

Commercial Finance- Hard Money

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Commercial Finance- Hard Money explores the little known world of financing real estate and business accounts receivable with respect to situations that banks and other financial institutions typically avoid. The year 2008 will be known for difficult financial times for large institutions, businesses and individuals. Financing will be harder than ever to obtain.

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The Merriam- Webster Online Dictionary defines hard as:

“1 a: not easily penetrated: not easily yielding to pressure b of cheese: not capable of being spread: very firm

2 a: of liquor (1): having a harsh or acid taste (2): strongly alcoholic b: characterized by the presence of salts (as of calcium or magnesium) that prevents lathering with soap <hard water>

{bot_wrgoogle}3 a: of or relating to radiation of relatively high penetrating power: having high energy <hard X rays> b: having or producing relatively great photographic contrast <a hard negative>

4 a: metallic as distinct from paper <hard money> b: of currency: convertible into gold: stable in value c: usable as currency <paid in hard cash> d: of currency: readily acceptable in international trade e: being high and firm <hard prices>

5 a: firmly and closely twisted <hard yarns> b: having a smooth close napless finish <a hard worsted>

6 a: physically fit <in good hard condition> b: resistant to stress or disease c: free of weakness or defects

7 a (1): firm definite <reached a hard agreement> (2): not speculative or conjectural: factual <hard evidence> (3): important or informative rather than sensational or entertaining <hard news> b: close searching <gave a hard look> c: free from sentimentality or illusion: realistic <good hard sense> d: lacking in responsiveness: obdurate unfeeling <a hard heart>

8 a (1): difficult to bear or endure <hard luck> <hard times> (2): oppressive inequitable <sales taxes are hard on the poor> <a hard restriction> b (1): lacking consideration, compassion, or gentleness : callous <a hard greedy landlord> (2): incorrigible tough <a hard gang> c (1): harsh, severe, or offensive in tendency or effect <said some hard things> (2): resentful <hard feelings> (3): strict unrelenting <drives a hard bargain> d: inclement <hard winter> e (1): intense in force, manner, or degree <hard blows> (2): demanding

the exertion of energy : calling for stamina and endurance <hard work> (3): performing or carrying on with great energy, intensity, or persistence <a hard worker> f: most unyielding or thoroughgoing <the hard political right>

9 a: characterized by sharp or harsh outline, rigid execution, and stiff drawing
b: sharply defined: stark <hard shadows> c: lacking in shading, delicacy, or resonance <hard singing tones> d: sounding as in arcing and geese respectively
—used of c and g e: suggestive of toughness or insensitivity <hard eyes>

10 a (1): difficult to accomplish or resolve: troublesome <hard problems> <the true story was hard to come by> (2): difficult to comprehend or explain <a hard concept> b: having difficulty in doing something <hard of hearing> c: difficult to magnetize or demagnetize

11: being at once addictive and gravely detrimental to health <such hard drugs as heroin>

12: resistant to biodegradation <hard detergents> <hard pesticides such as DDT>

13: being, schooled in, or using the methods of the natural sciences and especially of the physical sciences <a hard scientist>

14: of money: contributed (as by individuals or political action committees) directly to a particular candidate or campaign

Synonyms: hard difficult arduous mean demanding great exertion or effort. Hard implies the opposite of all that is easy <farming is hard work>. Difficult implies the presence of obstacles to be surmounted or puzzles to be resolved and suggests the need of skill, patience, or courage <the difficult ascent of the main face of the mountain>. Arduous stresses the need of laborious and persevering exertion <the arduous task of rebuilding>.”

As used in this article, hard money is intended to convey the idea that because of the current economic conditions, many financing needs will be more difficult to accomplish. They will require great exertion and effort to overcome the economic obstacles of the current economy. Compared to 2006 and 2007, periods of relatively easy money, to obtain financing today you will have to have firm, definite facts to support your financing needs. And the cost of money will be more difficult to bear. Hard money is harder to find, harder to obtain and harder to repay. Nevertheless, hard money may be an economic necessity as a means to an end to grow a business or complete a real estate transaction.

Why is 2008 a time of hard money? This is a difficult question to answer. If you ask 3 experts you probably will get three different answers. It may be the economic equivalent of The Perfect Storm- a True Story of Men against the Sea. The phrase perfect storm refers to the simultaneous occurrence of events which, taken individually, probably would be far less powerful than the result of their rare combination. These occurrences are rare by their very nature, so that even a slight change in any one event contributing to the perfect storm would lessen

its overall impact. The stock market crash of 1929 and following depression exemplifies a perfect storm of economic consequence.

What are these events today? 1) The Mortgage Melt-down. Major financial institutions in the United States are incurring billions of dollars in losses due to the loss in valuation of their investments in mortgage securities. The consequence for borrowers is that these institutions are less inclined to take risks when loaning money for fear of additional losses. And their regulators are demanding that regulated lenders raise their credit standards for borrowers to qualify for a loan. 2) The devaluation of the American dollar versus other world currencies. The U.S. government is spending ginormous amounts of money in excess of what it collect in revenue due to the political compulsion to spend taxpayers' money, the war in Iraq, Hurricane Katrina (and other natural disasters) and the war on terrorism. This makes our currency less valuable. It makes importing to the U.S. more expensive. The American people have less money to spend on goods and services, and their money buys less than it did a year ago because prices of necessities such as gasoline are higher. 3) The current tendency of Federal and State governments to reduce funding for social services, health services and education because of inadequate revenues; this hurts individuals and businesses who have less money to spend on products and services which creates additional drags on our economy. 4) The diminishing value of residential real estate all across the United States. This is related to the mortgage meltdown and the fact that many people incurred debts that they cannot repay. The real causes of these events are complicated and beyond the scope of this article. Suffice it to say that these are hard times and hard times create needs for hard money loans.

What exactly is hard money? Here are seven examples:

1) A commercial real estate loan where the borrower receives funds based on the value of the property, usually 50% or less, at an interest rate higher than a bank would charge. This is the most commonly understood type of hard money. In this financing, neither the income from the property or the borrower demonstrably supports the repayment of the loan.

2) A real estate loan to buy a residential property where the borrower cannot prove their income. This may be accomplished with financing from a seller, the only party willing to take the risk of non-payment.

3) A small junior lien on income producing commercial real estate where the first lien is very large. For example, a million dollar second lien behind a ten million dollar first lien. Most lenders simply do not want to consider a loan of this type because of the potential liability for repayment of the first lien. It is ten times the risk of the secondary loan.

4) Most loans to people with less than excellent credit. Many loans are based on credit scoring. If you do not have a credit score that is high enough for the lender's requirement, you simply do not get their loan and you may or may not be able to find a hard money loan to accomplish your objective.

5) Accounts receivable financing to construction contractors, medical providers and sellers of agricultural products. Most factors do not offer to these sectors of the economy because of the risks and complexities that are involved.

6) Purchase order financing for items with gross margins less than twenty percent. The twenty percent margin is a benchmark for sufficient profitability in a transaction to pay all financing costs and create profits for the business after all costs are paid. During hard economic times margins are squeezed. It is a vicious cycle.

7) Loans to businesses that are particularly negatively affected by the current economy. For instance, a loan to build a new lumberyard is impacted by the downturn in new real estate construction and a lower need for lumber. Most banks

would simply decline to consider such a loan. The same is true for developers seeking to build new housing tracts or office building developments. This is not a good time to try to start a new mortgage brokerage company; although it may be a good time to be a hard money lender provided that you are very, very careful in assessing your transactional risks.

What do all of these situations have in common? In times of easy money these situations would be less costly to finance and more likely to receive funding. Today, the lender's answer to your request for funding is more likely to be a polite but strong "no way". Many lenders have effectively (if not actually) shut their doors. Many lenders will simply decline to lend on hotels/motels, gas stations, owner/user properties, properties with any environmental issues. Borrowers who do not have FICO credit scores above 680, with substantial net worth and income will find it is very difficult to obtain many types of loans. Fortunately, the door for accounts receivable financing is still wide open.

The bottom line: Hard times in our economy will tend to force more individuals and businesses to borrow hard money- if they are able to get any money at all. Commercial financing with hard money will tend to grow as traditional sources of financing from banks and institutional lenders simply will not be available.

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