Lenders May Change Their Minds

Understand the reasons behind shifting commercial real estate deals

By Eric Thomas

Commercial mortgage brokers can't always be sure that private lenders will deliver on their promises and close on the deal. It is a frustrating problem. The broker may believe they have a deal and they may even hold a piece of paper in their hands that says the lender will fund the commercial real estate loan.

Brokers are often told, "Of course we can do that." Six weeks later, however, the lender loses interest in the deal or drastically changes the initial terms. Have you ever wondered why?

Investors drive the bus

Deals often fall apart because the decision to fund is not entirely up to the lender. People might not understand that many lenders use a combination of investors and banks to provide much of the money that will be lent to the borrower. This mixing of money forms the capital stack. When "Lender XYZ" says they are a direct lender, you might assume it's their money. What you don't know is that their capital consists largely of money from other entities.

The funds for a specific loan may come from many different investors. Each may have their own loan-eligibility criteria. The warehouse lender provides the private lender a line that is generally dependent upon a takeout from one or a combination of end investors. This may be an asset-management firm representing dozens of clients; an aggregator intending to securitize the loan as part of a larger offering; an institutional bank potentially syndicating the deal to other banks; a real estate investment trust (REIT); or an insurance company looking for yield.

The loan may depend on four or more layers of investors that provide the money for the loan. If any of these entities doesn't like the deal, your loan doesn't get made. It also should be noted that each of these layers is making money at your client's expense. This is why the mortgage broker often gets rate quotes of 9 percent or higher even when the borrower and subject property appear to warrant a lower rate.

Deals also may fall apart for a more subtle reason: The lender is making decisions based on the lending criteria from their investors, but investors frequently change their policies. An investor, for example, may decide to veto a loan if the property is occupied by a restaurant. If just one of the end investors changes criteria during the process, your pricing could be affected or it may even kill your deal.

Finding the right lender

Most lenders have a fairly basic capital stack. They finance and sell loans to just one entity. If that entity changes its policies or stops buying loans, however, it can impact every loan in the lender's pipeline. Lenders with better structures, conversely, have multiple financing outlets with several channels that enable them to sell loans as required.

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A commercial mortgage broker's best strategy is to find a lender they can trust to make a firm decision. That lender needs to have the power to make the decision whether to fund the loan. Good lenders will vet the deal at the beginning of the process. The most reliable lenders will have many funding avenues open to them, and will commit to funding the loan with their own money once they have issued a letter of intent to do the deal.

Definition:
Capital stack

The capital stack describes how a transaction is financed. Most commercial real estate acquisitions or developments receive investments from more than one source, and from investors with different goals. The two main categories in the capital stack are debt and equity. Most commercial real estate deals use both kinds.

Source: ArborCrowd

Good lenders also provide clients with one point of contact, ensuring that brokers get accurate information. The lender may, for example, regularly conduct conference calls with underwriters prior to issuing a letter of intent to fund the loan. They will keep brokers and borrowers informed about the underwriting process, and about what is going on behind the scenes with their own investors.

Experience also matters. Brokers often complain that lenders don't understand their clients' needs, particularly with respect to commercial loans of $5 million or less. Many lenders either started out as residential real estate lenders or as larger commercial lenders. They may believe in a one-size-fits-all residential lending model, or they may think that certain loans are too small to customize to clients' needs.

If a broker is trying to find a commercial real estate loan of less than $5 million, he or she should go to a lender with experience in small-balance loans. Commercial lending is never a take-it-or-leave-it proposition, because no two loans look identical. Brokers are best served by a lender who can say "yes" to many different scenarios while providing speed and flexibility. A lender should be a type of company that can fund a commercial loan for a foreign investor, or do a quick close within days on an office-property loan, for example.

It also should be noted that good lenders are not afraid to say "no." Many approved deals aren't worth the paper they are printed on. For mortgage brokers, the best thing in the world is a fast "yes" from a lender, followed by quick funding. The only thing that comes close to that is a four-minute "no." If a lender can't do your deal, they owe the broker and borrower the professional courtesy of not wasting their time. The best lenders will tell you immediately when they have to say "no." ■

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