Debt Service Coverage Ratio Formulas

Cash flow available to service debt should be compared to all debt service requirements of the borrower. Whenever possible, a debt service guideline of 1.25:1 is desired. The Business Loan Committee will consider a lower debt service guideline with appropriate mitigating strengths. A simple method of calculating cash flow is as follows:

Debt Service Coverage Ratio – EBITDA Method

Net income after tax
+ Depreciation expense
+ Amortization expense
+ Interest Expense
= Cash Flow Available to Pay Debt or EBITDA

Debt Service Coverage Calculation =

$$\frac{\text{Cash flow available to service debt}}{\text{Total principal and interest payments on all business debts}}$$

Cash flow available to service debt is then divided by the total of annual principal and interest payments of all existing debt plus the annual principal and interest payments for the new loan.

Whenever possible, this calculation should be made for the trailing three years and averaged. This will provide a more accurate indication of the borrower's ability to service debt on a sustained basis.

Income Producing Real Estate DSCR – NOI Method

Cash flow for income-producing commercial real estate with a triple net lease, where tenants pay directly for taxes, insurance and maintenance should be calculated as follows:

Gross rental income
- Vacancy rate (varies based on actual property and market conditions, average of 5%)
= Net rental income
- Property management (usually 2.5% of net rental income)
- Maintenance reserve (usually 2.5% of net rental income)
- Operating expenses (varies depending on type of lease, average of 10% to 50%)
= Net Operating Income or Cash Available to Pay Debt