

Find the Best Alternative

Do your homework and choose the lender that's best for the borrower and the deal in front of you

By Mark Fogel

Are you a commercial mortgage broker representing a middle-market real estate investor who has identified a prime opportunity to acquire a property that has little to no cash flow, yet the property has the elements of a "home run" investment upon stabilization? Is your client's prospective property located in a secondary or tertiary market, or is the client's credit history tarnished? Is the borrower looking to avoid recourse loans or does the client need financing with a loan-to-value ratio in excess of 75 percent to make the deal work? Is there significant rehabilitation or leasing required to capture the cash-flow upside of the property?

As a broker, if your client answers yes to any or all of these questions, you are likely finding yourself incredibly confused about the options for obtaining debt financing for the project. Since the Great Recession, the commercial real estate debt markets have been in some degree of turmoil, particularly in areas outside of the large gateway cities and in the case of loans on transitional assets valued at less than \$35 million.

This turmoil has been amplified by the retraction of the commercial mortgage-backed securities (CMBS) loan market, regulatory pressure on smaller banks and rising interest rates. Consequently, many investors, and the brokers they retain, face the prospect of having to navigate a complex array of alternative lenders to refinance and acquire properties.

Required research

In many cases, finding the right alternative lender for the borrower's project depends on the location, type of property and the



planned use of the loan proceeds. Alternative lending is extremely fragmented in the middle-market space — generally defined as midsize to small markets where acquisition deals typically involve commercial assets valued under \$50 million.

Lenders operating in this space generally have a specific focus and do not veer much from the desires of their respective capital partners. For that reason, borrowers involved in complex and transitional situations or deals are wise to turn to a mortgage broker.

Good mortgage brokers spend a significant amount of time researching lenders and understanding their lending programs, sources of capital, the strength of their platforms and their past performance. Commercial mortgage brokers who do their homework almost always earn their fees. They streamline the process of identifying the right lenders and then typically provide those lenders with a well-vetted loan request with all of the necessary information to get a rapid response.

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Mark Fogel is president and CEO of ACRES Capital, which he founded in 2012. Since then, ACRES portfolio has grown to over \$600 million in assets under management, and the company now employs 21 real estate professionals operating in three offices nationwide. Fogel has over 20 years of experience in commercial real estate finance, with a particular focus on providing developers and entrepreneurs with innovative debt and equity solutions. Fogel holds a Bachelor of Science degree in accounting from the University of Delaware and a Master of Science degree in real estate investment and development from New York University. Reach him at mf@acrescap.com.

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Capital sources

It is imperative that you understand the lender's origination, underwriting and decision-making processes. The relationship between a lender and its capital sources is typically the driving force behind the process of going from the initial loan submission to loan closing to loan servicing.

If you detect hesitancy from a lender when asking questions, you should dig deeper. Any reputable lender should be forthcoming and very willing to provide this information.

In some instances a lender may be nothing more than a correspondent for a variety of third-party capital sources, such as banks, insurance companies and pension funds. There is no committed capital behind these lenders. There is merely a fee arrangement that is earned on a deal-by-deal basis.

A correspondent using outside capital has almost no control of the actual process and eventual outcome. Although balance-sheet lenders or lenders with committed capital typically have that control, it is still important to understand the contractual relationship between the lender and its capital sources. Alternative lenders do not operate like banks, and there is no norm when it comes to their platforms and processes. Understanding these lender nuances is imperative before pursuing a financing deal.

Multiple interests

Many of the alternative lenders and their capital partners use various financial engineering techniques to boost returns. As opposed to a typical bank loan, which normally stays on the balance sheet of the bank through maturity, an alternative lender may securitize or sell all or portions of each loan. This process not only enhances returns, but expands the capacity of the lenders to make more loans. Additionally, it spreads risk among the loan participants and investors.

Although this may sound harmless to you as a borrower, it can make it more difficult to get a decision on anything related to your loan and also messy if you default on that loan. Once the loan risk is spread among various parties, including secondary-market investors, the decisionmaking is taken out of the hands of your lender and put in the hands of the governing documents. There is typically no latitude afforded to the originating lender.

In such situations, determining solutions for defaulted loans is rarely straightforward. The various players with a stake in the loan's fate can impede what the borrower deems as the optimal courses of action to work out the problem. If your client's mortgage will require significant input from the lender on a regular basis — draw requests, lease approvals, etc. — and the borrower eventually wants more flexibility, then stay away from lenders who don't control 100 percent of the loan stack.

Ultimately, a broker working for a client that is operating in the middle-market space must face the harsh reality that this is a difficult lending environment to navigate. Gone are the days when you could pick up the phone and call five local banks to find a loan that fits the client's needs. With a bank, you typically understood the process, players and decisionmaking. Not so with an alternative lender, because no two are the same.



Alternative lenders all have their strengths and weaknesses. It is essential to determine what attributes of a lender and loan are most important, and then do your research on behalf of the borrower. A broker who fails to do the required homework can make things significantly more complicated for the client.

Eventually the tide will turn, and the lending environment will improve. It always does. Until then, educate yourself on the alternatives available and make smart choices. Don't let the pressure lead you to take shortcuts, like choosing the best rate over the best lender. You and your client may pay for it in the end. ■