What's Not to Like?

The private lending space offers benefits to lenders and borrowers, alike.

by Robert "Bobby" Montagne

The roots of private lending date back thousands of years to Ancient Rome, when wealthy landowners and feudal lords used their land and property to obtain collateralized loans. Fast forward to modern times. Private lending has really come into its own since the economic crisis of 2008. Following the Great Recession and the ensuing heightened regulatory environment (e.g., Dodd-Frank), traditional banks emerged bruised and gun-shy, resulting in a dearth of capital otherwise necessary for entrepreneurial ventures. That vacuum has been filled in many ways by non-traditional lenders, particularly in the real estate sector.

Armed with market demand as well as the passage of the 2012 Jumpstart Our Business Startups (JOBS) Act, which was designed to spark investments in small businesses, a number of new entrants have recognized and seized opportunities through private placements, peer-to-peer crowdfunding, direct lending, private REITs and so forth. Accelerated growth in the private lending space has resulted in availability of new capital to fix-and-flippers, builders, developers and rental real estate investors alike.

As a premier provider of hard money loans for acquisitions, construction and renovation projects in the Washington, D.C., region, we at Walnut Street Finance feel privileged to have participated for two decades in the development and, more recently, private lending industries. Here's what we like about the private lending space.

Profitable and Scalable Investing

Over the last several years, there has been extraordinary interest in private lending, as it has proven to be both profitable and—on a risk-adjusted basis with proper underwriting and due diligence—secure. Between the JOBS Act, ever-improving technology and an influx of available data and transparency, private lending has evolved into a maturing and more readily available asset class. As a result, Wall Street investment firms and Silicon Valley techies have rushed to get into this space, offering borrowers access to capital and investors a new method of achieving healthy returns. This confluence of events has resulted in a lend/invest model that can be scaled and sustained across various platforms.

JOBS Act and Crowdfunding

The JOBS Act of 2012 revolutionized the private lending space for several reasons. With the passage of Title II of the JOBS Act, lenders can now, for the first time, generally solicit private offerings, so long as investors are "accredited" and the issuers (lenders, in this case) take reasonable steps to verify that status. In other words, this "506(c)" offering allows lenders to advertise investments in their funds or loans without the rigors of a public offering, resulting in wider access to retail accredited investors at a fraction of the cost and regulatory hurdles of a public offering.

Additionally, implementation of Title IV of the JOBS Act, nicknamed "Regulation A+," has resulted in the ability for lenders to raise up to $50 million from the general public, i.e.,

both accredited and non-accredited investors. Though a Regulation A+ offering does require SEC approval and ongoing reporting, the fees and reporting requirements are less cumbersome than traditional public offerings.

The above provisions, coupled with crowdfunding portals and impressive websites targeted directly to borrowers and retail investors, have created a remarkable internet footprint attracting peer-to-peer investors in real estate. Said differently, local builders and developers (borrowers) with a project in mind—and perhaps a property under contract—easily and efficiently can be matched with investors seeking to place money in secured, first-lien real estate loans. The borrowers and investors never meet, and the portal (or manager, as the case may be) essentially acts as a clearinghouse. The portals also provide liquidity to existing lenders by giving them one option for a secondary market, where existing loans can be sold in whole or in part while simultaneously offering investors the ability to select their investments (as opposed to, say, REIT investments, which are selected by the trust manager).

With the above tools at our disposal, we like operating in this market, especially with the potential to scale and reach wide audiences. In fact, Walnut Street Finance recently launched a 506(c) private offering, which allows us to advertise to the public.

Wall Street and Private Equity Validation

Private equity firms from Wall Street to Silicon Valley have entered the hard money arena in several ways, further validating private lending as an asset class. For example, Patch of Land and Asset Avenue have become household names in the hard money space, and each has raised millions of dollars from venture capital investors. Big banks, including Goldman Sachs, J.P. Morgan Chase and Wells Fargo, reportedly have begun extending credit lines to fix-and-flip lenders.

Importantly, secondary markets for hard money loans are beginning to crystalize. Industry leaders include Los Angeles-based PeerStreet, which buys loans and crowdsources them to investors, and New York-based Toorak Capital. Like Fannie Mae and Freddie Mac in the consumer space, these secondary market participants purchase “conforming” loans, thereby increasing liquidity and efficiency in the private lending market. Surely, another sign of a maturing space.

Social Responsibility

The money may be hard, but it isn’t mean. In fact, hard money lending promotes social responsibility in several ways:

- First-lien investing is used to rehabilitate dilapidated properties and thus revitalize neighborhoods. Hard money lenders are more willing than risk-averse banks to make loans on properties in marginal areas. The resulting gentrification is good for the local community, the economy and tax collectors.

- Human potential can be unleashed through hard money lending. Private lending provides a pathway forward for folks traditionally ignored by banks, as hard money loans are underwritten primarily on the basis of the property’s value. Entrepreneurs with some skills and the determination to work hard can turn a profit by rehabbing old properties. In other words, fixing-and-flipping is one way to achieve the American dream, and that makes us feel good.

- We like the idea that we are growing America by helping small businesses (contractors, builders, real estate investors, suppliers, vendors, inspectors and even stagers) achieve success. When we grant a hard money loan, we see ripple effects that strengthen the country’s employment picture.

Billions in Untapped Potential

Before becoming a private money lender, Walnut Street renovated and flipped nearly 200 row houses in Washington, D.C., neighborhoods such as Petworth and Eckington. For every property that we renovated or saw being renovated, we saw many more distressed properties on the same block, ripe for restoration. If you multiply the thousands of row houses in DC that need rehabbing by the average sales price for each, the untapped market is in the billions of dollars. After seeing first-hand this enormous potential in Washington, D.C., and realizing that lack of capital was holding back many real estate investors, we decided to enter the private lending arena.

Decades of experience as a developer, builder and equity owner give us unique skills and insights to help rehabbers succeed. We show borrowers how to avoid mistakes, how to choose vendors and suppliers wisely and how to stay on time and within-budget. We have contacts, know the local players and understand who has the ultimate power to make or break your project. Walnut Street Finance also prides itself on honestly and transparency. We do what we say we’re going to do. In real estate, we think that goes a long way.

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And guess what? We have fun doing what we do. For one thing, we get to wear a lot of hats. Our days are spent conducting comparative market analyses, pro formas and risk assessments in the office, then traveling on-site to check out projects and meet many different types of people along the way. ▪

ABOUT THE AUTHOR

Bobby Montagne is a real estate entrepreneur with thirty years of experience in commercial and residential property development, finance and sales. After developing more than 1,200 residential units and 200,000 sq. ft. of commercial space in the Washington DC metro area, Bobby started flipping houses on a large scale. He renovated and sold more than 200 row houses in DC neighborhoods such as Petworth and Eckington, helping transform those neighborhoods. After seeing firsthand the potential of the fix and flip market in Washington DC, and realizing that lack of capital was holding back many real estate investors, he founded Walnut Street Finance, a private money lender, in 2016. He now funds renovation projects in DC, VA, MD and DE.