NAMB | A publication of the **AMG Commercial Mortgage Group** | No.56:

// a view into the world of commercial mortgage brokering // OUTLOOKS

:: Editors Column ::

> FALL/WINTER 18' <

LET'S GET OUR FACTS STRAIGHT


Anthony M. Gramza

Regardless of what you may read or hear regarding the rules and procedures of the commercial mortgage brokerage industry, each brokerage firm operates under its own *modus operandi*.

The policy of AMG Commercial Mortgage Group is quite simple. The majority of our loan requests are funneled through our broker system. Almost all active brokers or agents are aware that our firm is one of only a few that are active in the "international loan arena". Our lending network is well established and have been successful in funding many projects from as low as USD3million to records of USD200 million. We have established ourselves as reliable, professional, and straight forward.

In an article to follow, we put on the collar, then review the client submission, analyze the proposal, investigate the facts, and then submit a preliminary report to our lender group. If the response is positive, then we move forward aggressively. Our next question to the client is "do you wish to retain our services"? If the answer is yes, then a mortgage placement agreement is prepared and forwarded to the client for their execution. Once executed by all parties, that agreement becomes part of the final exhibits to the lender indicating that our firm is the registered broker of record. That agreement, a protection for both the client as well as the brokerage firm outlines the legal terms, including loan amount, rate, terms, commission, and a "refundable retainer". Without accepting a refundable retainer to cover all expenses involved from the time of application to funding, we are at a standstill.

We have heard all the horror stories on why clients are willing to retain our services but unwilling to advance a refundable retainer. I have been a licensed real estate/commercial mortgage broker for the past thirty- two (32) years representing AMG Commercial Mortgage Group, Inc. We stand on our reputation, our successes, our extensive experience, and our commitment. If this commitment of three (3) and maybe up to twelve (12) months does not provide a comfort level to move forward, then clients need to seek other lending sources. It becomes a two (2) way obligation for both the client as well as we the commercial mortgage broker.

Commercial mortgage brokers consider themselves just as important as the clients attorney, CPA, or financial advisor. Without the broker and their many sources of mortgage funds, the transaction will not transpire. Clients need to think long and hard on making the decision to retain or not, the broker services and its SOP's. *—AMG—*

In this industry, it seems that we are wearing the collar all the time. I suppose that is true since many commercial mortgage brokers consider themselves to be the bearers of wisdom, knowledge, and forbearing, and have open ears to all the problems of clients.

Today, we are finding a reversal in our current operations. Money is plentiful, lenders both in the domestic as well as international markets are seeking loans for their portfolio or investor group and are continuously on the phones looking for deals. Yet, clients are working on viable projects, but don't have the initial equity to meet the minimum standards of the lender.

In several of our past newsletter articles, we listed problems on both sides of the transaction, however, today it's the clients turn. Since the beginning of this year, we list several of the reasons why transactions never get to be approval, nor to the initial underwriting stage. On the domestic stage, lenders are seeking 10 to 15% equity injection. In our dealings with international loan requests, as long as a client can produce a viable project and have at least 5-6% equity injection, the deal can be made. Over the period of the past six months, we have reviewed requests as low as USD 4 million and as high as USD 35 million, but when we provide the initial terms, the client states "unfortunately, I don't have the 5-6% liquidity"! What—"we thought we were going to get 100% financing. Now you, Mr. Broker are saying we need 5-6%! I don't have it. Mr. client, you are working on a major project, but don't even have liquidity to cover the lenders due diligence, nor the brokers refundable retainer! Hello! Move on Mr. Client.

I am not sure where clients are getting their information, but lenders want to see some liquidity, experience, strong resumes, and executed broker agreements. If a client feels that they will not need to deposit a lender retainer to begin the process, nor execute a broker agreement verifying that the broker who is presenting the transaction is their true representative, then they are having a "pipe dream"! As they say in any language….forget it!

With several of our lenders, 100% financing is available. How you say…. well our lenders provide 60% of the loan request and an equity partner provides 40%. The lender seeks a return of 5% or better, and the partner a 30-40% return on the profit over a given period of time. It's better than coming up with 30% or not making the deal happen at all. Are these financing options open to all…not always, but that is what you retain a licensed commercial mortgage broker for. Do it on your own……good luck. We wear the collar, we listen to the horror stories, we investigate the proposed or existing project, we check our lenders, we find the best financing for our client, and hopefully we provide a satisfied client.

"DO IT ON YOUR OWN…GOOD LUCK. WE WEAR THE COLLAR, WE LISTEN TO THE HORROR STORIES…"

Commercial Lenders come in all shapes and sizes, however with the continued scrutiny of "Regulators" both domestic and internationally, developers are faced with the dilemma of lenders still requiring at least 15% to 25% cash equity, years of experience, and personal liability. The list goes on and on and on...!

This is true whether you are purchasing, renovating, or expanding an existing Project or building new. We have seen these shortfalls of capital funded through some type of subordinate or mezzanine financing bringing in a "third party investor" which in some cases can be expensive and time consuming. Let's take a look what has developed in the current marketplace...!!

MEZZANINE DEBT VS. PREFFERED EQUITY

Mezzanine debt and preferred equity both sit between the senior debt and common equity in the capital stack and generally serve similar functions to fill a gap in funding and/or provide additional leverage.

The primary difference between the two is that mezzanine debt is normally structured as a secured loan on the property. Preferred equity in an investment in the property-owning entity will participate in the profits, usually annually or when the project is sold.

BENEFITS OF MEZZANINE DEBT AND PREFERRED EQUITY

Both of these "Financing Tools" provide the borrower/developer the opportunity to move forward with a project leveraging their initial cash while allowing the lender/investor a higher yield with only a modest increase in risk.

BASIC STUCTURE OF A "PREFERRED EQUITY LOAN":

Multifamily Project of $56,000,000.00 with the Developers' contributing $3,300,000.00 (cost of land).

LOAN FACILTY:

$42,000,000.00 (75% Maximum Loan Amount)

$10,700,000.00 (19% Preferred Equity)

NOTE: All proceeds from the cash flow, refinances or sales shall be distributed as follows, with regards to preferred equity:

First, to Lender until it has earned an "determined" annual return.

Second, to return the equity investors' initial capital contribution of $10,700,000.00.

Third to return the Borrower's initial contribution of $3,300,000.00.

Thereafter, 50% to Lender and 50% to Borrower.

Please note that this is actual example of a project that AMG has been instrumental in bring the developer and lender together. If you are interested in further detail, please contact our offices direct.

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International Update...

The doors have been open all year seeking new transactions. The funds continue to surface and yet, we cannot fill the hungry needs in getting all the dollars out to produce a satisfying yield for the investor.

Many of this year's projects have received favorable comments, and would be in our opinion, well received by our international lenders. However, although the submission meets the basic underwriting guidelines, the clients are minus liquidity to even start the process. In other words, a good project but no funds to handle the initial and immediate costs to start the due diligence process. Therefore, big dreams, high hopes, but no upfront coverage.

We estimate that a client needs a minimum of six (6) percent of the loan amount in a liquid position to get the process started. That will cover lenders due diligence/closing costs, insurance fees, country transfer fees, legal expenses, and of course, brokerage. We do not recommend to even present a transaction unless the client has upfront verification of funds (equity) necessary to meet the lenders basic guidelines.

Interest rates in both the domestic as well as the international arenas will rise during 2019, but we do not see major increases. 1/8, maybe ¼, but no more than ½% for the entire year, but with these increases, very little effect in the overall approval of new transactions. Lastly, we hope the soothsayers are correct with their crystal ball.

–AMG
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As we come to the end of another year, we continue our best to communicate with all our clients, lenders, associated brokers, agents, and dear friends.

To that end, we thank all who have shared the patience and positive attitude that has been needed during this year. As far as we can surmise, too much unsureness, too many high hopes and dreams, and an unwillingness to accept the facts encompassing many "would-be-clients. We hope and pray that many lessons have been learned...Unfortunately, the hard way. We hope that many minds will clear and have more positive opinions in 2019.

With that in mind, and with greetings and well wishes to you and your families, our best wishes for a Happy Thanksgiving, a joyous Hanukkah, a Merry Christmas, and a healthy and prosperous New Year.

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