Here's how to risk assess commercial mortgages

by Neil Sharma
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Commercial lending assessments are vastly more convoluted than residential ones, and a slew of conditions must first be met before lenders will agree to fund purchases.

David Mandel, president of First Source Mortgage Corporation, says that it's helpful to leverage local intelligence as a means of making informed decisions about proposed financing. For example, there's a plenitude of information with which to forecast a property's performance in the Greater Toronto Area and Golden Horseshoe.

But intelligence also extends to potential borrowers' experience.

"You don't want to lend to someone who has built an infill home and now wants to build a 12-storey building," said Mandel. "It's best to work with borrowers whose experience and knowledge matches the scope of the loan. You also don't want to lend to someone who doesn't have skin in the game. If there's no motivation to wake up in the morning when the going may get tough, then that's a problem."

Lending on a readily marketable security with reasonably broad appeal is also imperative because, while anybody can lend money, you need to know how you're getting it back, says Mandel.

"Some real estate is very specialized, so you need to be mindful of your exit possibilities if you were find yourself selling the property," he said.

Risk assessing a property should heavily rely on the borrower's experience and detailed financial background (or lack thereof), willingness towards transparency, but not overreliance on appraisal surplus.

"If requests for documents are not met in a timely manner and answers are not as relevant as they should be, that's a red flag, said Mandel. "If there's no immediate comfort with the borrower or you feel they aren't being truthful enough for you, then walk away.

"If you can't drive there in approximately two hours, or the nearest food store is in the next town, it's unlikely we'll lend on it."

Land loans in the GTA, while sometimes too risky for A lenders, is something First Source considers a niche offering with strong risk-adjusted returns for its investors.

Brokers also need to do their own due diligence before approaching lenders, and sometimes it's a lot easier than one would think.

"Recently, a broker called me to refinance a commercial property tenanted by a restaurant," said Mandel. "The purpose of the funds was to renovate the property. I asked how the tenant being a restaurant was going to remain open during extensive renovations. Also, what's the current rent and what is the increase in rent going to be so the landlord could recoup some of the additional investment in the property? The broker had no idea."

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Laura Martin, COO of Matrix Mortgage Global and director of Private Lending Hub, advises that commercial mortgages aren't for the faint of heart, in spite of being leaps and bounds more remunerative for brokers than residential mortgages.

"The volume of documents you need to collect is much greater and you need to scrutinize them more carefully," she said. "Commercial appraisals are way more involved and they deal with environmentals, which is generally not something you deal with on a residential purchase, so it adds another layer of complexity in analyzing the asset."

For residential mortgage brokers contemplating change like shifting up a gear or two into the world of commercial mortgages, Mandel is emphatic about the value of education.

"Typically, a residential broker sees a big deal and possibly 10 times the commission of a residential deal wrapped up in one deal and they'll often lose the deal because they overprotect the fee rather than sharing with someone who can actually ensure a significantly higher closing ratio. Education is priceless."

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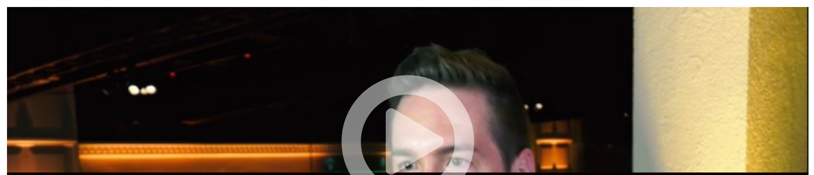

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