6 Questions To Ask Your Loan Broker

Commercial mortgage brokers assist in most apartment loan transactions. Even investors who have strong lender relationships can benefit from a broker's familiarity with the current lending environment and underwriting parameters. All of which help you get the best deal. Nonetheless, it is important to ask the right questions to ensure that your broker is aligned with your priorities and transparent about their role in the financing process. Below are some key questions you will want to ask your broker to start the partnership on the right foot.

1. **How are you compensated?** Mortgage brokers earn compensation through fees or yield spread premiums (sometimes both). In the former case, the investor is paying the broker a fee that ranges from 0.50% to 1.50% of the final loan amount. This is usually paid through escrow at loan closing. In the latter case, the lender is paying the broker the amount of the "yield spread premium." In other words, the broker is being paid for selling you a higher interest rate over the lender's wholesale rate.
   Sometimes these yield spread premiums are undisclosed or hidden in the fine print. This introduces a conflict of interest that may compromise your broker's role as a fiduciary. If one lender pays a yield spread premium and another doesn't, you can imagine how that might incentivize a mortgage broker to act against his client's best interests by directing that client to the lender that pays the referral fee. On the other hand, some brokers will waive or reduce their fee when they are compensated by the lender. This means that an investor can reduce or eliminate closing costs to the broker by effectively financing their fee with a higher interest rate. Some lenders even show this math on the program/rate sheets that they share with brokers by including options with negative loan fees or points. As you would expect, the rate increases with the "negative" loan fees.
   I recommend talking to your broker about compensation up front that way you aren't questioning their fidelity and you aren't surprised at loan closing.

2. **What types of lenders are you considering?** There are a few lender types that offer debt on apartments: balance sheet lenders (e.g., commercial banks like Chase or Wells Fargo), government sponsored entities (Freddie Mac, Fannie Mae, FHA), and capital markets (life insurance companies, mortgage REITs, CMBS). A single lender cannot offer competitive programs for all potential loans. As such, each type of lender has different preferences that can lead to significant differences in quoted terms for the same property. Furthermore, even lenders of the same type compete differently for loans. For example, if an investor is looking to refinance a $2 million loan, capital markets lenders will be a poor fit. Specifically, their execution is more costly and their preference for larger loans means they won't offer their best rate on this sized transaction. Worse yet, seeing it as a small opportunity, the lender won't see you as a priority compared to their usual larger deals. Once you outline the needs of your loan, you should ask your broker how the lender types compare with respect to your loan and which type they feel will offer the best deal. This ensures the broker is considering all options, which is important since lenders move in and out of the market. For example, Freddie Mac introduced their

small balance program in late 2014. A broker accustomed to working with banks on smaller loans may not consider agency options as they historically weren't as competitive on smaller loans.
Even small differences in rates can compound given the size of most commercial real estate loans. Consequently, it can save an investor tens of thousands of dollars to find the most competitive lender for their property.

3. **Will the loan be recourse?** An investor who prefers non-recourse or is unable to provide a personal guaranty due to the nature of their ownership structure should let their broker know early in the process. As mentioned above, the best type of lender will vary based on recourse or non-recourse. Capital markets providers and agency lenders are more keen on non-recourse, whereas banks generally prefer recourse. Even if you are willing to provide a personal guaranty, you should ensure that your rate is lower to reflect the benefit of your guaranty compared to a non-recourse structure. See my previous article "Recourse: What's the value of your signature" for a discussion on the merits of recourse vs. non-recourse.
   Discussing your recourse preference early helps the broker prudently find the best lender for your property.

4. **Can I pay off my loan early?** Most commercial mortgages have a prepayment "premium" or penalty that lasts about as long as the fixed rate term. This means if you pay off your loan before the end of the penalty period, you'll have to pay a fee that ranges between 0.5%-5.0% of the amount you prepay. This is a considerable cost that can stymie your investment strategy whether you intend to sell or refinance for a lower rate. Not only should you know if there is a proposed prepayment penalty on the new loan, but you should evaluate any existing loan for prepayment amounts due upon refinancing. As mentioned in my previous article "5 Common and Costly Refinancing Mistakes," an existing prepayment premium can pose a costly surprise that rears its head after committing to new financing. In addition, when considering your new loan, the you want to consider the new prepayment premium relative to your investment strategy. If you intend to renovate the property and refinance to pull out the new equity, you will want a shorter prepayment premium that allows you to refinance within a couple of years. On the other hand, if you intend to stay put for a while, you might be more comfortable with a longer prepayment penalty duration in exchange for a longer fixed rate period or other structural benefit. Keep in mind that prepayment penalties do not allow flexibility if (when) things change. As such, you may want to negotiate in a waiver in the event of refinance with the same lender or sale of the property to a third party. The key thing is to have this discussion with your broker early so they can incorporate your strategy in when searching for your optimal lender.

5. **What are the total expected costs to close the loan?** Many investors focus on the interest rate, but a broker will help you focus and compare other refinancing costs. How much is the good faith deposit? Is there a rate lock fee or is it a deposit? What are the expected third party costs for legal, appraisal, and environmental? These are all

questions an investor should be asking their broker when comparing lenders. If comparing lenders by rate alone, an investor may miss other costs that make the all-in borrowing cost higher than expected.
Make sure that your broker includes a breakout of fees in their comparison presentation. You're not getting a comparison presentation? You might want to find a new broker.

6. **Have you closed a loan like mine with your recommended lender?** You want to know if your broker has worked with this lender before. It's fine if they haven't, since there are many lenders in the market, but the broker's previous experience may help you decide between lender options. One lender may have the best rate, but your broker might tell you that their closing process is more arduous or that they ask for every Schedule K-1 for the past 3-years. It might be worth the initial headache to get the better rate or other structural feature, but the important thing is to set your expectations accordingly so that you can close your loan smoothly with minimal surprises.

Most brokers want to help you find the best loan for your property, but to do so, they must understand your needs. Asking these questions fosters conversation that helps build that understanding early and, in the end, helps your broker find you the best loan.

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