Don't Fret Over a Bank-Loan Turndown

Hard money and related niche loans can solve problems for complex borrowers

By Emily Landgraf

What do you do when your borrower is declined for a commercial mortgage loan at a bank? This is a question most commercial mortgage brokers are going to face at one time or another, since there are many small-business owners who will not qualify for traditional financing.

It might seem that after a bank turns down a loan request, a borrower's options are very limited. To some commercial mortgage brokers, hard money might appear to be the only alternative.

In fact, this isn't the case. Although some commercial borrowers are going to be limited to hard money loans because of poor credit, seasoning issues and a variety of other factors, there are plenty who can qualify for a mortgage that combines the characteristics of bank and hard money loans. It's important for brokers to understand their clients' financial situation as well as the type of loans they'll qualify for.

Hard money defined

Hard money loans are a type of asset-based financing through which your borrower receives funds secured by a commercial property, generally at a high interest rate. These loans are typically interest-only products and tend to be short-term solutions — one or two years — with a balloon payment at the end.

Borrowers requiring a hard money loan often have experienced a distressed financial situation, such as a bankruptcy or foreclosure, which has damaged their credit. Interest rates are usually at least 12 percent and can often be much higher because lenders are taking on more risk with a hard money borrower's situation. The other costs of a hard money loan also tend to be higher, with lenders charging as much as 10 percent to close the deal.

Hard money loans aren't cheap, but they do fill a void in the small-balance commercial mortgage market. So, it's important to be able to recognize a borrower who will only qualify for this type of deal and to select the right hard money lender.

When it works

If your borrower's credit scores are particularly low, a hard money loan might be the only option. Hard money loans can be a way for borrowers in financial trouble to obtain the funds they need while reestablishing a positive payment history. As a broker, it's important to encourage your borrowers to make their payments on time and to keep records of these payments, since most hard money lenders don't report them to the credit bureaus.

Seasoning issues also can keep a borrower from qualifying for a mortgage from a bank or some private lenders. Generally speaking, if your borrower has owned a commercial property for less than two years, the individual will run into issues with seasoning. In this case, a hard money loan could be the right solution as these types of lenders usually don't have seasoning requirements.

Borrowers who need a bridge loan and are planning to sell their property to pay it off also are potential candidates for hard money financing. Bank loans and some private-money mortgages are usually longer-term loans with prepayment penalties, so a hard money loan that can be paid off quickly without incurring additional fees is your borrower's best bet in this situation.

Another case in which your commercial borrower may need a hard money loan is for a purchase-and-rehab property. Few banks are willing to provide financing to borrowers looking to rehabilitate small commercial properties, and even many nonconforming lenders shy away from these situations. If your borrower is looking to purchase a commercial property with the intent to fix it up and sell it, a hard money lender is going to be a good source for obtaining the necessary funds.

Finally, for some borrowers who need a commercial mortgage in a very short time frame, waiting for a bank loan to close simply isn't an option. Commercial hard money lenders are known for closing deals quickly and, in the right situation, a borrower will think it's worth the extra costs.

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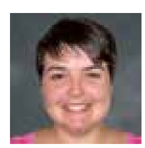

Emily Landgraf is the social media coordinator at APEX Mortgage Corp. APEX is a nonconforming national lender that specializes in small-balance commercial mortgages ($25,000 to $1 million). APEX excels in understanding the credit and income nuances of the self-employed. Learn more about APEX at apexmtg.com. Reach Landgraf at (800) 262-2739, ext. 211, or elandgraf@apexmtg.com.

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Hard money loans are a great option for some commercial borrowers. There are other options, however, for small-business owners who cannot qualify for bank loans but are looking for something relatively inexpensive and stable. For the borrower between a bank and a hard money place, there's another option.

Pursuing the alternative

Nonconforming commercial lenders with rates and terms in between those of banks and hard money lenders are a great option for many small-business owners looking to refinance or purchase a property. This niche is still relatively underserved, but there are lenders who are willing to work with nonbankable borrowers and their commercial mortgage brokers to create long-term financing solutions that benefit all parties involved.

So, how can you tell if a borrower can qualify for alternative financing that isn't hard money? Your borrower's credit history is going to be an important factor.

If you're working with a borrower whose scores disqualify them for a bank loan, but they aren't necessarily low enough to necessitate hard money financing, your borrower could obtain an alternative nonconforming commercial mortgage. It's also important to note why their scores are too low for bank financing. If your borrower has recent late mortgage payments, they'll likely only be able to obtain a hard money loan. Credit issues stemming from medical emergencies or financial problems unrelated to their business, however, are obstacles that some nonconforming lenders can work with.

If your borrower is looking for long-term financing, a nonconforming commercial mortgage with the right lender is a great choice. Many borrowers don't want hard money loans, which require a fast exit strategy as the loans tend to balloon within two years. For borrowers seeking a more secure and consistent financing option, an alternative small-balance commercial mortgage could be a good solution.

Commercial mortgages from nonconforming lenders also can function as an exit strategy for borrowers who currently have a hard money loan. Once the borrower has reestablished a positive payment history and improved their credit, they're more likely to qualify for one of these in-between loans with a private lender. Refinancing a hard money loan with an alternative small-balance commercial mortgage will put your borrower on more secure financial footing.

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Although there are some commercial borrowers who will require hard money financing, there are nonconforming lenders with alternative products that will be a better fit for some of your clients. As a commercial broker, it's important to be able to distinguish when a hard money loan will be the best fit and when your client can qualify for something in between a bank loan and hard money. Understanding your nonbankable borrowers and the type of commercial mortgage that suits their needs will allow you to place deals with the right lenders, which in turn will lead to more closed loans and additional broker income. ■