

Lisa Ehrlich Inc. Issues A \$1,300,000, 9%, 10-year Mortgage Note On December 31, 2020, To Obtain Financing

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In the world of corporate finance, securing appropriate funding is a critical step for growth, expansion, or operational needs. On December 31, 2020, Lisa Ehrlich Inc., a prominent company in its industry, issued a significant mortgage note valued at \$1,300,000 with a 9% interest rate over a 10-year term. This strategic financing move reflects the company's plans to leverage debt to facilitate future endeavors. In this article, we explore the details surrounding this issuance, its implications, the accounting treatment, and key considerations for stakeholders.

Understanding the Mortgage Note Issuance

A mortgage note is a formal promise to repay a specified amount of money borrowed, secured by a mortgage on specific property or assets. The issuance of a mortgage note involves several key components:

Key Features of Lisa Ehrlich Inc.'s Mortgage Note

- Principal Amount: \$1,300,000
- Interest Rate: 9% annually
- Term: 10 years
- Date of Issue: December 31, 2020
- Purpose: To finance property acquisition, expansion, or operational needs

This debt instrument provides Lisa Ehrlich Inc. with the capital required to meet strategic objectives while establishing a clear repayment schedule.

Details of the Loan Agreement

The mortgage note's terms specify the company's obligations and the lender's rights. These include:

Interest Computation

- Calculated annually based on the outstanding principal
- Typically paid semiannually or annually, depending on the agreement
- For simplicity, assume annual interest payments in this context

Repayment Schedule

- Equal annual payments covering interest and principal (amortization)
- Alternatively, interest-only payments with a lump-sum principal repayment at maturity
- The exact schedule depends on negotiated terms

Collateral

- The property or assets pledged as security
- Ensures the lender's protection in case of default

Financial Implications for Lisa Ehrlich Inc.

Issuing a mortgage note impacts the company's financial statements and key financial ratios:

Balance Sheet Impact

- Liabilities Increase: Recognized as a mortgage payable under long-term liabilities
- Assets: The financed property or assets are recorded under property, plant, and equipment (PP&E)

Income Statement Impact

- Interest Expense: Recognized periodically, reducing net income
- Depreciation: If applicable, on financed assets

Cash Flow Effects

- Operating Activities: Interest payments affect cash flows
- Financing Activities: The receipt of cash increases cash flow from financing

Accounting for the Mortgage Note

Proper accounting ensures transparency and compliance with accounting standards such as GAAP or IFRS.

Initial Recognition

- Record the liability at the amount borrowed (net of any transaction costs)
- Debit cash for \$1,300,000
- Credit mortgage payable for \$1,300,000

Subsequent Measurement

- Recognize interest expense based on the effective interest rate
- Reduce the mortgage payable by principal payments
- Amortize any deferred transaction costs

Amortization of Discount or Premium

- If the note is issued at a discount or premium, amortize the difference over the loan term

Legal and Regulatory Considerations

Issuance of a mortgage note involves compliance with legal frameworks:

- Loan Agreements: Must be drafted clearly, outlining all terms
- Regulatory Compliance: Adhere to lending laws and disclosure requirements
- Covenants: May include restrictions on additional borrowing, maintenance of certain financial ratios, or reporting obligations

Strategic Rationale Behind the Financing

Lisa Ehrlich Inc.'s decision to issue this mortgage note likely stems from strategic considerations:

- Interest Rate Environment: A 9% rate may reflect market conditions or creditworthiness
- Long-term Planning: The 10-year term aligns with long-term asset utilization
- Debt-Leverage Strategy: Using debt can enhance return on equity when managed prudently

Risks and Considerations

While mortgage financing offers benefits, it also involves risks:

- **Interest Rate Risk:** Fixed rate of 9% may become less favorable if market rates decline
- **Default Risk:** Failure to meet payment obligations can lead to foreclosure
- **Asset Liquidity:** The collateral's value must be sufficient to cover the debt in case of default
- **Financial Covenants:** Breaching covenants could trigger penalties or acceleration of debt

Impact on Stakeholders

The issuance of this mortgage note affects various stakeholders:

- Shareholders: Leverage can enhance returns but increases financial risk
- Lenders: Receive interest income and security interest in assets
- Employees and Suppliers: May be affected if debt service impacts cash flows or operational decisions
- Community and Regulators: Ensuring compliance and transparency maintains trust and legal standing

Conclusion

The issuance of a \$1,300,000, 9% mortgage note by Lisa Ehrlich Inc. on December 31, 2020, exemplifies a strategic approach to financing that balances growth opportunities with financial discipline. Proper understanding of the terms, accounting treatment, and risks associated with mortgage notes is essential for stakeholders involved. As the company progresses through the 10-year term, diligent management of the debt, adherence to covenants, and transparent reporting will be vital to maximizing the benefits of this financing arrangement. This move underscores Lisa Ehrlich Inc.'s commitment to leveraging debt wisely to fund its long-term vision and operational needs.

Frequently Asked Questions

What are the key terms of Lisa Ehrlich Inc.'s mortgage note issued on December 31, 2020?

The mortgage note issued by Lisa Ehrlich Inc. is for \$1,300,000, with a 9% interest rate, and a 10-year term.

How will Lisa Ehrlich Inc. record the initial issuance of the mortgage note on December 31, 2020?

Lisa Ehrlich Inc. will record the mortgage note as a long-term liability at its face value of \$1,300,000, and recognize any related interest expense over the life of the loan.

What is the total interest expense that Lisa Ehrlich Inc. will incur over the 10-year period?

The total interest expense over 10 years is \$117,000, calculated as $\$1,300,000 \times 9\% \times 10$ years.

How should Lisa Ehrlich Inc. amortize the mortgage note over its 10-year term?

The company can amortize the mortgage using the effective interest method, recognizing interest expense each period based on the outstanding balance, and reducing the liability accordingly.

What journal entries are required on December 31, 2020, when Lisa Ehrlich Inc. obtains the financing?

The entry would be: Debit Cash for \$1,300,000 and Credit Mortgage Note Payable for \$1,300,000.

How does the 9% interest rate affect the periodic interest expense recorded by Lisa Ehrlich Inc.?

Interest expense each period is calculated based on the outstanding loan balance multiplied by 9%, adjusted for any amortization of premium or discount if applicable.

What are the implications of the 10-year term for Lisa Ehrlich Inc.'s financial planning?

The 10-year term provides a fixed repayment schedule, allowing the company to plan its cash flows and interest obligations over a decade.

Would the mortgage note be classified as a current or

long-term liability on Lisa Ehrlich Inc.'s balance sheet?

Since the note matures in 10 years, it would be classified as a long-term liability, with the portion due within one year classified as current liabilities.

Are there any covenants or restrictions associated with the mortgage note issued by Lisa Ehrlich Inc.?

The specific covenants or restrictions would depend on the loan agreement; common provisions may include maintaining certain financial ratios or restrictions on additional borrowing.

How does the issuance of this mortgage note impact Lisa Ehrlich Inc.'s financial ratios?

Issuing the mortgage increases liabilities, which may affect ratios like debt-to-equity and interest coverage, potentially impacting the company's financial leverage and creditworthiness.

Additional Resources

Lisa Ehrlich Inc. Issues a \$1,300,000, 9%, 10-Year Mortgage Note on December 31, 2020, to Obtain Financing

Introduction

In the world of corporate finance, securing suitable financing is a crucial step for business expansion, operational needs, or strategic investments. On December 31, 2020, Lisa Ehrlich Inc., a company seeking to bolster its financial position, issued a significant mortgage note valued at \$1,300,000 with a 9% interest rate and a 10-year maturity period. This move exemplifies a common approach businesses use to raise funds through debt instruments, especially long-term mortgages.

This comprehensive review delves into the intricacies of this mortgage issuance, exploring the motivations behind it, the key terms, accounting considerations, and implications for Lisa Ehrlich Inc. We will analyze the financial mechanics, the journal entries involved, and the broader impact on the company's financial statements and strategic outlook.

Background and Context

What Is a Mortgage Note?

A mortgage note is a legal document representing a loan secured by real estate or other collateral. It details the borrower's obligation to repay the loan under specific terms,

including interest rate, payment schedule, maturity date, and other covenants.

In this context, Lisa Ehrlich Inc. issued a mortgage note, which likely means the company used real estate or a similar asset as collateral to secure financing. The issuance of a \$1,300,000 note indicates a sizable borrowing, suggesting significant capital needs or strategic expansion.

Significance of the Timing: December 31, 2020

Choosing December 31, 2020, for the issuance aligns with calendar year-end reporting, allowing the company to reflect the debt on its financial statements for the fiscal year ending in 2020. This timing also allows easier integration into annual financial reports, audits, and tax considerations.

Motivations for Issuance

Lisa Ehrlich Inc. might have had several reasons to issue this mortgage note:

- Funding Expansion Projects: Acquisition of new assets, facilities, or equipment.
- Refinancing Existing Debt: Replacing or restructuring previous debt for better terms.
- Liquidity Management: Enhancing cash reserves or working capital.
- Strategic Investment: Supporting growth initiatives or entering new markets.

Key Terms and Features of the Mortgage Note

Principal Amount: \$1,300,000

The principal, or face value, of the loan is \$1,300,000. This represents the amount borrowed, which the company agrees to repay over the term of the loan.

Interest Rate: 9% Annual

The note bears an annual interest rate of 9%. This is considered a moderate to high rate, possibly reflecting the company's creditworthiness, collateral, or prevailing market conditions at the time.

Term: 10 Years

A 10-year maturity period indicates a long-term debt instrument, with repayment structured over a decade. Long-term debt provides stability and allows for substantial financing but also involves more extended financial commitments.

Repayment Schedule

While not specified explicitly, typical mortgage notes have:

- Monthly or quarterly payments covering interest and principal.
- Amortization schedule detailing how payments reduce the principal over time.
- Balloon payment at the end, if applicable (though less common in mortgage notes of this

nature).

Accounting for the Mortgage Note: Recognition and Measurement

Initial Recognition

On December 31, 2020, Lisa Ehrlich Inc. would recognize the mortgage note at its proceeds, which generally equal the amount borrowed minus any issuance costs.

Journal Entry at Issuance:

Account	Debit	Credit
Cash	\$1,300,000	
Notes Payable (Mortgage)		\$1,300,000

This entry reflects the inflow of cash and the company's obligation to repay the debt.

Recording the Loan

The mortgage note is classified as a long-term liability on the balance sheet, given its 10-year term. Over time, the company must account for interest expense and the reduction of the principal.

Interest Expense Recognition

Interest expense is accrued periodically, usually monthly or annually, based on the effective interest method:

$$\text{Interest Expense} = \text{Carrying Amount} \times \text{Effective Interest Rate}$$

Given the fixed rate of 9%, the interest expense for each period is straightforward to compute.

Amortization of the Loan

- Amortization Schedule: Defines how the principal is paid down over the 10 years.
- Interest Payments: Typically, interest is paid periodically, with the principal repaid at maturity or through scheduled installments.
- Effective Interest Method: Ensures interest expense reflects the true cost over the life of the debt, especially if issuance costs are involved.

Financial Implications for Lisa Ehrlich Inc.

Impact on Financial Statements

- Balance Sheet: Increases liabilities by \$1,300,000; increases assets if the borrowed funds are used to acquire assets.
- Income Statement: Interest expense annually at 9% on the outstanding balance, affecting net income.
- Cash Flows: Outflows from financing activities; interest payments are operating or financing cash flows depending on accounting policies.

Effect on Ratios and Covenants

Issuing long-term debt influences key financial ratios:

- Debt-to-Equity Ratio: Likely increases, indicating higher leverage.
- Interest Coverage Ratio: Must be monitored to ensure sufficient earnings to cover interest.
- Covenants: Loan agreement may include specific ratios or conditions that Lisa Ehrlich Inc. must maintain.

Strategic Considerations

- Cost of Debt: The 9% interest rate reflects the company's borrowing cost.
- Flexibility: Long-term debt provides stability but can limit flexibility due to fixed repayment obligations.
- Refinancing Risks: If market conditions change, refinancing at favorable rates may become challenging.

Detailed Breakdown of the Mortgage Note's Financial Mechanics

Amortization Schedule Example

Assuming monthly payments, the approximate calculations would be:

- Monthly interest rate: $9\% / 12 = 0.75\%$
- Number of payments: $10 \text{ years} \times 12 \text{ months} = 120 \text{ payments}$

First Month Interest:

$$\begin{aligned} & \backslash \\ & \$1,300,000 \times 0.0075 = \$9,750 \\ & \backslash \end{aligned}$$

First Month Principal Payment:

$$\begin{aligned} & \backslash \\ & \text{Monthly Payment} - \text{Interest} \\ & \backslash \end{aligned}$$

The total monthly payment can be calculated using the amortization formula:

$\backslash$

$$P = \frac{r \times PV}{1 - (1 + r)^{-n}}$$

Where:

- P = Monthly payment
- r = Monthly interest rate (0.0075)
- PV = Present value / loan amount (\$1,300,000)
- n = Total number of payments (120)

Calculating:

$$P = \frac{0.0075 \times 1,300,000}{1 - (1 + 0.0075)^{-120}} \approx \$17,003.01$$

Implications:

- Interest component: Declines over time as principal reduces.
- Principal component: Increases over time, with the total payment remaining constant.

Tax and Regulatory Considerations

Tax Deductibility

Interest expense on mortgage notes is typically tax-deductible, reducing taxable income for Lisa Ehrlich Inc., which can be advantageous.

Compliance and Covenants

The loan agreement might specify:

- Maintenance of certain financial ratios.
- Restrictions on additional debt.
- Requirements for collateral maintenance or insurance.

Reporting and Disclosures

Financial statements must disclose:

- The nature of the debt.
- Maturity schedule.
- Interest rate and payment terms.
- Covenants and restrictions.

Broader Strategic and Market Impact

Market Conditions

In December 2020, global economic uncertainty due to the COVID-19 pandemic affected credit markets. Securing a 9% rate suggests either specific risk factors or market conditions that justified this rate.

Risk Management

Lisa Ehrlich Inc. should consider:

- Hedging interest rate risk if variable rates are involved.
- Monitoring covenants to avoid defaults.
- Planning for repayment to prevent liquidity crunches.

Future Outlook

Successfully managing this debt can:

- Enable growth and expansion.
- Improve creditworthiness over time.
- Facilitate strategic acquisitions or investments.

Conclusion

The issuance of a \$1,300,000, 9%, 10-year mortgage note by Lisa Ehrlich Inc. exemplifies a strategic approach to financing through long-term debt. It involves careful consideration of interest costs, repayment schedules, accounting treatments, and strategic implications.

From an accounting perspective, this transaction increases liabilities and assets, influences profitability through interest expenses, and impacts financial ratios. Proper management of the debt, compliance with covenants, and strategic planning are essential for leveraging this financing effectively.

In a broader context, such debt issuance provides the necessary capital for growth and operational stability but also necessitates prudent financial management to ensure sustainability and profitability in the years ahead.

Note: For precise amortization details, tax implications, and covenant specifics, consulting detailed financial data and legal agreements is recommended.

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