Q1/2023 LENDER'S GUIDE

Shifting Focus in Today's Market

for the Commercial Lending Market

A commercial lending guide designed to provide insight and guidance to commercial lenders as they shift their typical lending focus in response to an increasingly problematic market featuring rising interest rates and a resulting decrease in loan volumes.

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WHAT TO EXPECT

Shifting Focus in 2023

Despite the tumultuous second half, CRE performed relatively well in 2022, with apartments at full occupancy, warehouses showing growth and retail sites recovering after 2020. Even with all these positive metrics, CRE lenders are faced with an increasingly problematic market with the interest rates resulting in a decrease of loan volume. With interest rates that rose quickly in 2022 along with inflation, many borrowers needing real estate secured loans are faced with higher financing costs, lower loan amounts, and more protective covenants for lenders and investors.

Where is the shift?

We know and understand commercial lending and commercial real estate and we know that in times like these, lenders can and should, shift focus.

In this guide, we'll address four (4) emerging products for 2023 and tell you the why and the how:

1. Loan Mods
2. Bridge Lending
3. Mezz Lending
4. C&I Lending

Leveraging a technology solution that supports 'market shift needs' is essential.

By shifting focus to these loan types and leveraging solutions that support these loans, commercial lenders and institutions can access opportunities in an increasingly complex time for commercial lending. Let's get started.

1 Loan Modifications

Over the past 6 months, customers, particularly banks and private lenders, using the now unavailable LIBOR Index have needed to shift to alternative indices such as SOFR. In addition, as the market continues to struggle and refinancing remains difficult to close, both situations have prompted the need for an expanded and more sophisticated standardized modification document platform. Working directly with these customers, GoDocs has enhanced the number of standard support modification alternatives allowing lenders to immediately produce lawyer quality modification documents, with all required recordable and non-recordable documentation.

Speed accuracy and complexity are essential for banks that need to keep their loans as performing assets, notwithstanding the need to make midterm modifications and adjustments to essential terms and conditions.

One specific lender GoDocs works with has a portfolio of hundreds of LIBOR loans that demanded this solution. With our ModDocs® product, the lender was able to execute loan modifications, even those that were not generated within the GoDocs platform. This is an automated functionality that makes loan modifications easy for the customer, no matter the level of complexity.

Get REO Off the Books

Loan Modifications *(continued)*

Why should commercial lenders focus on loan mods now?

Simply put, because lenders are more inclined to agree to the "short term" as of now. With 5- and 10-year loans made between 2013 and 2017 maturing over the next year or so, and with economic conditions the way they are, lenders are more inclined to agree to these short-term loan extensions rather than enter into longer term loans.

With this in mind, consider the following:

- For loans made in a lower rate environment, loan assumptions made in the current higher rate environment have lenders requiring interest rate re-sets as part of approving new loan assumptions.
- With rents flattening and demand for new housing starts plateauing, borrowers and lenders are seeking short-term relief in the form of loan modifications to help them avoid loan defaults and to keep their projects viable under economic conditions improve.

Property Foreclosure Avoidance — Get REO Off the Books

Understandably, lenders want to avoid taking properties back in foreclosure— after all, their business is in loans, not in property ownership. This is especially true at banks and credit unions. With regulators pressuring lenders to get any REO assets off the books within 12 months and with uncertainty in the markets ever-present, these financial institutions could face big losses if they foreclose now and attempt to sell within the next year. The downsides wouldn't stop there, either, and could potentially include an FDIC downgrade of the lender and a bit more attention from the feds every three months than any institution wants.

Loan Modifications *(continued)*

Creative Mod Remedies

With this said, creative mod remedies are the way to go. They offer a more lucrative and secure approach to these properties. In this way, mods become a lender's best friend by allowing a lender to bring a loan out of a current or pending default scenario so that:

- The loan will be shown on the lender's books as a "performing" asset; and
- The lender will be able to pursue a non-judicial solution for a full loan payoff.

GoDocs Cloud™ — Mods at a Fraction of the Cost
No Matter the Origination

The GoDocs Cloud™ ModDocs® solution accelerates loan doc modification at a fraction of what attorneys charge. It works regardless of the attorney or system used to draft the original docs. With a perfected product, GoDocs offers an excellent alternative to risky in-house forms as lenders look to extend maturity dates, adjust rates, change loan types, transfer to different borrowers, or change underlying collateral like adding cash agreements. For any scenario, any complexity, GoDocs has the built-in functionality to execute.

2 Bridge Lending

Why should savvy lenders look this way?

We just recently had a conversation with a non-QM lender that had shifted everything over to bridge lending. This was so they could make bigger loans with less risk involved, particularly with 6- or 12-month interest only bridge loans. This scenario also creates great churn and burn on capital and is perfect for today's environment with high interest rates.

As you know, these loans provide short-term, IO financing to provide funds in the following ways:

- For repairs and cosmetic improvements
- To provide financing as a transition from a construction loan to permanent financing; and/or
- To provide working capital for a borrower's business operations.

However, borrowers are not eager to get into long-term high interest rate loans; lenders have tightening capital limitations, so lenders are lowering the LTV ratio for their loans (resulting in lower loan amounts).

Meeting in the Middle

With less conventional loan funds available, lenders and borrowers can meet in the middle with short term interest-only bridge loans. These options can help all parties get through these tough economic times with less exposure to risk. Bridge loans also provide short term relief for non-QM borrowers who want interest only funds to acquire and improve 1-4 unit rental properties without having to commit to long-term, high interest rate financing.

These loan options will also prove beneficial to developers looking for short-term financing for new MFH and retail projects that are leasing up more slowly and, thus, are not stabilized sufficiently to qualify for a favorable permanent loan. With economic uncertainty as prevalent as it is right now, lenders can benefit from catering to these niche borrower needs with bridge loans.

GoDocs Cloud™ — Built in Features to Support Any Bridge Loan Scenario

GoDocs Cloud™ loan document automation for commercial loans provides built-in features to support even the most complex bridge loan scenarios:

- Short term bridge loan options (i.e., 6-12 months) that can include a built-in extension (i.e., 3, 6 or 12 months).
- Short term bridge loan option can roll into a 3- or 5-year mini-perm loan.
- A hold back of loan funds to pay for improvements and repairs with proper disbursement controls and loan balancing provisions without the need of a full set of construction loan docs.

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Feeling the crunch for mezz lending as banks tighten their underwriting requirements.

3 Mezz Lending

Borrowers Are Demanding It

We recently started partnering with a commercial lender looking to grow its portfolio of mezz loans. They anticipate that these loans may be secured in a number of ways, including:

- A pledge of the equity ownership interests in the borrowing entity (or its single asset entity owner of the borrower);
- A junior lien on the real property collateral; or,
- A combination of both security interests. In addition, a mezz lender often requires cash management tools (i.e., soft or hard lockboxes) to protect its position as being subordinated to the payment rights and enforcement remedies of the senior lender.

The commercial lender is focusing on mezz loans because of the demand they are hearing in the market from borrowers and investors who are feeling the crunch as banks tighten their underwriting requirements and make loans with more conservative loan-to-value ratio requirements.

Mezz Lending *(continued)*

Bridging the Gap

Providing subordinate financing to bridge the "capital gap" for investors, mezzanine lending has proven an essential part of CRE structured finance transactions (both for construction and re-positioning loans) in recent years, delivering the additional loan funds needed in a tighter, more restrictive market for conventional loans.

In addition to bridging a financial gap, there are many other reasons lenders will want to focus on mezz lending in the months to come. Mezz lending can help borrowers reduce the equity contribution for a single project, achieve better leverage ratios, and enjoy more flexible repayment options in many scenarios, making them potentially lucrative products for lenders. With conventional mini-perm/perm lenders making more conservative loans, many borrowers need to seek out mezz financing to act as an additional capital bridge until they can re-finance at a future date under more favorable conditions.

In addition to bridging a financial gap in an investor's capital stack, lenders have a number of additional reasons for shifting focus to providing mezz lending in the current uncertain economic environment which is likely to continue for at least another 12-24 months. Mezz lending can help borrowers reduce the equity contribution needed for a single project, achieve better leverage ratios, and enjoy more flexible repayment options in many scenarios, all at favorable interest rates for lenders, all of which make such loans potentially lucrative products for lenders. With conventional construction, bridge and mini-perm lenders making more conservative loans, many borrowers need mezz financing to act as an additional capital bridge until they can re-finance their overall debt for a project at a future date under more favorable conditions.

Mezz Lending and the Loan Portfolio Stress Test

In today's tight credit climate, mezz lenders can be a resource for both borrowers and for senior bank lenders as the latter work to meet their stress test requirements. This is accomplished by providing the additional capital needed when banks lower their LTV ratio requirements to adjust the overall strength of their loan portfolios.

Many mezz lenders establish relationships with brokers and bankers as resources that can step in to make new projects financeable during periods when banks are struggling to satisfy their stress tests. Mezz lenders fill a gap for borrowers, investors, and lenders. If properly structured, mezz loans can provide secondary support for senior debt, particularly with respect to construction loans, large CRE portfolio loans and other loan types.

Mezz Loans for Construction

Mezz lending also has an increasing importance with respect to current construction loan debt structuring.

Construction lenders are making more conservative loans, thus requiring borrowers to come up with greater equity contributions. For borrowers without sufficient independent capital, mezz financing provides a necessary part of the capital stack for many new construction projects. Mezz loans provide much-needed funds that senior lenders can treat as "equity" which permits an investor to avoid bringing in new co-investors with ownership controls in order to pursue new construction projects.

Borrowers and senior lenders often prefer adding subordinate debt to meet the capital gap as opposed to involving new investors that want certain control and management rights which are not required as part of mezz financing. Mezz debt is fully subordinated to the senior debt, meaning the mezz lender is paid only after the senior lender is paid in full and senior only to the borrower receiving its return on its capital investment.

With the subordinated nature of mezz debt, mezz lenders are able to receive a higher interest rate because of the increased risk being assumed by the mezz lender. The lender is permitted to secure their debt with a pledge of the equity ownership interests in the borrower entities.

4 C&I Lending

Diversify and Expand

In an uncertain economy hovering between inflation and recession, businesses need additional working capital lines of credit to even out cash flow needs, provide additional capital for acquisitions, and fund capital improvements. Additionally, businesses have less revenue to fund new inventory, new equipment, etc., so lines of credit are needed to fill the capital gap.

A growing regional bank customer approached us because they wanted to diversify and expand their C&I loan products. This bank was responding to a greater demand from its borrowers to provide business credit financing to meet a variety of needs, including:

- Smoothing out cash flow;
- Taking advantage of asset acquisition opportunities; and
- Building up inventory during times of abundance as insurance against future supply chain disruptions.

We worked with the bank to adapt and expand their original loan products to provide comprehensive, compliant, and creative document packages to meet these unique needs borne out of the current economic conditions.

Global supply chain problems present huge disruptions in cash flow for a variety of industries, including retail sales, construction, and inventory warehouse distribution centers. This cash flow crunch has caused many businesses to seek interim financing solutions to help them meet periodic payroll and other operating expenses shortfalls.

C&I Lending *(continued)*

In addition, in the current unstable economic market, lenders have a greater need to employ cash management tools (i.e., soft or hard lockboxes, springing lockboxes, detailed revenue waterfall requirements, etc.) that permit lenders to manage the flow of funds for its borrowers to make certain that business expenses, including debt expenses, are paid on a timely basis before the borrowers' funds are employed for other capital expenses.

GoDocs Cloud™ — Raising the Bar on C&I Lending

With GoDocs C&IDocs™, the capabilities are robust, easy to use, and come with the most comprehensive and versatile built-in lender protections. Lenders can engage in the dynamic platform to create a range of capabilities, from easy to the most complex, to support their specific underwriting requirement.

Below are several highlights of the C&IDocs platform include the ability to document the following transactions:

- Term loans (single disbursement with interest-only or amortizing repayment options);
- Line of credit loans (multiple disbursements typically used for collateral types representing equipment, vehicles, or inventory);
- Revolving line of credit loans (borrowing base transactions secured by multiple collateral types, such as inventory, receivables, intellectual property, equipment, accounts, etc.);
- Business line of credit loans (revolving or non-revolving) secured by all business assets; and
- Interest-only bridge loans secured by a pledge of ownership interest(s) and/or a business assets general security agreement.

CONCLUSION

A number of economic factors are limiting borrowers' access to cheap, easy credit or investment. Yet, businesses continue to need loan funds and additional capital to pursue their business in a high-interest environment driven by Federal Reserve policies aimed at reducing inflation.

The purpose of rising interest rates is to slow the flow of capital, but the reality is that businesses still require additional funds, whether in the form of debt or investment, to maintain, sustain and/or expand their business ventures during tough economic times. Because direct investment by third party investors always comes with control issues, debt remains the first preference for real estate developers and businesses to address capital needs. Hence, the need for bridge loans, mezz loans, C&I loans, business lines of credit, working capital lines of credit and other similar types of loans that provide higher interest, but shorter term capital.

These loan types are favorable for both lenders and borrowers in this current economic environment.

6 Products That Deliver Documents *Faster, Cheaper, and at Higher Quality*

We offer six products tailored to the exact needs of the commercial lender.

CommercialDocs®

For commercial real estate and C&I loans, all commercial property types, term loans, fixed, adjusted, interest-only, revolving lines of credit, bridge loans, and rehab loans.

Easily automate any commercial loans — regardless of complexity.

InvestorDocs®

Specifically built for business purpose loans secured by 1-4 unit residential properties. Easily customize each document package for any transaction, lender requirement, and applicable state law.

Faster and less expensive than traditional attorneys and legacy software.

ApartmentDocs®

For loans secured by multifamily properties (5 or more units), and for all multifamily property types including apartments, mobile home parks, and assisted living facilities.

Custom-tailored to meet any lender's loan programs and requirements.

ModDocs®

For any modification extensions, loan assumptions, loan default materials for commercial, multifamily, and investor-owned 1-4 unit loans.

Includes default letters, demand letters, pre-negotiation letters, and forbearance agreements.

ConstructionDocs™

For all commercial construction loan types including ground-up, fix & flip, major rehab, modest rehab, and minor rehab projects.

Standard to complex, automated loan docs that provide protection without excess.

C&IDocs™

For a more accessible commercial option providing complex and compliant legal loan documents for working capital and equipment lending.

Capturing unique financial covenants, reporting requirements, and collateral monitoring provisions.

GoDocs®

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Powering Lender Growth with Doc Gen Automation

Accelerate Commercial Lending at Scale

The automation leader in commercial loan document generation.

Contact us to start automating your loan documents.

LET'S MAKE IT HAPPEN

GET YOUR CUSTOM ROI

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