A Head for Hard Money

Think like a private-money investor when considering hard-money loans for your clients

By **Dale Morrison,** mortgage broker, Pacific West Funding

After being turned down by institutional sources, many mortgage brokers look to other sources to help fund clients' loans. Hard money can offer an important source of financing for borrowers to solve some of the difficult or unusual situations that may arise.

Private-money investors don't have the same rules and regulations as traditional sources, however. They are a "loan committee" of one, and they make the funding decision. Private investors are typically individuals who have worked hard for their money and who want to fund loans to collect a monthly income from their investment.

For success with hard money, brokers must understand what goes through investors' minds before they fund a loan. They should put themselves in investors' shoes.

What's the equity and loan to value?

The first thing to address is the loan to value (LTV). Equity is key. It is the ultimate protection for investors in the event of default. It makes up for many mistakes, and it is what private-money investors look at from the outset to see if a property is worth funding.

Typically, the rule of thumb for maximum LTVs is:

- **70 percent for single-family residences (owner-occupied and non-owner-occupied);**
- **65 percent for commercial properties;**
- **60 percent for industrial properties;** and
- **50 percent for vacant land.**

Private investors understand that there are credit challenges, income-documentation difficulties and other situations that can arise when placing a loan through institutional sources. If there is a lot of equity in the property, they likely will be interested in extending a loan to the borrower.

What's the story?

Next, private-money investors want to know the "story" — why they should make a loan. Why is the borrower going after a hard-money loan and paying the higher rates and fees? Some questions investors will ask are:

- **Are the borrowers in default?** If so, what caused the default? What has changed to justify making a loan?
- **If borrowers have lost their jobs, what are their prospects of finding work?** If there are none, what is their plan?
- **If borrowers want a large cash-out, what is their purpose?** Do they have a productive purpose? Or is this going to put them in a tough financial situation later, when investors may have to foreclose?

Things happen in people's lives, including divorce, death, loss of employment, bankruptcy or other circumstances. A hard-money loan may be the only solution to help borrowers get back on their feet.

Does it make sense?

The next thing investors want to know is if the loan makes sense. Can the borrower repay the loan? Some questions they will ask are:

- **What are the monthly rents?** Do they come close to servicing the monthly payment?
- **If vacancies are involved, what is the likelihood of filling the units?** And how fast?
- **Are repairs necessary?** What are the borrowers planning to do with the property?

Often, borrowers will make certain claims about the property, but common sense may tell the investor that those claims don't add up. No worthwhile investor wants to make a loan knowing that the borrowers have no chance of making the monthly payment. Investors make loans to get a return on their capital, not to foreclose.

The investor approach

The above questions are what go through investors' minds as they look at loans. Ultimately, mortgage brokers should think like investors and ask themselves, "Would I do this loan?" If brokers can say yes, then they have a loan that should be marketable in the hard-money world.

Of course, it is not always as simple as asking those questions. There are some difficult situations that can arise, and that's when brokers need a private-money expert. About 80 percent of the time, however, analyzing the loan from the investor's perspective should help brokers decide if they have a hard-money loan.

Hard money provides an opportunity for brokers to help borrowers, to earn a nice paycheck and, in most cases, to work with borrowers in the future to refinance out of the hard-money loan once their situation has changed.

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