

Screen Your Commercial Deals

There's money in commercial loans — along with time-wasting black holes

By **Jeff Rauth**, president, Commercial Finance Advisors Inc.

BROKERING COMMERCIAL MORTGAGES certainly has its perks. It is generally viewed as a prestigious profession, and brokers tend to deal with sophisticated borrowers on most transactions. The income potential also can be uncapped, as some seasoned commercial brokers earn seven figures — and this is without having a lot of fixed expenses or a large support staff.

Thus, many residential mortgage brokers are entering the commercial market. These brokers shouldn't think that commercial mortgages are a cake walk, though. Rather, they must be prepared and know exactly what they are doing.

Brokers coming from the residential side will find many differences. One primary difference is the lack of conformity among lenders in processes and underwriting guidelines. There also is a lack of broker protection, which alarms many residential brokers. In fact, many commercial banks will not accept deals from brokers or allow them to be paid on the settlement statements. Rather, some banks expect the borrower to pay brokers directly, outside of closing.

Ultimately, it is easy to get sucked into working on unfundable deals. As such, while new commercial brokers should become efficient in all aspects of the business, prescreening deals is especially important. After all, every time you work on a loan, you are investing your time. If the deal has a low — or no — probability of closing, you will be hard-pressed.

Successful brokers will collect the whole loan package, sit down with it and decide if they can do the deal. If they determine that the deal is fundable, they then must decide whether

they want to work on it. Brokers should ask themselves if they have control over the deal or the borrower, as well as if they know where to place the deal.

Reviewing tax returns

A complicated part of prescreening loan requests is extracting all the income out of the borrowers' tax returns. This is necessary to determine the debt-service-coverage ratio (DSCR) and how much of the borrowers' income can be used to service the mortgage.

When it comes to reviewing tax returns, owner-occupied transactions can be more complicated than investment deals. As such, brokers must understand how to review the entire set of tax returns. Tax returns for owner-occupied deals typically include personal, business and real estate returns.

Determining the net operating income (NOI) can be complicated. An accurate NOI is needed, however, to determine the DSCR, which is calculated by dividing the NOI by the annual debt service. Most lenders require a 1.2 DSCR. In other words, for every \$1 of mortgage payments, the business or investment property should have \$1.20 of net income.

While a 1.2 DSCR is often considered standard, some banks or lenders will be more conservative, with a minimum of 1.3. Conversely, some commercial lenders will be more aggressive and accept loans with a 1.1 DSCR or less.

Choosing wisely

It's important to remember that many deals are turned down because borrowers lack enough income. What complicates this further is that most brokers deal with loans that have issues.

Many borrowers with perfect scenarios typically will go to their local bank. It can be difficult to compete on these because broker fees will be hard to justify. So successful commercial brokers will look for loans with "hair," or workable issues. They just need to find the right kind of hair.

There's no set answer for what the right kind

of hair is, but consider this example: Say you receive a restaurant deal in which the borrower must have a 65-percent loan to value (LTV) with a 25-year amortization schedule for the loan to cash flow. Most banks will not go beyond 60-percent LTV and a 20-year schedule, so you will have a competitive edge if you work with one that will spread out the amortization schedule and go to 65 percent.

It also helps to find banks that consider themselves "story lenders" — i.e., those willing to listen to the borrowers' story and that will fund the deal if the story makes sense. For example, most lenders or banks won't look at deals on loans in forbearance. But if the borrowers were never late with their payments, have good credit and have a business that cash flows, story lenders might look beyond the forbearance.

Borrowers' credit scores also can cause issues. Many commercial lenders won't review a deal if the borrower's credit score is less than 680, though others might not even look at these credit scores. If you have sources that cover the 580 to 660 range, though, you will have an edge because the borrower will not have as many other options. This will increase your chances of having some control over the deal.

Commercial brokers therefore must be good at looking at deals that are marginal and at accurately predicting whether they can fund these deals.

Avoiding trouble

There are a number of issues that can kill a loan. One occurs when borrowers file their own tax returns or when they hire an accountant to file only their business returns — and they do their personal returns themselves.

In many cases, borrowers won't know what they're doing or won't include all their income. Not only is this illegal, but seeing different income levels on the various tax returns also will create doubt in the underwriter's mind about the borrowers' true personal and business income.

If it doesn't kill the deal outright, it will cost

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Jeff Rauth is president of Commercial Finance Advisors Inc. He has written a training manual and offers other tools for brokers. Visit cfa-commercial.com/commercial-mortgage-training.html. Reach

Rauth at jrauth@cfa-commercial.com or (248) 885-8797.

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you a considerable amount of time as you collect more documentation trying to prove what you can and cannot use as income.

Another scenario to avoid is trying to qualify a deal with only a partial package. Typically, you need three years of personal, business and real estate entity returns, as well as year-to-date profit-and-loss and balance sheets. If you only have a partial package and don't know the full story about the deal, you'll most likely waste your time reviewing and working on it.



To make your transition to commercial brokering a success, prescreen deals before you work on them. Once you have a good understanding of borrowers' loan requests, you can determine which banks or lenders will be a good fit. You must look beyond their guidelines and know what they really like.

If you get to know the lender's appetite and what types of deals it funds, you will increase your chances of closing your borrowers' loans and getting paid for all your hard work. **!**