LEAVING THE WILD WEST BEHIND

THE PRIVATE LENDING INDUSTRY IS EMBRACING A SHIFT TO MODERNIZED LANGUAGE

Private lenders with institutional capital continue to be a major source of funding for commercial real estate investors across the country. These companies are working to alleviate the national housing shortage — estimated in 2020 at 3.8 million units.

But even as the industry grows and matures, it's still working to move beyond the stigmatized "hard money" language from its early "Wild West" days. The private lending sector has come a long way and many members have stated a case for why hard money is a term the industry should eliminate. In the past few years, industry attitudes have steadily moved in the direction that change is needed and it's time to drop the hard money moniker from the industry's vocabulary. ▸

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KEY POINTS

The changing look of private lending

- An increasing number of online searches use the term "private lending" instead of "hard money."
- Improved underwriting and other efficiencies have made these companies more professional.
- Private lenders want to continue institutionalizing this sector of commercial real estate finance.
- The industry is in the process of replacing the term "hard money" with "private money."

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The history of loans secured by hard assets reaches back thousands of years. The idea of using real estate or other assets to secure a loan may be one of the oldest kinds of credit financing. But the term "hard money" is relatively new, originating in the U.S. during the Great Depression when individuals took their money out of banks following the collapse of the banking industry.

The lack of money in circulation led to banks cutting back on their lending activities. Private lenders began to offer loans backed by real estate as a solution to property owners desperate for cash. But these hard money loans often had much higher interest rates than what banks would charge.

Following World War II, the nation saw a boom in the need for housing as servicemen and women returned from duty. There was an increased need for both ground-up construction and the rehabilitation of existing properties. Real estate investors used these types of loans to renovate existing properties and eventually sell them for a profit. Again, property owners didn't have many options from banks, so hard money reemerged as a last resort for those who sought capital against their holdings.

PLAYERS TAKE ACTION

In the past decade, private lending has undergone a transformation. A number of major players have created better underwriting standards, provided efficient access to funding in the capital markets and offered overall support for the institutionalization of the sector. The growth of the industry has created a very efficient market with many options for borrowers. "Hard money" is no longer an accurate description for the industry today.

In March 2022, the National Private Lenders Association (NPLA) passed an official resolution that encouraged industry participants to no longer use the term "hard money," and instead use terms like "private lending," "bridge lending" and "transitional lending." Through this resolution, the NPLA confirmed its commitment to supporting the cessation of the use of the term "hard money" to describe the lenders or products in the industry.

The association has started to publicly state and promote the reasons for this shift on its website, along with general efforts to urge members to cease using the term, as well as to educate borrowers and the public to transition away from the old language. This resolution was a direct result of open discourse among private lending organizations.

On its website, the American Association of Private Lenders (AAPL) published an article, "The Demise of 'Hard Money' in a Private Lending World." The article highlights the group's efforts since its inception to minimize the use of the hard money term. AAPL also made the change around hard money terminology the focus of its 2021 conference.

Industry publications, including this one, have taken the bold step of renaming listings of products formerly classified as hard money and are now calling them "private money." The change begins for *Scotsman Guide* in this issue. Such changes are an exciting milestone for all involved in the process and are proof that industry leaders are in support of the transition.

Jeff Tesch, CEO of RCN Capital, one of the largest private lenders in the country, agrees with the shift. He said that he is proud to be an industry member who is helping to guide the movement of private lending away from the hard money language.

"Our industry has institutionalized and is more competitive than ever, with professional firms competing to offer favorable terms and meet exploding unmet borrower demand for capital around the country." Tesch said. "'Hard money' is no longer an appropriate description for what we do, and a term we should avoid to gain greater acceptance from Wall Street."

PROOF IN NUMBERS

Beyond leading industry players, Google keywords and search traffic are another indicator that things are changing. There is evidence that the legions of local real estate investors and entrepreneurs seeking this form of funding are beginning to embrace the private lending name.

Homing in on specific keywords, "private money lenders" experienced 516% growth from October 2021 to September 2022 in the number of average monthly searches. During the same period, searches for "private lender near me" experienced 46% growth. Conversely, "hard money lenders near me" saw a 17% decline.

Additionally, a snapshot of 1,000 keywords related to "hard money" on Google in November 2022 showed an estimated total monthly search volume of about 440,000. A snapshot of 1,000 keywords related to "private lending" at this time showed an estimated volume of about 676,000.

WORK IS NEEDED

The ability to complete this shift is only as strong as the industry's collective efforts. It will require grassroots education and many conversations between lenders and borrowers; real estate investment forum conversations between veterans and newbies; and a slow shift to remove hard money language from marketing materials and websites.

Many companies still use this terminology in online advertising to capture a slice of existing searches. Concerns about changing the term grow as private lending faces headwinds in today's economy. Smaller and less institutionalized companies are hesitant to make large business adjustments or step away from lucrative marketing tactics during times of uncertainty.

While the shift in language can be beneficial to business growth in the long term, less-established players may fear that a change in core messaging will impact existing client relationships. But private lending also is an inclusive industry, so it's important to recognize that individual lenders should be allowed to adjust at their own pace. The good news is that these conversations are happening between lenders at industry conferences and with investors on the ground. There is little doubt that change will continue.

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The continued move away from hard money terminology will be a marathon, not a sprint, but it will ultimately be beneficial in the long run. Private lenders must continue to take a close look at industry practices and language. Improving the way they work and the language they use will help establish private lenders as providers of uniform and predictable lending products that are similar to and just as trustworthy as those offered by large banking institutions. •

John Beacham is CEO and founder of Toorak Capital Partners, a leading correspondent lender dedicated to purchasing small-balance, business-purpose residential, multifamily, mixed-use and residential bridge loans throughout the U.S. and the United Kingdom. Headquartered in Summit, New Jersey, Toorak acquires loans from leading originators and manages all aspects of the investment portfolio, including loan sourcing, pricing, underwriting, acquisition and asset management. For more information, visit toorakcapital.com. Reach Beacham at (212) 393-4100.