

NORTHEAST BANKS & LENDING

Specialty Lending Makes Sense in 2007

In recent years, specialty lenders have become more prominent in the real estate lending arena. They seem to have filled a niche or partnered with a traditional lending source to facilitate additional funding for borrowers. Many of these lenders can be private equity sources, hedge funds, pension funds, non-bank lenders and individuals. The focus has been in bridge and construction financing in addition to other short-term loan programs. Their success is a direct result of the changes in the real estate market and the entrepreneurial nature of the industry. Their ability to adapt to market demand has fueled their success. Market trends indicate an increase in asset-based loans and a reduction in traditional bank financing mainly because typical banking sources may not be able to provide the type of loans required by these entrepreneurial borrowers.

One of the major benefits of using this type of lender is not only the speed of execution, but the flexibility of the lender. It is not unusual for a loan to close in less than half the time usually required by traditional lenders. Timing becomes a critical factor when selecting a lender since the need for new funding is almost always time sensitive. This becomes evident when a borrower may have been essentially left at the altar by another lender that has turned a loan down at the last minute after a long underwriting period, and the borrower now only has a limited time to close.

Specialty lenders are not typically subject to the regulatory constraints of institutional lenders. When they are providing senior debt, mezzanine or gap equity financing the flexibility in their funding alternatives becomes very apparent. The loan structures vary and funding can be secured in a number of ways to accommodate the needs of the borrower and the project. Underwriting of the loan tends to focus on the business plan, collateral value and experience of the borrower. Credit worthiness and cash flow are considered, but they are not the driving force behind the underwriting process.

Many borrowers require a hybrid of lending solutions at different stages of their loan or project. Typical lending sources may not have the resources or desire to service these complex and multi-stage loan transactions. Many development deals that require a land acquisition loan are usually combined with some monies for pre-development costs followed by a construction loan. This type of loan can prove to be very tedious due to multiple loan advances. A real estate construction loan can also change frequently, and institutional sources are somewhat inflexible to these types of fluctuations from the original budget.

There are numerous other advantages that specialty lenders provide to the real estate lending arena. Banks often refer loans that have a short fuse or do not fit their lending guidelines to non-traditional lenders. In many cases a borrower may have exceeded the loan limit of their bank or the project type is out of favor. Referrals in these situations benefit the bank as well as its customers.

Specialty lenders are a good fit for banks since they are transaction oriented and not relationship driven. Banks can refer projects to non-traditional lenders, while still maintaining their relationships. Another bank would only consider the loan if the account relationship follows. There is also an opportunity for institutional sources to provide permanent funding for projects that are financed on an interim basis by specialty lenders.

Specialty lenders and traditional lenders will work together on certain transactions in order to meet all of the funding needs of the borrower. When evaluating a project it is possible that a specialty lender may eliminate the need for additional equity by providing a higher leverage debt alternative to the borrower. The benefit of structuring a deal this way allows the borrower to retain complete ownership of the project, which will provide higher return to the project sponsors. For example, the bank may provide the senior loan equaling 75 percent of the total costs of the project, where a specialty lender could improve the leverage beyond that point. For these reasons, specialty lenders and traditional sources benefit by working together to meet the needs of each project.

Because of the diverse and entrepreneurial nature of our society, the loan types and structures are constantly changing and evolving making it difficult to standardize such loan programs. The structuring of these multi-faceted, highly complicated loan transactions with multiple moving parts requires a higher level of education and a more complete understanding of asset based lending, structured financed and real estate finance. These

transactions have gradually become more sophisticated as borrowers are realizing that non-traditional or specialty lenders are capable of meeting more of their financing needs.

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