

Before You Pass Up the Next Commercial Loan Lead.....

by Art "Ski" Swiatkowski

Thinking about getting into commercial lending? Not sure where to start? If you are like most residential mortgage originators or brokers, you periodically have someone requesting your help in obtaining funding for a commercial property. To this point, you've always passed on these opportunities for one or more of the following reasons:

- 1) Your company doesn't do commercial loans.
- 2) Commercial deals are a mystery to you and you don't want to jeopardize your relationships. You don't want to look bad in the eye of the clients.
- 3) You are not afraid to try something new, but you have no idea where to start. Furthermore, these deals look very complicated.
- 4) You're too busy with residential business and don't want to dilute your efforts in a residential market that is going strong.

I'm sure most readers can relate to one or more of these reasons. Having spent 17 years in the retail residential side of the business before moving into commercial, I can relate to all of them. But let's suspend judgment for a moment. Let's look at why you should be taking advantage of commercial loan opportunities.

A Known Client Base - You're already doing business with potential commercial loan clients. Look in your closed loan files. You'll most likely find many business owners, self-employed borrowers, entrepreneurs, and investors who may own or would like to acquire a commercial or income producing property. You've already created the relationship. Why not cross sell services that can help them with their commercial financing needs?

Diversification - We all know that residential lending has slowed down. Wouldn't it be smart to diversify your product offerings with an origination plan that included a commercial component that could help you through this downturn?

Less Competition - There are far fewer mortgage originators and brokers in the commercial side of the business than in the residential side. Try this. Pick up your local yellow pages. Look up "mortgages." You will typically find page after page of sources for mortgage loans. Now, read the various sized box ads. You'll notice that only a few (and I mean very few) will state that they do commercial loans.

Existing Referral Sources - The referral sources you deal with on the residential side constantly see clients with commercial loan needs. Whether you get leads from real estate agents, attorneys, accountants, or financial planners, they can be a great source for commercial business. Once again, you've already created the relationship. It doesn't take much to expand your service and tap into these potential deals.

Be a Mortgage Professional - If you are a true mortgage professional, expanding your knowledge about the industry is part of what you do. By venturing into the commercial arena, you will learn about different lending approaches and market dynamics that will make you a well-rounded originator and a real problem solver.

Greater Income Potential - I'm not suggesting that you abandon your residential business for the commercial horizons, but I am suggesting that without a tremendous amount of effort and with good direction, you could realize a significant boost in your revenue by adding commercial and income-producing loans to your product menu. The bottom line is, you are leaving money on the table when you could be picking up those deals.

I hope I have convinced you that venturing into doing at least a few commercial loans may be worth further consideration. Let me give you some good advice that can simplify your transition into the profitable world of commercial originations. Here are six tips to get you started:

Tip #1 Start Small

Start by going after small commercial deals. Small commercial loans are generally considered to be loans under \$1 million. Besides the loan size, small commercial deals tend to be associated with certain property types and usage. Here's a partial list for your reference:

- Multi-family - 5+ unit apartment buildings (this varies in some states)
- Mixed Use Property - Properties with commercial and residential components, for example, a pizza restaurant with two apartments above it.
- Small Office Buildings
- Free Standing Retail Stores for example, a convenience store
- Small Hotels, Motels and Bed & Breakfast
- Storage Facilities/Warehouses
- Bars/Restaurants

- Gas Stations/Auto Repair
- Dry Cleaners
- Light Manufacturing Facilities

There are several reasons why small commercial is a good place to start. Firstly, there are more small commercial properties out in the market than there are large commercial properties. For every multi-million dollar, high-rise office building in your market, there are hundreds of small commercial and income-producing properties.

Second, the competition for the larger deals can be fierce. Because of the large commission dollars at stake, many of the savvy commercial brokers operate in this category. They have the knowledge and relationships with aggressive funding sources that will give them a significant edge over a rookie. Another thought to consider, is that the potential borrowers for large loans tend to shop their deals extensively. Don't let the allure of a big payday fool you into spending great amounts of time on a deal for which you won't get paid. You would be wasting time that could be better spent closing several small commercial deals.

A third reason is that small commercial loans are generally much less complex transactions. For example, the due diligence, negotiations, and documentation required to put a \$15 million hotel deal together can make a \$400,000, 8-unit apartment building deal look like a walk in the park.

Fourth, since small commercial deals are less complex, they tend to close more quickly than the large transactions. Think about the examples above. Which do you think would most likely close sooner?

Fifth, the amount of time needed to gain a working knowledge of the small commercial deal is much less than with the larger loans. There are a few small commercial lenders that have simplified the loan submission process and introduced stated-income/asset, light documentation programs in order to give residential originators an easier start on the learning curve.

The last and perhaps the best reason for starting with the small deals is that the lending environment for these transactions has changed. Many of the traditional lenders (banks and thrifts) across the country have stopped lending on small commercial properties or have been acquired by larger institutions that choose not to lend on these deals. This has created a service void in many markets, as well as an opportunity for those brokers that recognize it as a source of new business.

Tip #2 Leverage the Experience of Others

Many of the commercial money sources have sales representatives or loan officers that will help you learn how to do these small deals. These people have a vested interest in getting you started and avoiding the hurdles that may pop up along the way. Create relationships with these people. Utilize their commercial product knowledge to your advantage. You'll both benefit.

Another potential resource to leverage is experienced commercial brokers. Find one who is willing to work with you in gaining an understanding of small commercial and income-producing property deals. The commission split of co-brokering a transaction can be looked at as a cost of your education. This is money well invested.

If a commercial broker won't work with you, call another broker. The smart commercial brokers will look at you as a potential continuous origination source. They know that most residential originators won't go deep into the commercial arena. In fact, if they do a good job by making it easy on the originator, they know that most people will take the easy road, especially if there's a commission at the end of it.

However, take heed to this word of caution; be sure to get references from those individuals with whom you intend to co-broker deals. You want to find someone you can trust to guard your interests and the interests of your client.

Tip #3 Invest in Your Education

The National Association of Mortgage Brokers (NAMB) and some state associations offer commercial courses and workshops at very affordable prices. Check their websites. A small investment in time and money here could yield a huge return. NAMB is currently developing a series of courses for residential-going-into-commercial brokers as well as those already seasoned in commercial lending.

A few wholesale lenders also hold seminars and workshops. Though these are usually slanted more to their programs, they can give you enough specific information to have you moving in the right direction rather quickly.

Your commercial education should also include learning the programs of the various lenders with whom you choose to work. Unlike the residential world where the secondary market has created a framework of uniformity, the commercial market is still very diverse in the loan parameters and requirements of individual lenders. It is extremely important for you to learn what specific lenders do and how they do it. Knowing this information will keep you from wasting time on deals that can't be done and increase the likelihood of closing the loans that can be done.

Tip #4 Do Not Apply a Residential Mindset

This can be difficult to make the shift if what you know best is how to do residential loans. But, if you keep a few things in mind when taking on a commercial deal, you can make the process a much easier experience.

- Try to remember that commercial loans are more about the property than the borrower. Find out all you can about the property's occupancy and/or vacancy rates, the building's rating, past rent rolls, and any environmental concerns you may see. These are all contributing factors that may make a difference in whether or not the loan can be made.
- There is generally greater risk involved in commercial lending. Consequently, you will not find the aggressive lending approaches you have in the residential side without adjustments to the pricing, LTVs, or additional collateral. Don't let your clients set their expectations around the terms of a residential loan that they are familiar with. Managing client expectations is one of the keys to success in commercial lending.
- The appraisal is a critical factor in structuring a commercial loan. Since this is true, a quality appraisal is imperative. Many lenders have a recommended appraiser list. Check with them before having an appraisal done. Also, prepare your client to pay more for a commercial appraisal, maybe five to six times more than a residential appraisal. Trying to save your client money at the expense of the quality of the appraisal can result in having them spend more money and jeopardize the deal. With appraisals, you generally get what you pay for.

Tip #5 Target Prospects that Need Your Help

In the small commercial loan category, there are basically three levels into which a transaction may fall.

- **Top quality deals** that are characterized by bank caliber credit and property type. These are comparable to the "A" paper deals in the residential side. Borrowers can expect very good rates and LTVs, but they must be prepared to provide plenty of documentation and meet all of the sometimes-rigorous requirements of the bank.
- **Less than bank quality loans.** Deals end up in this category due to credit, inability to provide documentation, or uniqueness of the property. These loans still have merit, but are unacceptable to the traditional lenders. Rates will be slightly higher, LTVs will be lower, but you can still get good loan terms. Think of these as your residential "B/C" deals. This is the domain of the intermediate/non-conforming commercial lenders.
- **Hard-Money Deals.** These properties and borrowers have circumstances that make them unattractive to all but the private-source equity lenders. High rates, usually very low LTVs, and short terms are characteristic of these loans. This is how the lender protects themselves on these very risky deals.

Let's face it. If it's a top quality deal, the banks and thrifts are snapping them up. In fact, there's a good chance that you won't see most of these. Additionally, unless you have a good handle on the needed documentation and flow of these transactions, they could become an exercise in frustration. Focus your effort on helping those clients that fall outside the bank's radar screen. There are plenty of self-employed, entrepreneurs, business owners, and investors that can't or won't provide a bank with acceptable documentation. Maybe they've had a personal or business situation that has affected their credit. Perhaps the property is located in a less appealing part of town. Their local bank may have already turned many to these prospects down. As a result, an opportunity for you to serve these individuals has been created.

Tip #6 Do it NOW!

The last piece of good advice is to get started. It's up to you to take the first step.

- Write a brief action plan.
- Take a commercial course.
- Read a book on commercial lending.
- Call a commercial lender or broker.
- Create some inertia.

As you take action, you'll begin to see the many opportunities and resources that are at your disposal. Do it NOW!

In these trying times, there is no time like the present to enhance your book of business and increase your earning potential, while serving the customers you probably already have in your files.

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