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Alternative loans - a useful tool for both small businesses and R.E. developers/investors

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Small businesses and real estate developers/investors continue to be confronted with enormous obstacles in their attempts to access capital for their business operations and ventures. Despite operating in a historically low interest rate environment for the last several years, banks of all sizes and types have had to deal with complex and onerous government regulations that have somewhat hampered their ability to make commercial loans to the aforementioned market segment. As a result; smaller commercial entities who rely tremendously on obtaining conventional bank financing; have had to access capital from other alternative and non bank sources in order to "fuel" their short and long term financing requirements.

A number of years ago, Pepperdine University in California conducted a study that revealed that only one out of every five small businesses whose annual revenue is $5 million or less qualifies for conventional bank financing. Hence; 80% of this small business market segment does not qualify for a bank loan and needs to satisfy their financing needs from an alternative or non bank lender.

Typically; businesses who do not qualify for conventional bank or even SBA financing will use an alternative lender on a "bridge" basis for one or two years until their cash flow improves to a level that will allow them to secure bank financing and pay off the bridge lender. My company has been involved in numerous transactions in which we provided interim financing for a small business who needed it for a short period of time and then that business was able to "fix" certain negatives issues that existed with their financials and then venture back into the marketplace to obtain a less expensive bank loan and pay off the alternative loan.

In terms of real estate development and investment, many participants in the marketplace use our capital on an interim basis until they sell one of their holdings. In some instances; our capital is even utilized in distressed situations. For example; late last year; my company closed a $450,000 commercial loan to a real estate investor who was in foreclosure on a mixed-use commercial property in Connecticut that was in a very desirable location. Prior to undertaking this transaction, I met with the borrower who told me that he had met with a bankruptcy attorney who had advised him to file a Chapter 11 Bankruptcy petition. Based on the existing circumstances of the borrower; this advise that was given to the borrower by the attorney was misguided and lacked foresight. The borrower's property had recently been appraised in excess of $800,000 and he owed the creditor that was foreclosing on the property approximately $350,000. Thus; he had a tremendous amount of equity in the property. Although filing bankruptcy would have stalled the foreclosure process by several months; the outstanding debt on the property would have continued to grow and further erode the equity in the property. In addition; the petition would have not only cost the borrower at least another $15,000 or more in legal fees and but it would also have further impaired his credit for many years into the future. Also; a bankruptcy filing would have further encouraged additional "vulture" real estate investors to become attracted to this property who would then try to purchase the property for far less than its existing market value.

As a more viable option; I convinced the borrower to accept a private commercial loan from one of my company's investors and to immediately list the property for sale. The loan proceeds were allocated to pay off all of the existing creditors on the property as well as create an interest reserve on the private loan so that the borrower didn't have to concern himself with making any loan payments while he actively marketed the property for sale. "Fast forward" eleven months later; the CRE broker whom was retained by the borrower successfully attracted a buyer to the property who ultimately paid in excess of $700,000 for the property. As a result of this real estate closing; the borrower was able to pay off my company's private loan in less than one year and was able to exit the transaction with net proceeds of a few hundred thousand dollars in cash that can now be used to provide financial stability for he and his family. He also avoided a lengthy; costly; and damaging bankruptcy petition which provided no guarantee that the borrower would have been able to attract private capital at a later date if needed.

As part of this "win win" scenario for all of the parties involved in this transaction, the investor that funded the private loan earned an excellent ROI on their investment and their capital was only committed for less than one year. That investor can now take the $450,000 in principal plus their "winnings" from this transaction and reinvest it in a similar private loan that is both well secured and provides a realistic exit strategy.

There are still many small businesses and real estate developers/investors in the marketplace who are unaware that private and alternative lenders exist and the potential benefits that can be derived by accessing a private loan. As the private lending industry continues to grow; I expect that this industry's visibility will increase amongst the small business community especially since the burdensome regulatory environment for the banking industry will continue to persist for the immediate future thus impairing that industry's ability to lend.

Every small business and real estate developer/investor should network with their outside professionals like their CPA; attorney; wealth manager/investment adviser; etc. so that they can be introduced to various private and alternative lenders whose capital could be very useful to their entity at the appropriate time.

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