \text{UCF}$$

See Table 3-1 at the end of this section for a quick reference on underwriting UCF for each property type.

### 3.4 Case Studies

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3 Case Studies are presented here to demonstrate the basic underwriting principles for each property type. The 3 case studies are as follows:

Case 1 – Commercial (The underwriting principles presented in this case can be applied to Office, Retail and Industrial)

Case 2 – Multifamily

Case 3 – Hotel

## **CASE 1 – OFFICE**

### **Salient Facts**

<b>Net Square Feet: 47,793</b>
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**Market Rent: \$19.00 PSF**

**Market Occupancy: 96%**

**Appraiser's Estimated Tenant Improvements & Leasing Commission: \$0.71 PSF**

**Engineer's Recommended Annual Reserve ("Capex"): \$0.14 PSF**

**Market Management Fee: 4%**

### **Key Underwriting Points**

**1. Base Rent**

Rents in-place from 9/1/98 rent roll. Vacant space of 1,250 SF grossed up by market rent of \$19.00 PSF.

**2. Above Market Rent**

Marked to market The Time Group from \$20.50 PSF to \$19.00 PSF.

**3. Vacancy**

Used greater of actual, market, or PAS's minimum 5% vacancy of EGI and reimbursements.

**4. Other Income**

Other income consists of parking income. This income item is sustainable, recurring, and a market norm and has therefore been included.

**5. Reimbursements**

Trailing 12 months (T-12) reimbursements was grossed up by average economic vacancy of 2% to reflect full occupancy.

**6. Management Fee**

Used the greater of actual, market, or PAS's minimum management fee of 4% EGI.

**7. Expenses**

Used T-12 (6/30/98) operating expenses except where noted.

**8. Real Estate Taxes**

Used current tax bill.

**9. Insurance**

Used current insurance expense.

**10. Reserves ("Capex")**

Used PAS's minimum of \$0.20 PSF.

**11. Tenant Improvements and Leasing Commissions**

Used PAS's minimum of \$1.00 PSF.

## **CASE 2 – MULTIFAMILY**

### **Salient Facts**

**Units: 193**

**Market Occupancy: 96%**

**Engineer's Recommended Recurring Replacements: \$235 per unit**

**Market Management Fee: 4.1%**

### **Key Underwriting Points**

**1. Base Rent**

Rents in-place from 9/14/98 rent roll. Office unit grossed up by \$465 per month, the average rent in place for 2-bedroom units.

**2. Vacancy**

Vacancy underwritten at 14% of EGI in order to constrain to T-12 (6/30/98) actual EGI.

**3. Discount/Concessions**

Based on Trailing 12 months (T-12) for the period ending 6/30/98 and the unit used for office space.

**4. Other Income**

Based on T-12 (6/30/98) and includes laundry commission and other tenant services only. These income items are sustainable, recurring, and a market norm and have therefore been included.

**5. Management Fee**

Used PAS's minimum management fee of 4%. Management is a borrower related entity, therefore, 4% is used instead of the 4.1% market/actual management fee.

**6. Expenses**

Used T-12 (6/30/98) operating expenses except where noted.

**7. Real Estate Taxes**

Based on conversation with County Assessor's Office, taken against the loan amount.

**8. Insurance**

Used current insurance expense.

**9. Reserves ("Capex")**

Used PAS's minimum \$250 per unit.

## **CASE 3 - HOTEL**

### **Salient Facts**

**Rooms: 350**

**Market Occupancy: 70%**

**Market ADR: \$87.25**

**Fixtures, Furnishings and Equipment (FF&E): Lender collects a FF&E of \$19,462.**

**Actual Franchise Fee: 5%**

**Market Management Fee: 4%**

### **Key Underwriting Points**

#### **1. Room Revenue**

Based on lower of market or actual ADR and lower of actual, market, and PAS's maximum occupancy rate of 80%.

#### **2. ADR & Occupancy**

Always use trailing 12 months if available because of seasonality. Since trailing 12 months were available, ADR was based on actual T-12 (6/30/98) ADR of \$89.16, constrained to market occupancy of 70%.

#### **3. Departmental Revenue**

Based on T-12 (6/30/98) % of Total Revenue ratio. The ratio represents each source of Departmental Revenue as a percentage of Total Revenue. To calculate the T-12 (6/30/98) ratio, complete the following calculation for each revenue source:

Example: 
$$\frac{\text{Food \& Beverage (T-12)}}{\text{Rooms Revenue (T-12)}}$$

Apply the T-12 percentage calculated above against UCF Rooms Revenue (ADR of 89.16, constrained to 70%) to get UCF Food and Beverage Revenue. Follow the same calculation for all other Departmental Revenue.

#### **4. Other Income**

Based on T-12 (6/20/98) period includes honor bar income, gift shop rent and miscellaneous.

#### **5. Departmental Expenses**

Based on T-12 (6/30/98) % of Total Revenue ratio.

#### **6. Management Fees**

Based on PAS's minimum 4% of total revenue.

#### **7. Franchise Fees**

Equals 5% of total revenue. Used the higher of actual, market, or PAS's minimum of 5%.

#### **8. Other Expenses**

Includes costs associated with Other Income noted above.

**9. Operating Expenses**

Based on the T-12 (6/30/98).

**10. Real Estate Taxes**

Based on County tax bill confirmed by the Tax Assessor's office.

**11. Insurance**

Based on the current actual premiums.

**12. FF&E**

Based on 4% of total revenue. Used higher of actual collection or PAS's minimum of 4%.

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**Table 3-1**

<b>UCF Component</b>	<b>Commercial (Office, Retail, Industrial)</b>	<b>Multifamily</b>	<b>Hospitality</b>
<b>Gross Potential Rent (GPR) / Room Revenue</b>	<ul style="list-style-type: none"> <li>• GPR is based on income in place (as of the current rent roll) or the Trailing 12 months base rent plus vacant space and space occupied by Management at the market rent.</li> <li>• The market rent used for grossing up these spaces can be an appraiser's estimate, the figures for the last two or three leases or the average income in place.</li> <li>• Mark to market tenants with above-market rents.</li> <li>• Do not include rent from tenants more than 60 days delinquent.</li> <li>• Consider tenants expiring within the next four months as vacant.</li> <li>• Include contractual step-ups within next four months.</li> </ul>	<ul style="list-style-type: none"> <li>• GPR is based on income in place (as of the current rent roll) or the Trailing 12 months base rent plus vacant units and units occupied by Management and the on-site Manager unit at the market rent.</li> <li>• The market rent used for grossing up these units is the same as described under commercial.</li> <li>• Mark to market tenants with above-market rents.</li> </ul>	<ul style="list-style-type: none"> <li>• Room Revenue is based on the Trailing 12 months Average Daily Room Rate (ADR).</li> <li>• Food and Beverage Revenue and Telephone Revenue should be based on the T-12 months % of Total Revenue ratio.</li> </ul>
<b>Vacancy</b>	<ul style="list-style-type: none"> <li>• Vacancy should be taken as the greater of actual or PAS standard.</li> <li>• Vacancy should always be economic vacancy.</li> <li>• In cases where the local market is higher than both the standard and actual, an explanation should be provided why the subject performs superior to the market.</li> <li>• If no explanation is available, vacancy should be taken as the greater of actual, market, or PAS standard.</li> </ul>	Same as commercial	<ul style="list-style-type: none"> <li>• Vacancy is based on the greater of 20%, actual economic vacancy or market vacancy applied to Rooms Revenue.</li> </ul>
<b>Discounts / Concessions</b>	<ul style="list-style-type: none"> <li>• Items deducted from GPR include, but are not limited to: rent reductions, free rent periods, and rent from suites occupied by Management offices.</li> <li>• This should be based on the recent historical level.</li> </ul>	<ul style="list-style-type: none"> <li>• Items deducted from GPR include, but are not limited to rent reductions, free rent periods, and rent from units occupied by on-site Manager and Management Office.</li> </ul>	N/A

<b>UCF Component</b>	<b>Commercial (Office, Retail, Industrial)</b>	<b>Multifamily</b>	<b>Hospitality</b>
<b>Other Income</b>	<ul style="list-style-type: none"> <li>Other income should be based on the recent historical level as long as it is consistent with the income generated by the property over the last three years and is common in the market.</li> <li>All sources for other income should be footnoted.</li> <li>For retail properties, sources of other income may include percentage rent.</li> <li>For office properties, sources of other income may include parking and storage income.</li> <li>All interest income, late fees, and other non-recurring income should be excluded from GPR.</li> </ul>	<ul style="list-style-type: none"> <li>Other income should be based on the recent historical level.</li> <li>All sources for other income should be footnoted.</li> <li>Sources of other income may include laundry, vending machine, and storage income.</li> <li>All interest income, late fees, and other non-recurring income should be excluded from GPR.</li> </ul>	<ul style="list-style-type: none"> <li>Other income should be based on the T-12 months % of Total Revenue ratio.</li> <li>Sources of other income may include income from no-shows, gift shop, and valet.</li> </ul>
<b>Reimbursements</b>	<ul style="list-style-type: none"> <li>Reimbursements should be based on the recent historical level.</li> <li>All reimbursements should be grossed up to full occupancy.</li> <li>The appropriate vacancy adjustment for reimbursements should then be made in the vacancy line item.</li> <li>Any adjustment made to expense levels should trigger a corresponding adjustment in reimbursement levels.</li> </ul>	N/A	N/A
<b>Departmental Expenses</b>	N/A	N/A	<ul style="list-style-type: none"> <li>Rooms, Food and Beverage, Telephone, and Other Expenses should be based on the T-12 months % of Total Revenue ratio.</li> </ul>
<b>Management Fee / Franchise Fee</b>	<ul style="list-style-type: none"> <li>Management fee should be entered as the greater of actual, market, or the PAS standard fee.</li> <li>Should, however, the subject be managed by the borrower/sponsor or a firm associated with the borrower/sponsor, the PAS standard fee should be used.</li> </ul>	Same as commercial	<ul style="list-style-type: none"> <li>Management Fee - Same as commercial</li> <li>Franchise Fee should be entered as the greater of actual, market, or the PAS standard.</li> </ul>
<b>General Operating Expenses</b>	<ul style="list-style-type: none"> <li>General operating expenses should be based on the recent historical level.</li> <li>Do not include averages, approximations, or figures adjusted for inflation.</li> <li>All trends, spikes, and noteworthy changes in expenses should be addressed in the footnotes.</li> <li>Expenses should be normalized and non-recurring expenses dropped below the line.</li> </ul>	Same as commercial	Same as commercial

<b>UCF Component</b>	<b>Commercial (Office, Retail, Industrial)</b>	<b>Multifamily</b>	<b>Hospitality</b>
<b>Fixed Expenses</b>	<ul style="list-style-type: none"> <li>• Real estate taxes and insurance expenses should be based on the current level.</li> <li>• The above expenses should be supported by the actual bills for the current operating year.</li> <li>• Ground leases should be based on current contractual ground lease payments.</li> <li>• Abnormal future increases (over 5%) in ground lease payments should be included in stabilized numbers.</li> <li>• Ground leases must have pre-determined steps.</li> </ul>	Same as Commercial	Same as Commercial
<b>Replacement Reserve ("CAPEX") / FF&amp;E</b>	<ul style="list-style-type: none"> <li>• Replacement Reserve provides funds for anticipated expenditures required to maintain the building.</li> <li>• Replacement Reserve should be taken as the greater of the recent historical level, the figure provided by the Engineer's report or the PAS standard.</li> <li>• All trends, spikes, and noteworthy changes in reserve/capex levels should be addressed in detail in the footnotes.</li> </ul>	Same as Commercial	<ul style="list-style-type: none"> <li>• FF&amp;E is based on greater of the recent historical level, the figure provided by the Engineer's Report or the PAS standard.</li> </ul>
<b>Tenant Improvements / Leasing Commissions</b>	<ul style="list-style-type: none"> <li>• TI/LC is the calculated cost to renew or replace tenants to maintain the underwritten occupancy at the property.</li> <li>• TI/LC should be taken as the greater of the recent historical level or the PAS standard.</li> <li>• In cases where the local market figures (as shown in the appraisal or market study) works out to be higher than both the standard and actual, an explanation should be provided why the subject performs superior to the market.</li> <li>• Properties may have different TI/LC costs for different tenant spaces. For example, costs for anchor tenants will vary from costs for in-line space in a retail center. For those properties where TI/LC differ for different tenant types, calculate a weighted average of TI/LC costs.</li> </ul>	N/A	N/A

### 3.5 Sizing the Loan

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Once the Underwritten Cash Flow (UCF) is determined, PAS uses four factors to determine the size of the loan. The size of the loan will be a function of the lesser of the following four parameters:

1. **The Debt Service Coverage Ratio (DSCR)** – DSCR is the ratio of UCF to Annual Debt Service (“ADS”). This ratio represents the ratio of the UCF to the amount required to service the debt. This ratio will vary depending upon the property type. Consult Appendix A for property specific guidelines.

$$\text{DSCR} = \text{UCF} / \text{ADS}$$

#### Example

The Borrower is requesting a loan for office building ABC in the amount of \$14,000,000. The ADS was calculated at \$1,296,651 with a 10 year term amortized for 25 years at 8%. The UCF was calculated at \$1,400,000. The actual DSCR is calculated as follows:

$$\$1,400,000 / \$1,296,651 = 1.08$$

In the event that the application in this example requires a 1.25 DSCR, at the same loan terms the maximum loan size would be \$12,095,000.

2. **Rating Agency Maximum Loan based on the Refinancing Constant at the Minimum Refinancing DSCR** – Rating agencies require coverage on a historical average constant for a particular property type. The sizing constant and coverage for each property type is listed in Appendix A.

$$\text{Rating Agency Maximum Loan} = \text{UCF} / \text{Refinancing Constant} / \text{Minimum Refinancing DSCR}$$

#### Example

The UCF for office building ABC was calculated at \$1,400,000. Looking at the PAS Underwriting Guidelines, the Refinancing Constant for an office building is 10.09% with a Minimum Refinancing DSCR of 1.10. The Rating Agency Maximum Loan is calculated as follows:

$$\$1,400,000 / 10.09\% / 1.10 = \$12,613,000$$

The maximum loan PAS would size for office building ABC using the Rating Agency Maximum Loan as the factor is \$12,613,000.

3. **Loan-to-Value (LTV)** – The size of the loan will also be compared as a percent of the value of the property, with the value being the appraised value. Commonly, PAS will not lend more than 75% (or 80% in certain circumstances) of the value of the property.

$$\text{Loan-to-Value} = \text{Loan Amount} / \text{Property Value}$$

### Example

Office building ABC was appraised at \$18,600,000 and the borrower is requesting a \$14,000,000 loan. The Loan-to-Value is calculated as follows:

$$\$14,000,000 / \$18,600,000 = 75\%$$

Given the acceptable LTV ratio, the maximum loan PAS would size for building ABC using the LTV as the factor is \$14,000,000.

4. **Loan-to-Acquisition** – The size of the loan will also be compared as the percent of the cost or purchase price of the property.

<b>Loan-to-Acquisition = Loan Amount / Purchase Price</b>
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### Example

The Borrower recently agreed to purchase office building ABC for \$17,500,000 net of costs and is requesting a \$14,000,000 loan. 75% is the maximum Loan-to-Acquisition PAS is willing to accept for this particular property. The Loan-to-Acquisition ratio is calculated as follows:

$$\$14,000,000 / \$17,500,000 = 80\%$$

Given the unacceptable Loan-to-Acquisition ratio of 80%, PAS would lower the size of the loan to \$13,125,000 to reach an acceptable Loan-to-Acquisition ratio of 75%.

**Looking at the four examples above for office building ABC, the example using DSCR (factor 1) as the factor in determining the size of the loan resulted in the lowest loan amount. PAS would therefore size the loan at \$12,095,000.**

## **Underwriting Definitions**

**Effective Gross Income (EGI)** = Gross Potential Rent – Vacancy – Discounts/Concessions + Other Income + Reimbursements

**Total Operating Expenses** = Management Fee/Franchise Fee + Marketing + Legal and Professional + Payroll + Other Administrative Expenses + Utilities + Repairs + Cleaning/Decorating + Other Operating Expenses

**Total Fixed Expenses** = Real Estate Tax + Insurance + Other Fixed Expenses

**Total Expenses** = Operating Expenses + Fixed Expenses

**Total Capital Costs** = CAPEX/FF&E + Tenant Improvements and Leasing Commissions

**Net Operating Income (NOI)** = EGI – Total Expenses

**Underwritten Cash Flow (UCF) = Net Cash Flow** = NOI – Total Capital Costs

**Debt Service Coverage Ratio (DSCR)** = UCF/Annual Debt Service (ADS)

**Preliminary Loan to Value** = Loan Amount/(NOI/Cap Rate)

**Final Loan to Value:**

**Acquisition Financing** = Loan Amount / the lower of Appraised Value or Purchase Price

**All Other Financing** = Loan Amount / Appraised Value

## **Underwriting Hospitality Definitions**

**Total Departmental Revenue** = Rooms + Food and Beverage + Telephone + Other Income

**Total Departmental Expenses** = Rooms + Food and Beverage + Telephone + Other Expenses