Carving Your Niche
When venturing into commercial lending, understanding problem scenarios can help spur profits

By Mike Boggiano, senior vice president, national sales manager, Silver Hill Financial LLC

In commercial lending, certain borrowers or deals are often viewed as problematic. Thus, some traditional lenders and originators turn down these would-be borrowers. But a savvy broker working with the right lender can turn these scenarios into opportunities to attract an often-underserved segment of borrowers.

Residential mortgage brokers can use these “problem” situations to carve a successful business niche by matching the right commercial lender program with borrowers. Focusing in a particular niche can help position you as an expert to borrowers and referral partners.

Three distinct, interrelated areas are often considered problematic, by conventional commercial standards. Learning more about each can give you some insight into capitalizing on business that others might be turning away.

Self-employed borrowers
Many self-employed borrowers understate their taxable income by declaring losses and/or overstating expenses — anything to decrease income on which they’re taxed. Banks typically look at the bottom line or net income and use this figure to approve or deny a loan. Thus, hard-money or stated-income programs usually are these borrowers’ only viable financing sources.

By contrast, lenders who examine tax returns to figure a self-employed borrower’s realistic net income, resubmitting over- or understated figures, could approve more deals. For example, adding back any noncash expenses and negating any nonrecurring cash-flow items to the “bottom line” gives lenders a more accurate picture of borrowers’ annual income. Those using this approach might even qualify a self-employed borrower for loans with 90-percent loan-to-value ratios (LTVs), among other options and rates.

A program that examines borrowers’ global income when making credit decisions would be a good fit for many self-employed borrowers who are being turned away or who find unfavorable terms from traditional lenders.

Owner-occupied properties
Generally, traditional lenders have a limited appetite for financing small-balance-commercial loans. They prefer to invest in low-risk properties that have cash flow with a strong debt-service-coverage ratio (DSCR).

Consider an owner-occupied property, one in which the borrower’s business property resides. This property type also includes properties leased to a related entity with the majority of the underwriting qualifying income coming from the business the borrower owns.

Owner-occupied properties tend to be limited-tenant buildings, and the fewer the number of tenants, the riskier the property. In other words, it is more difficult to debt-service if one out of four tenants is lost than if one of 14 were lost. In addition, conventional lenders rarely debt-service these properties because only the nonowner-occupied units are generating rent.

Some consider owner-occupied properties a problem, but other brokers can look for a program that turns them into prospects. For example, a small-balance-commercial lender using a debt-to-income (DTI) underwriting approach would be a good fit to fund limited-tenant, owner-occupied properties. In some cases, the DTI ratio can even be stretched for a higher tolerance of approving the deal.

Underwriting approach
Conventional commercial underwriting examines the subject property’s ability to repay the loan by calculating its DSCR. With owner-occupied properties, traditional lending institutions usually only approve properties that generate more than enough income to pay the mortgage, insurance, taxes, maintenance and operating expenses.

Typically, banks look for a property to generate at least $1.20 in net operating income for every $1 in the proposed mortgage debt. If this ratio falls short, they will most often pass on the deal.

By comparison, a DTI analysis focuses on the borrower’s personal ability to carry the debt on the loan. This is the familiar method used for conventional residential mortgages. If a commercial mortgage were evaluated on DTI rather than the property’s DSCR, many rejected commercial deals would instead be considered and funded.

In addition to being an easier process for brokers and borrowers, a DTI underwriting approach has added benefits. First, a commercial lender with DTI underwriting can finance vacant properties or those with inadequate debt-service ratios.

For example, consider a property that needs renovation before it can produce income. With DTI, a strong borrower could get the funds needed for a profitable investment.

Second, in markets where values are high and cap rates are low, it is difficult for properties to generate enough cash flow to support a higher LTV. The higher the LTV, the higher the debt load, and the harder it is for rents generated to carry a high mortgage payment plus related property expenses.

The same scenario in a DTI analysis may yield an approved deal based on the borrower’s DTI ratio. This approach may even allow for 90-percent LTV in some cases — an impossible feat if relying on the property’s debt service.

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Look for a commercial lending program with an underwriting approach that does not focus solely on the property's debt-service coverage. For example, alternative lenders are more likely to offer a streamlined underwriting process that is similar to residential.

Equally important to understanding various scenarios and how you can help borrowers in the small-balance-commercial field is the broker training and support lenders provide, including marketing tools to reach key prospects and to grow your referral network. After all, if you are looking to create your niche in small-balance-commercial deals, you can speed your path to success by partnering with a lender that will guide you every step of the way.

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