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Private Commercial Mortgages. February, 2008

David Barnett

For those of you who have been following my column, I wrote last summer about commercial mortgages and, in particular, conduit lenders. With the meltdown of the sub-prime mortgage market in the US, a chilling effect has taken hold of the credit market everywhere. In some cases, it is getting harder for most to borrow money.

Imagine a scale from A to D where the people at the A spot are the most desirable borrowers and people in the D space have a history of payment issues. During the heyday of lending (about a year ago) institutional lenders were able to move further and further down the scale and lend to riskier clients because they could sell off the loans to investors. This gave the lenders at the top and middle of the scale access to more customers who were traditionally outside their lending criteria.

The people who were really hurt by this are the lenders who normally cater to the clients at the worst end of the scale. As most people know, if you are going to take a risk, you need to be rewarded. Traditionally, lenders who make the riskiest loans charge the highest rates and are always concerned about defaults. Now that the credit market has moved back to being more normal (maybe even more conservative than normal) the high risk lenders are staking out more of their traditional territory.

You can recognize some of these lenders by the following labels: private mortgages, private funds, hard-money loans, etc…

Generally, a mortgage from one of these lenders will feature the following:

Points. This is an upfront fee that is either added to or subtracted from the loan amount. Ie. You get a $90,000 loan and the mortgage on your property is actually $94,500. You have been charged $4,500 in fees that will be paid when the loan is repaid. If you do the math, this would be 5 points or 5% of the sum borrowed.

Higher Interest. Don't expect to find one of these types of loans for less than 12% interest.

Low payments. Borrowers who need these loans are usually in some type of difficulty and are trying to restructure or make changes in their business. Lenders help out by typically asking for interest-only payments. Given the example cited above, the payment would be $945/m.

Short terms. The term of these loans is usually 12 months, sometimes 24. If you haven't found a new solution by the end of the term, expect more fees to renew.

Low LTV. Don't kid yourself. These lenders know that if you could get your money elsewhere, you would. Therefore they are always a little paranoid about foreclosure. This means they need to protect themselves in case they need to take the property and sell it. In order to ensure enough value, don't look for more than 60-65% of the property's appraised value. Some lenders may allow you to pledge equity in other properties to gain access to more funds.

Who are these loans for? Well, companies that have had a hard year and get their mortgage called by their banker. Sometimes traditional lenders might not believe in a project such as converting an old industrial building into condos. A hard-money lender may like this kind of thing. If you're going to borrow money to fix up a house and sell it, don't ask a bank for a 3 month mortgage. It's not worth their while to do the paperwork on something like that. A private borrower, however, may specialize in this sort of thing.

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