Commercial Real Estate Underwriting Checklist

A 5-Stage Institutional Framework for Deal Sizing, Due Diligence & Investment Committee Review

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1 Property & Rent Roll Due Diligence

- ☐ **Rent Roll vs Bank Deposits:** Reconcile trailing 12-month actual collections against signed lease agreements; verify tenant concessions and delinquency.
- ☐ **Lease Rollover Schedule:** Audit lease expiration concentration; ensure no single year exceeds 20% of net rentable area without structured capital reserves.
- ☐ **Tenant Credit & Co-Tenancy:** Review anchor credit ratings, sales volume reporting thresholds, sublease clauses, and exclusive-use provisions.
- ☐ **Property Condition Assessment (PCA):** Inspect roof life, HVAC age, foundation integrity, and ADA compliance. Budget immediate day-1 repair reserves.
- ☐ **Zoning & Title Review:** Validate lawful conforming use, parking ratio compliance, easements, and absence of mechanics' or tax liens.

Target Benchmark: WALT > 4.0 years for commercial retail/industrial; lease collections > 97% of billed rent.

2 T-12 Quality of Earnings & NOI Normalization

- ☐ **Gross Potential Income (GPI):** Baseline in-place rents; compare against submarket comps to establish realistic market rent upside.
- ☐ **Economic Vacancy & Credit Loss:** Apply realistic market vacancy floor (underwrite 5.0%–8.0% minimum, even if historical is 0%).
- ☐ **Management Fee Normalization:** Impute professional third-party management fee (4.0%–6.0% of EGI) if seller was self-managing.
- ☐ **Tax & Insurance Reassessment:** Model post-sale property tax assessment at actual purchase price; obtain binding builder/hazard insurance quotes.
- ☐ **Replacement Reserves:** Deduct ongoing capital reserve below the line ($250–$350/unit for multifamily; $0.15–$0.30/sqft for commercial).

Rule of Thumb: Multifamily OpEx ratio typically 35%–45% of EGI; NNN retail/industrial OpEx 12%–20%.

3 3-Way Commercial Debt Sizing Engine

- ☐ **Constraint 1: Maximum LTV Sizing:** Compute loan cap = Property Purchase Price × Target LTV (typically 65%–75% for bank/agency loans).
- ☐ **Constraint 2: Minimum DSCR Sizing:** Compute loan cap = Reconstructed NOI ÷ Minimum DSCR (1.25x) ÷ Annual Debt Constant (k).
- ☐ **Constraint 3: Minimum Debt Yield Sizing:** Compute loan cap = Reconstructed NOI ÷ Lender Minimum Debt Yield (9.0%–10.0%).
- ☐ **Identify Binding Constraint:** Pinpoint whether LTV, DSCR, or Debt Yield establishes the maximum permissible loan amount.
- ☐ **Amortization & Refinancing Terms:** Model 20–30 year amortization schedule with balloon payoff at year 5, 7, or 10.

Sizing Formula: Max Debt = MIN(Price × LTV, NOI ÷ DSCR ÷ k, NOI ÷ Target DY).

4 Equity Capital & Leveraged Return Yields

- ☐ **Total Cash Required:** Sum purchase down payment (25%–35%) + closing costs (1.5%–2.5%) + lender escrow reserves + upfront capex.
- ☐ **Year-1 Cash-on-Cash Return:** Calculate pre-tax net cash flow (NOI – Annual Debt Service) ÷ Total Initial Cash Invested.
- ☐ **Positive vs Negative Leverage Check:** Compare Going-In Cap Rate against the Annual Debt Constant. If Debt Constant > Cap Rate, leverage is dilutive.
- ☐ **Unleveraged vs Leveraged IRR:** Run 5-to-10 year discounted cash flow projection with terminal exit cap rate expanded by 25–50 bps.
- ☐ **Sponsor Waterfall Structure:** Define preferred return hurdles (7%–8%) and promote splits (80/20, 70/30) for LP investors.

Target Return: Class B core-plus multifamily target CoC 7.5%–9.5%; 10-year levered IRR 13.0%–16.0%.

5 Downside Sensitivity, Stress Testing & IC Decision Matrix

- ☐ **Interest Rate Shock (+100 bps / +200 bps):** Re-evaluate DSCR and cash flow if floating rate resets or refinancing rate spikes at loan maturity.
- ☐ **Vacancy Stress (+300 bps / +500 bps):** Verify Break-Even Occupancy = (OpEx + Debt Service) ÷ GPI. Must remain comfortably below 80%.
- ☐ **Expense Inflation (+10% Spike):** Stress test property tax reassessment spikes, utility tariff jumps, and insurance premium increases.
- ☐ **Refinancing Exit Test:** Ensure exit loan balance can be refinanced at year 10 assuming terminal cap rate expands by 50 bps.

Investment Decision Matrix:

✔ **PASS / ADVANCE:** DSCR ≥ 1.30x under base case, ≥ 1.15x under +100 bps shock; CoC ≥ 8.0%.

⚠ **RE-TRADE / ADJUST:** Binding DSCR curtails loan; renegotiate asking price to restore equity yield.

✖ **WALK AWAY:** Negative leverage, BER > 85%, or environmental / structural defects.