The Allure of Small Balance

Efficient work and attention to detail can make lower-value loans worthwhile

By Paul Cleary

Illustration by Dennis Wunsch

Not every deal glitters like gold, but there's a gem of a story locked away in most commercial real estate transactions. Even the smallest transactions carry compelling tales of, perhaps, an ambitious borrower, or maybe a promising piece of property. Effective originators learn the story under the surface of every deal and tell it in a way that makes an effective case for their clients.

Many in the commercial real estate lending arena believe that originating and closing small-balance commercial real estate loans is harder and more complex than large-balance lending. In many ways, it is. Although the loan balances are smaller — typically less than $5 million — the information can be less accessible, the borrowers many times less sophisticated and the lenders sometimes less interested. Yet, the stories, and the wide array of scenarios at play among small-balance borrowers, are often more enjoyable than the task of dealing with larger loans.

Opportunity cost

For originators, there are ways to streamline the process as you develop or enhance your small-balance lending efforts. When evaluating a client-loan opportunity, think about whether it's really the right opportunity for you. Does the client have realistic expectations for financing? Do you have the potential relationships necessary to create a home for the loan? If the answer to these questions is no, it may be best for both you and the client if you pass on the opportunity.

You spend significant time closing a loan, small balance or not, and learning as you go may not be your best time investment, especially in small-balance lending where commissions are smaller. You can be the best originator in the business, but if the client has unrealistic expectations, or is not prepared, or is incapable of providing the information you need, you may find that the opportunity cost of pursuing the business is too high.

Effective communication

Technology has done wonders for business communication. E-mail, texting and file sharing increase the efficiency of information-sharing, but can also reduce your effectiveness if not managed correctly. E-mail attachments and shared files allow you to do, in minutes, tasks that only a few years ago would have taken hours or days. But the technological advantages can evaporate if you're forced to spend too much time sorting through information to discover what's there, and struggling with the message to learn what's really being communicated. Texting, for instance, is effective for communicating only the most basic information. Save it for setting up dinner plans, not for dealing with the details of a loan package.

But increasing the effectiveness of your communication can add to your profitability by

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reducing the extra time spent clarifying your communication. Include introductory paragraphs in cover e-mails, or a one-page summary of the information presented in the various documents placed into the file-sharing portal.

Remember, among the key items often omitted in loan information is the basic information about your deal, property or borrower. Put yourself in your reader's place, and point the reader in the correct direction. The result is likely to be faster decisionmaking and more closed deals, especially in small-balance lending where the loans are smaller and time frames are compressed.

A compelling case

Whether you're in a courtroom or a lender's office, you're arguing a case, and your chances of being persuasive improve if you can develop and present a compelling theory of the case.

Set the tone for your client by putting the loan application in context. Telling your client's story effectively is the most important part of the process. In a legal setting, this effort is critical, because a disorganized or deficient theory will probably result in a disorganized, lost case. In a lending situation, a disorganized presentation of the loan request will probably end up in a disorganized loan process and, ultimately, a negative decision from the lender.

To develop your theory of the loan, present the answer to three questions. What has occurred already with the investment (in relation to the borrower and the property)? Why did it occur? Why does the loan request make sense?

In preparing your loan summary, think about how best to communicate the facts as they relate to your client. Many times, in determining what has occurred with the investment, your client will only know a piece of the story. For example, what is the expected current appraised value of the property? Do you have the resources to check this expectation? Because the value is closely related to the net operating income of the property, you need to run the numbers yourself to assist your client in determining the size of the loan request and probable debt-service coverage.

In many small-balance loan requests, especially those where the property or the sponsor has challenges, it can be helpful to understand and explain the history of the property, as well as the background of the sponsor and the loan profile itself.

This is not simply a presentation of facts. After all, human decisionmaking is at the core of the loan- application process. Understanding the "why" places the underwriting facts in context and improves potential lenders' understanding and comfort in approving a loan. Without the "why," lenders can only rely on their own experiences to fill in the gaps, which may not fairly serve your client.

Even if you establish that the loan meets a lender's parameters and the narrative supports the information presented, your job may not be completed. An advocate also must show that the client can support the loan and that the risks are mitigated.

Just saying it won't make it so. The commonplace example of this is the "good property, strong borrower" platitude that accompanies many loan requests. After demonstrating your knowledge of the loan and the background of the financing, think about how the not-so-great facts are mitigated by the great facts. Again, you have the opportunity to control not only the first impressions but subsequent impressions along the way. Continue to support your view of the loan's value by supporting its wisdom.

Smooth running

One unique aspect of small-balance lending is the heightened volumes of loans required to make the lending machine work. The volume of loans that need to be moved requires effectiveness in reviewing the information in the right order and at the right time.

Every lender is expected to perform some level of due diligence — some do more, some do less — and it is not feasible or productive to present every potentially necessary piece of information at the inception of the loan request. Data dumps will simply overwhelm decisionmakers and may muddle the positive aspects of the loan request.

Organize and simplify. Highlight the positives, but don't ignore the negatives. The evidence that the lender will review or uncover during the course of due diligence should be in line with the theory you have presented. We all know how difficult it can be to un-ring the bell when facts do not line up with the theory presented, or when the information presented is trivial or confusing.

In reviewing your loan opportunity and presenting a clear case for your loan to be approved, consider the following:

- Is this a cash-out request on a recent purchase?
- What is the title history?
- Are there credit issues that need to be reviewed with the client before presentation to a potential lender?
- What is the loan structure you would recommend that best fits the client's business plan?
- How will you be paid for your efforts in closing this loan?
- Do you understand the cash flows of the property and the borrower's financial position?
- What potential character issues are there that the client may present?

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The march of technology continues to provide new tools for discovering and delivering information with ever- increasing speed, but not necessarily increasing clarity. As you think about your business, it may be helpful to identify ways to increase the effectiveness of your communication and the presentation of your loan requests to help you drive profitability. Even though the pace of business has increased and made direct, personal communication less prevalent, there is always the old-school telephone. A two-minute phone conversation can often provide more clarification than a dozen back-and-forth e-mails, saving time for brokers, borrowers and lenders. With adequate time and the ability to put together a compelling case for your client, you're positioning yourself for success in small-balance lending. ■

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