IS IT "HARD MONEY" OR IS IT "HARD TO GET MONEY"?

BY JOSEPH ANDAHAZY

You hear the expression all the time. "My client needs a Hard Money Loan." Usually that means somebody was turned down for traditional financing or the borrower just knows he will never qualify for a bank loan because of either negative credit, questionable income, or maybe the property itself does not meet the qualifying criteria. Another reason could be he has an opportunity to acquire a property, but needs to close on it within a very short period of time or risk losing it. The only apparent solution is to find a bridge loan from a private investor or the more common terminology: Hard Money.

Who are these Hard Money Lenders? They are well educated, business-savvy entrepreneurs receiving handsome returns on their loans. Most are comprised of mortgage consultants, brokers, realtors, CPAs, attorneys or just plain old business "fat cats" with deep pockets. Most are very experienced in real estate matters, posing as private portfolio lenders operating their little enterprise out of their Self-Directed IRAs. Some lenders are established store-front companies backed by a large investor pool or hedge funds marketing through online web sites, financial industry media and social business networking groups.

Larger firms market with a more corporate approach with names like … ABC Financial Solutions Inc., or XYZ Capital Funding, Inc. Their web sites can have a more corporate look and feel with photos of towering office buildings or people in business attire clutching brief cases and shaking hands in a boardroom environment. All designed to make you feel you have arrived and met the "professionals" who will fund your deal and FAST! Some even promote closing in 7-10 days. Now, I have not yet seen large street signs outside of office buildings that read… "HARD MONEY LOANS." Although in today's environment, I think it could only be a matter of time.

Hard Money Lending Philosophy - Being somewhat discrete about their business is common because the Hard Money Lender loves the personal control they have over every deal, and prefer having not to answer to anyone except their own conscience or the small investor pool who have trusted them with their participation agreements and contributions. The art of the deal, as they see it, fuels their intellectual prowess to fund, or not fund the request. You are purely at their mercy and they know it.

For a Hard Money Lender, the "gut feel" is the compass they follow. This is why nothing is decided upon until they speak to the borrowers via conference call to gain a sense of with whom they are dealing. I If possible, meet them in person at the location of the subject property. I have found this meeting is the most important step in attaining a positive response, even more important than verifying requirements such as Tax Returns, Asset Statements, Public Records etc. All are in the interest of validating the basis of the borrower's credibility. The Hard Money Lender's rules of engagement will alter as they see fit for each scenario.

Unlike automated underwriting engines which produce results within minutes, hard money underwriting places more emphasis on the personal experience of the borrower and the physical attributes of the subject property. Standard verifications of personal assets and credit ratings are requested. I have found the deal itself will be decided on the merits of the potential value of the finished property and the borrower's ability to sell his experience to the lender. The lender has no desire to take over the property should the loan default. However, part of the lender's decision process will include a full assessment of how to quickly it could "unload it" and the cost to do so in the event of a foreclosure.

Because the housing bust is still with us after two years, some very experienced investors have designed comprehensive business plans seeking Hard Money Lenders to be their "floating funds" resource while they hunt for and bid on multiple foreclosed homes from bank REO listings. Banks are eager to quickly unload their REO properties because that only improves their Balance Sheets. To the real estate investor - having the ability to close fast, rehab fast and sell fast, is key. To the Hard Money Lender, partnering with an experienced investor who has mastered the "buy-fix-sell quickly" model will certainly want to continue the relationship because of the minimized risk and the positive return expectations.

Even with interest rates in the mid-teens, and the combining lender / broker fees ranging from 3-8 points, most investors will chalk that up to the cost of doing business. Having that financial "system" in place allowing them to move quickly in managing multiple purchase contract bids, maintaining a regular rehab crew busy on their projects, and marketing the finished home for sale, is what they prefer. If a real estate investor can return quality work within a few short months and sell the property with a nice profit, then everyone wins. The system can be very effective.

The phrase "skin in the game" is widely used in this industry to learn how much cash/equity the borrowers will have in the deal. The more they do, the more likely the lender will help accommodate the remaining amount. Loan-to-Value financing percentages hover around 50-65 percent in this market for cash-flowing properties. That is about as far as a Hard Money Lender will want to feel comfortable.

What Properties Qualify for Hard Money? Mostly investment properties only; both residential and commercial that traditional banks and mortgage companies, for whatever reason, will not finance. The property can be any type. Keep in mind, you will have more success in gaining the interest of a Hard Money Lender if the property is a "cash-flowing" entity such as an operating restaurant, golf course, auto repair shop or apartment building verse raw land in a remote location. There may be lenders for raw land, but usually they will want to cross-collateralize the loan against some other asset belonging to the borrower and/or principals of the company.

Not all Hard Money Lenders operate the same way, so you will need to know what they will and will not fund. Over the past several years I have created a matrix of lenders and the types of loans they offer, the qualifying property types and which states they will lend. I have also discovered, as a general rule, the smaller Hard Money Lenders prefer to lend on properties in their own neck of the woods and not cross several county or state lines. Being in close proximity to a deal they have funded only adds to their comfort zone and control. Only the larger firms with deep pockets appear to promote their ability to fund nationwide and some even internationally.

Most Hard Money Lenders will not lend on primary residences because of the regulatory and licensing laws governing high rates and fees, so they tend to stay in the "investor properties only" world and preferably commercial properties. Typically, the notes will be drawn up as commercial business loans lending in the name of an entity. However, someone will have to personally guarantee it, unless the Hard Money Lender funds the loan as "Non-Recourse," which is easier for the lender to take over the property in a default situation. Again, it all depends on how they feel about the deal and who they're lending to.

Hard Money Application Requirements – Mostly a Hard Money lender will follow the rules of the commercial loan industry. The first submittal is the Executive Summary. This document should be no more than two pages to include a brief introduction of the subject property, bios on the borrowing team, the purpose of the loan, the amount being requested with specific detail on the Use of Funds. There should be a few photos of the subject property with some detail from the tax record with map locations and designations. Also the length of time or the term period for the loan should be identified. Most important is the Exit Strategy. This is a detailed plan on how the lender will be repaid.

If this document is designed correctly and provides all the important strategic information to get your message across, then you should be able to strike the interest of the Lender to move to a conference call with all the parties associated with the deal. An example would be the Broker – Lender and the key principals borrowing the money. Usually the conference call is the "make" or "break" point of the process. If it does not go well, than it does not mean your deal is not fundable. Not enough interest was created with this lender. This is a normal part of the process. However, if you are talking to your fourth or fifth lender and you are hearing the same issues, then you will need to reassess your deal.

Now, if your call generates a favorable response, the lender will (should) generate a "Letter of Intent" to lend [LOI]. I say "should" because all lenders do not act the same or have the same requirements. In any event, The LOI will spell out the terms of the loan i.e. interest rate, fees, term period, due diligence fee, escrows, monthly payments and any conditions. Your signature on that letter will signify your intent to accept the loan under the terms specified.

The LOI may stipulate a required upfront "due diligence" fee which the lender uses to perform their background checks, verifications, title searches, site surveys, appraisals and related legal checks regarding the borrower, the subject property and for the production of final loan commitment letter (LOC). Depending on the size of the loan and the location of the property, this fee can be rather stiff and possibly reach four digit figures. Again each lender operates their own game plan so be aware. The fee may or may not be refundable in part for any unused amount if the loan is denied. But it is always shown as a credit towards the borrower's total settlement cost at closing. It is important to understand the process after the LOI is accepted and signed. I suggest obtaining the due diligence process in writing before handing over any fee. Not having a thorough listing of expectations regarding the fee, a time table for the due diligence performance and expected date of loan decision, could drag out the process for months.

Where to find Hard Money Lenders – The first time I discovered a Hard Money Lender was years ago as I was processing a payoff scenario for a client being refinanced. The first trust lender being paid off was an individual, not some bank or mortgage company. As I spoke to the individual collecting his payoff information, he began selling me on his ability to provide funding when borrowers or properties do not qualify. From then on I discovered business networking groups and real estate investment groups in my area where I met several more. I started collecting names and making phone calls learning all I could about their capabilities.

Of course today all you really need to do is an online search for: HARD MONEY LENDERS and click away to your heart's desire. But know this: there are brokers posing as lenders, so ask first if they are truly the "lender" or source of the capital. Sometimes you have to co-broker a deal and that's OK if that's what it takes to close your deal. I have worked with brokers several times and as long as there is a formal agreement, you are fine. Also, there are "scammers" out there posing as lenders. (Most are offshore). Their only goal is to convince you to accept an LOI so they can collect upfront due diligence fees. After they have your money, they slowly torture you by not returning phone calls or emails until you are so exhausted, you just give up and move on. So if it's your first time working with this lender, ask for references. One good way to check them out is to have them send a few copies of previous settlement statements and their attorney contact information. If they balk at your request to verify their credibility, then hang up the phone.

So as they say in Boy Scouts, "Be Prepared" before you contact a Hard Money Lender. Educate yourself first. It is the deal that is presented and packaged properly that has any chance of rendering a positive response. The success of attaining a hard money loan will depend on your ability to sell yourself and the property to the person who is actually writing the check [in most cases]. Not being prepared, you could strike out fast within minutes into your conference call. Do your homework first and you will improve your chances of sliding into home plate with the cash you need to get your deal done.

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