

## Increasing your success through Commercial loans (Part 2)

By: Jeff Long, CPA

This article is a continuation of the information in the previous issue of the Journal. By now hopefully you are aware that our company, Financial Resources, makes residential loan originations and can help you make money as outlined in my previous articles. However, in this article I want to explore commercial loans and how you can make the BIG money!

Financial Resources, is a full service residential and commercial mortgage company. We have been in business since 1989. The main office for the company is in New Hampshire and there are branch offices in Oklahoma and many other states. I have worked out of the Oklahoma office for the last 11 years. Recently, I was transferred and promoted to the main office in Meredith, New Hampshire, as the Director of Commercial Lending & Private Mortgages.

There is a lot to know about commercial loans that is why it is my goal to make it easy to understand. Thus to open up new horizons for you in this new year I will explore the many facets of commercial loans in a series of articles. In this article I will continue with the basics so you can have an overall understanding of commercial loans and increase your confidence level when you find a commercial deal. In future articles I will explore how commercial loans are underwritten and show you how to recognize a good commercial deal from a bad commercial deal. I will also give you some marketing ideas on how you can find good deals and make the big money. Throughout some of the articles I will provide you with some case studies to show you the full loan process. I now want to explain the two categories of loans, commercial purchases and commercial refinances. For all commercial loans are considered to be either a "Purchase" or a "Refinance" or a variation of both as in the case of some construction loans.

**COMMERCIAL PURCHASES:** Any real estate transaction that involves the transfer of ownership in a property is considered a purchase. The key underwriting factors in purchase deals include: the property information, the credit of the borrower, the down payment as a percentage of the purchase price and the ability to repay the debt.

**COMMERCIAL REFINANCES:** Any real estate transaction that involves paying off existing debt, taking cash out of a property and paying for improvements or rehabilitation is considered a refinance. The key underwriting factors in refinance deals include: the property information, the credit of the borrower, Loan-to-Value (LTV), and the borrower's ability to repay the debt. Some refinances are just "Rate and Term" refinances, meaning that we are only paying off the existing debt on the real estate and the closing costs. This would be in contrast to a "Cash Out" Refinance where the borrower is taking some cash out of the property for one reason or another.

Now that we have explored the two categories of commercial loans I will now address the three main types of commercial loans.

The three major types of commercial loans:

No two commercial loans are exactly alike. There can be slight differences or vast differences from one loan to the next. However, most loans can fit into one of the following loan types: (1) Grade “A” loans which include bank loans, conventional loans, SBA loans and HUD (Housing and Urban Development) loans; (2) Grade “B-C” loans which include stated income loans, weak credit loans, unique property type loans, private mortgage simultaneous closes and many other loans that fall outside the standards of Grade “A” loans; (3) Grade “D” loans which are typically known as hard money loans or bridge loans. Please note that other mortgage companies might have other ways of classifying types of loans, however, Financial Resources believes this is the most common form of classification. When you submit a loan to a company such as Financial Resources it is important for you to express your opinion as to what kind of loan you think you are sending.

Marketing Idea!!! Why would someone bring a loan to you instead of a local bank? The keys are the faster service, the program flexibility and higher loan-to-value that you can offer through lenders like Financial Resources. It can take banks from 15-45 days to issue a loan approval where as Financial Resources typically can issue a loan approval in 5-7 days. Banks often require their borrower to pay for a multi-thousand dollar appraisal prior to issuing a loan approval. Then once the appraisal is completed, then the bank starts underwriting the loan. We continue to hear horror stories about this bank practice, because some borrowers actually get turned down for having weak credit or low income or some other easily identifiable item after they paid for an appraisal. To offer better service to our borrowers, Financial Resources believes that we should clear all of the obvious hurdles such as borrower qualifications, credit, income, down payment, and property appearance up front. Then once these issues are cleared and approved, then it is time to order and pay for an appraisal. In regards to program flexibility, if a borrower doesn’t fit one program, we have the ability to switch that borrower into another program and close the loan. In contrast, banks typically do not have many program options. Thus when a borrower gets declined for a bank loan, the bank typically doesn’t have an alternative. Thus the borrower ends up wasting their time with the bank and then has to start over with another lender. In regards to Loan-To-Values, Financial Resources quite often is able to offer 5-15% higher LTV loans when compared to the same approval given by banks. Thus by mentioning the information in this paragraph to all of your commercial prospects, you will be able to sway some of your Grade “A” borrowers and many of your Grade “B-C” borrowers and most of your Grade “D” borrowers into bringing their loan to you instead of a bank.

GRADE “A” LOANS: This type of loan has the most stringent underwriting standards that have to be satisfied. If all underwriting parameters are not met then most likely the borrower will not qualify for a Grade “A” loan. In future articles I will explore the key underwriting concepts that in varying degrees apply to all loans. The key underwriting concepts not in any particular order are as follows: the property type, determination of the actual the property value, the appearance and location of the property, the use of the property, the income generated by or at the property, the Debt-Service-Coverage-Ratio (DSCR), the borrower’s credit, the Loan-To-Value (LTV), and the amount and source of a down payment or equity. I will now explore the main kinds of Grade “A” loans.

Conventional Grade “A” loans: This would be for properties such as: Apartment complexes, office buildings, shopping malls, warehouses, mini-storage, hotels and many other types of quality properties. Grade “A” loans for borrowers who wish to purchase a property should have at least the standard 10%-30% down payment and the property income should be fully

verifiable through our review of the SELLER'S tax returns for the previous 2 years. Additionally, the loan amount and payments should fit a 1.15 to 1.50 debt service coverage ratio depending on the property type. Our interest rates will then range between 6-10% on an adjustable or fixed basis with amortization terms between 20 and 30 years. With this type of loan we are typically competing directly with local and national banks thus the profits are slim.

SBA (Small Business Administration) loans and SBA Look-a-Like loans: Financial Resources uses this loan program on many loans. SBA loans are perfect for many borrowers and their situations. SBA loans are only for commercial real estate properties where the borrower will owner-occupy at least 51% of square footage of the building. We also have what is called an SBA Look-a Like program that has more aggressive parameters whereby the property only needs to be 20% owner occupied. The remaining building square footage can be leased to tenants for additional income. Thus an owner-occupied restaurant or an owner-occupied dry cleaner are properties that would qualify. Conversely a multi-tenant strip mall or a multi-tenant office building where the borrower is not occupying at least 20% of the space, would not qualify. SBA loans can be used for property acquisitions, expansions, or rate and term refinances. Typically, SBA rates are adjustable and tied to the Prime rate. The most common SBA interest rate is prime+2.75% over a 20 to 25 year amortization with no balloon. The maximum loan-to-value on an SBA loan is 90% with a 10% down payment. However, some property types or loan sizes will not qualify for 90% LTV thus the borrower may need a 20-30% down payment.

Business Loans (no real estate): Under some extremely narrow parameters, we can make a business loan to a borrower. The loan would not be secured by real estate. The loan is an SBA loan that requires that the business be owner-operated. The minimum borrower credit score is 640 and the income must be fully verifiable. The borrower must have at least 20% down and the minimum loan amount is \$250,000.

HUD loans: For loan amounts greater than \$2,000,000 and ONLY for apartments, nursing homes, assisted living facilities and mobile home parks the 85-90% LTV HUD loan might be the answer. HUD will finance up to 90% of the cost to construction or rehabilitate a property at some amazing terms. Thus a borrower who wishes to build a \$2,000,000 to \$100,000,000 apartment complex can go through you to get the job done. If a borrower wants to purchase an existing property or refinance an existing mortgage on a property he already owns then the 85% LTV HUD loan offers some hard to pass up incredible terms. The typical HUD loan has fixed rates for 35-40 years WITHOUT a balloon. The interest rates are typically about ½% to 1% higher than the prevailing interest rates on a typical residential house loan. Presently the HUD rates are in the low 6s. HUD loans do not require a personal guarantee and the loan is fully assumable. In future articles I will explore HUD loans and the big commissions available for you in greater detail. In the meantime, if you come across a borrower who has any involvement with an apartment complex, nursing home, assisted living facility or mobile home park where the loan is greater than \$2,000,000 you should consider this loan type.

There is so much information to share but so little time. I look forward to expanding on the many topics, underwriting parameters, loan types, and exciting stories about closed loans. Perhaps the most important issue to you is how you make money from all of this information. The answer is that if you have solutions to other people's problems then you will make

money. Adding commercial loans to the services you offer can put thousands of new dollars in your pocket. Thus I would encourage you to continue reading my series of articles. If you have a loan you wish to discuss please call, send a fax or send an email to my assistant Frank Gindoff or myself.

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