The Times They Are a-Changin'

An altered real estate landscape has created new hard money opportunities

By Yanni Raz

Hard money lenders have seen dramatic changes in recent years. There was a time when the industry was just a small segment of real estate financing.

Incredible profits were made in past years by lenders and borrowers, but the real estate marketplace has changed. With those changes, the perception of hard money lending and its purpose in the industry have altered considerably, as well.

Change doesn't always have to be a bad thing, however. Hard money lenders should be aware of the changing real estate landscape, how uncertainty is impacting the lending process and which practices can help protect capital investments. To assist in this, let's go over a few of the dynamics that have changed hard money loans.

Real estate volatility

Property prices have risen since the real estate market fell into oblivion, but that doesn't mean we are enjoying a stable marketplace. Volatility is still historically high, and lenders and borrowers need to understand the risks. Prices are up, and it has certainly seemed like a seller's market of late. But many property owners are still teetering on the edge of default, creating a marketplace that features motivated sellers and capable buyers.

Sounds great, right? It can be, provided buyers consider appraisal prices versus historic market prices. Until things settle down, expect hard money lenders to take a wait-and-see approach. Market volatility increases risk, and because the goal is to generate gains while protecting capital, this development is, without a doubt, a sound strategy.

Tightening LTV standards

Hard money loans used to be readily available to any property investor interested in assuming the risk. But as these loan types increased in popularity, many lenders began tightening the purse strings a bit. Some point to lessons learned over time because, despite popular belief, lenders do not want to seize properties due to default. Unfortunately, such situations do occur, leading many lenders to tighten loan-to-value (LTV) ratios on loans they are making.

This change hits property flippers the hardest, and they are quickly learning they have to subsidize improvements on their locations through other channels. The LTV varies from lender to lender, but in many markets borrowers are finding that competition for investment capital is reaching a fever pitch, and the impact can be felt across the industry.

Lender-criteria changes

Remember when all an investor needed to acquire hard money capital was a location and a dream? Well, those days are long gone.

Today, hard money capital investors are interested in the long-term income prospects of a particular property. Many of these lenders consider what they could do with the location if default occurs. But this key component also helps the borrower. By inquiring about the long-term income value of a location, lenders and borrowers can adequately assess the investment opportunity. In some cases, this uncovers oversights that prevent lending and borrowing disasters.

Competition is great for any industry. But in this case, mortgage brokers need to understand it is creating a situation where they must fully understand that borrowers and hard money lenders have to do their due diligence before agreeing to finance an endeavor.

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For the hard money lending industry, 2014 was a game-changer where investors witnessed increased market volatility, while simultaneously seeing a tightening of borrowing requirements. All of these changes, when viewed in the proper light, appear to be great for lenders as signs of a maturing industry.

From a lending perspective, strict guidelines on opportunities can further protect investment capital. From a borrowing perspective, the tightening of purse strings can help property investors avoid disastrous situations.

Although this volatility will likely continue through third-quarter 2015, one important fact remains: Large banks continue to be frugal, fueling opportunities for hard money lenders and property investors alike. ■

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