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Distress is the Mother of Opportunity

Hard-money loans may turn unwanted properties into viable investments

Commercial real estate investing has been a hot-button topic in recent years, as the industry has been turned inside-out with volatility, the collapse of the housing market and, of course, the tightening of capital by the banking sector. For hard-money investors and borrowers, opportunity abounds in these turbulent times because the ability to capitalize on distressed properties opens the door to great opportunities for profit.

Not all distressed properties pose the same profit potential, however, which is why mortgage professionals and their clients should educate themselves about what to look for, how to secure funding, and how to generate a healthy return on their transactions.

Identify properties

A property is distressed when it is advertised for sale by its mortgage lender or is currently under an order of sale because of foreclosure. In these instances, the property is usually priced to move because the bank or other financing institution has little-to-no interest in hanging on to it any longer than necessary.

Unfortunately, the same dynamic that leads to these opportunities also makes it difficult to find the financing to purchase the property, presenting a dilemma for real estate investors. With conventional lenders generally unwilling to offer up capital, how can these properties be expected to move? This funding gap has created a growing hard-money lending industry that has become a major player in the commercial distressed real estate market.

Considerations

Hard-money lending offers borrowers who have available capital lucrative investment opportunities and provides those without capital the chance to reap healthy profits from distressed properties.

There are a few factors that help originators and investors determine whether or not the hard money is right for their clients' distressed properties.

1. **Valuation:** Hard-money loans are contingent on the appraisal of the

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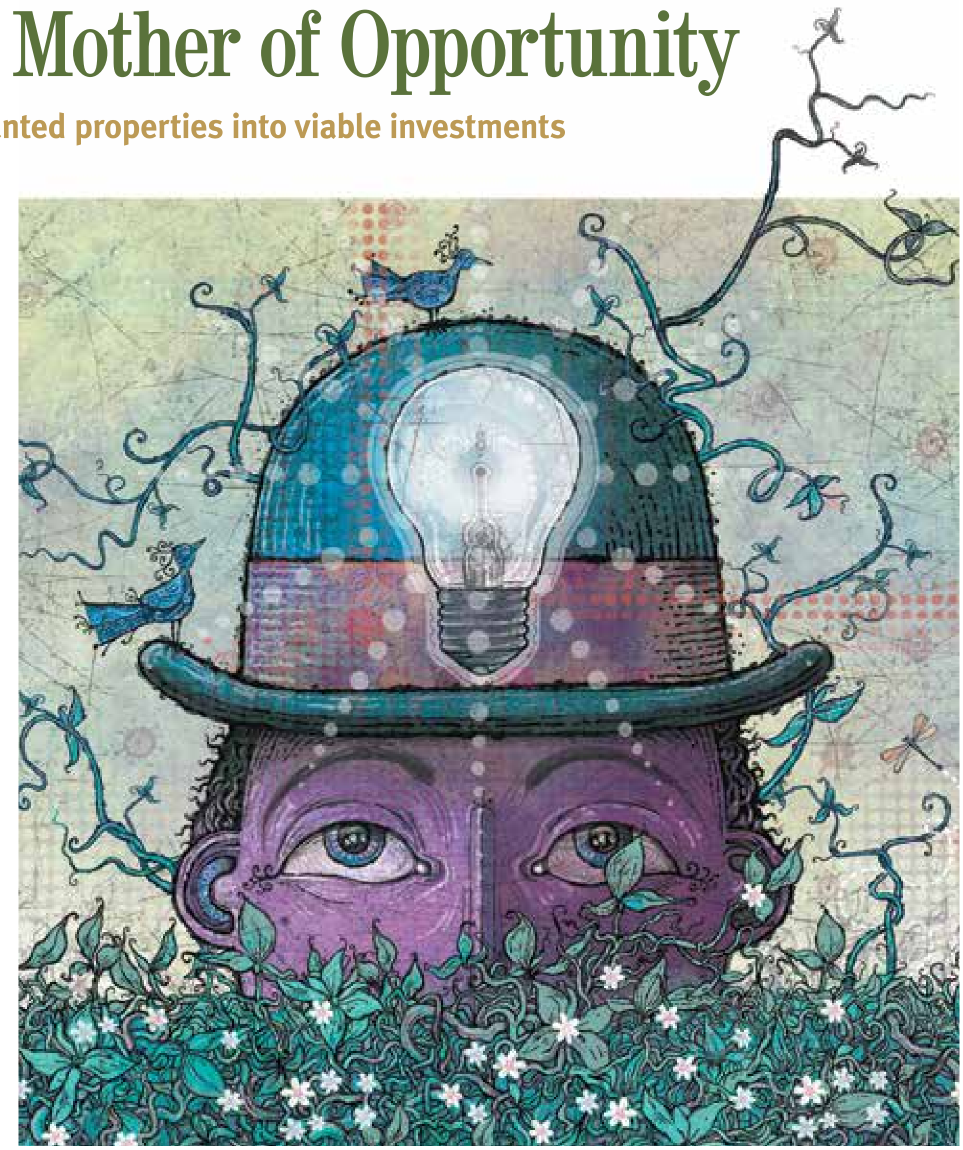

Illustration: Dennis Wunsch

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property. Because the lending institution generally will offer about 70 percent of the total valuation, a borrower will want to be certain that the appraisal is accurate. This will allow the hard-money lender to hedge its bet on the high-risk nature of the loan because the property is then placed as collateral against the loan itself. Should the borrower default, the property is turned over to the lender as repayment.

2. **Protecting borrowers:** Investors interested in acquiring and flipping locations using hard money should be well-versed in the various nuances associated with the property's value and the conditions of the loan. They must be certain that they have properly appraised the amount and cost of work necessary to restore the property because repair- and renovation-cost overruns may lead to a financial nightmare. Fortunately, hard-money lenders don't want to own the property they lend on, so they tend to be diligent in verifying that the borrowers' proposal for profit is a sound investment. Getting a second opinion on the work that a distressed property requires is always wise, however.
3. **Convenience versus interest rates:** Distressed properties provide great investment opportunities, but to capitalize on them, time is of the essence. A necessity in this niche is to secure funding quickly. Hard-money lenders usually have the ability to set up an appraisal and provide funding in a matter of days, whereas conventional lenders may take weeks. The speed factor alone is enough to ensure that your client's distressed-property opportunity isn't thwarted by other investors with deeper pockets.

There is a price to pay for the convenience of hard money, however — the loans often carry higher interest rates than those of conventional lenders. This should come as no surprise because the risk is greater for hard-money lenders, given this niche's characteristic speedy approval process, among other factors.

Discounts

Distressed properties are often available for a steep discount because the lenders simply are trying to unload them and recoup their initial investment. The current commercial real estate climate may have emerged up from its post-recession doldrums, but that doesn't mean the market has fully recovered. Mortgage lenders still are sitting on countless distressed properties, and are actively seeking investors to take them off of their hands.

Mortgage originators and investors who understand how to use hard-money lending as a tool to secure quick capital for distressed properties will be able take advantage of new and lucrative opportunities, and improve their ever-important bottom lines. ●