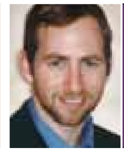

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Hard Money's Not What It Used to Be

Underwriting criteria is tightening for these loans, even as demand increases

As commercial mortgage brokers know, gone are the golden days of easy underwriting and fast credit. Many hard-money lenders are no longer in business, and most of those that remain have substantially changed their underwriting criteria. Deals that used to close are no longer fundable.

What does this mean for commercial mortgage brokers that have survived thus far? Brokers who want to be successful in today's market need to know what hard-money deals will get funded — and what won't.

It is important to understand the root causes of the turmoil in hard-money financing. There are four primary causes to the meltdown:

1. **Bad loans:** Many lenders made fundamentally bad loans on the wrong type of collateral. They often thought the market would continue to increase and therefore marginal loans would be fine. The essence of hard-money financing is lending on the quick-sale value of the real estate. Hard-money lending's default rate is traditionally greater than conventional financing, and lenders must be prepared to own the real estate if the note is not paid. Many lenders got away from this model, however.
2. **No movement in loans:** Traditionally, hard money is intended to be a bridge into either a property sale or refinance into conventional lending. Unfortunately, because of the economy, most hard-money borrowers cannot sell or find alternative financing. This has tied up capital that lenders could use for other projects.
3. **Deterioration in values:** Few people accurately predicted such a steep drop in values on commercial properties. The drop in prices has led to strategic defaults and foreclosures.
4. **Lack of capital/leverage:** In the boom years, it was easy for lenders to leverage their money to increase returns and lending capacity. It is no secret that most lenders are now cash-constrained. Under the old model, hard-money lenders could typically use the secondary markets to sell their loans and turn their cash. They could then use this cash to make new loans. Because of the tightened economy, most lenders now fund with cash, a group of private investors or via a fund, all of which has dampened their lending capacity.

All these factors have forced hard-money lenders to re-evaluate their business models. Many lenders have dropped out of the market, and those that remain have changed dramatically. The remaining lenders in the hard-money arena are adapting to the new market dynamic. These adaptations include changes to underwriting criteria, programs and their lending areas.

This tightening includes changes to:

- **Loan-to-value ratios (LTVs):** Gone are the days of high-leverage transactions. Most lenders today require borrowers to have substantial skin in the game. The typical LTV is 50 percent to 65 percent for hard-money transactions.
- **Property valuation:** Lenders are conservatively evaluating properties based on the quick-sale value. For commercial properties, lenders are using higher rates of return (capitalization rates) when evaluating the income approach of the property. Today's cap rates range from 10 percent to 12 percent for most properties.
- **Property types:** Lenders are looking for good, clean deals. Few are still doing development deals or large land transactions. Most are focusing on investment single-family homes and income-producing commercial properties (e.g., office, retail, light industrial and multifamily).
- **Credit scores:** Some hard-money lenders have started setting minimum credit scores for their programs. Others have not set minimums but are looking more closely at credit for red flags like recent bankruptcies, items turned over to collection, etc.

Along with tightened lending standards, many lenders have fundamentally changed their product offerings. For example, many lenders used to offer programs between the hard-money product and the more-conventional bank product. Most of these programs are no longer available, including stated and light-document programs. The markets tanked, and the secondary markets no longer have an appetite for these products. There are a couple of outfits attempting to do a stated commercial product, but most of these products are almost full-document programs. They need all the financials, appraisals, etc. This is basically the same information needed

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for a full-doc loan except the rates are substantially higher.

Many lenders have also pulled back on their lending areas and now focus on their home lending areas. There are few truly national hard-money lenders left. Many have picked their key markets and are focusing their resources there, because they understand the nuances of their home market best.

Just as bank standards have tightened, forcing more people into hard money, hard-money lenders also have tightened their standards. These changes are challenging for mortgage brokers and their clients.

There are still deals funding via hard money, however. The key for mortgage brokers is to understand the changes and work on deals that fit the new parameters. Brokers who can master this model will continue to gain market share even in a tough economy.