

What You Should Know About “Hard Money” Lending

By Weston A. Jones, Principal Broker, *Mentor Financial Group*

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So What Is “Hard Money” Anyway? Most people have heard the term before but are not sure exactly what it means. Don’t be confused by the term “Hard Money”. The name doesn’t mean that this money is difficult to obtain because, in reality, Hard Money loans are some of the easiest funds to procure. Generally speaking, the industry defines “Hard Money” as “*unconventional asset based lending*” in which the collateral of the loan is real estate. It is considered unconventional because these loans do not meet the traditional underwriting criteria of Institutional Lenders (ILs).

A Hard Money Lender (HML) is typically the “lender of last resort” due to the loan’s unconventional characteristics: fast funding timeline, a borrower’s credit score, loan type, etc. Private—or “Hard Money”—lenders include real estate funds, pension funds, insurance companies and/or private individuals with money available for lending. Some have deep pockets while others have limited resources.

Based upon their own criteria, HMLs lend money primarily on a short-term basis to borrowers who use it for a variety of profitable purposes. These may include the following real estate loan types: bridge, refinance, development, acquisition, rehab, etc. Since Hard Money is more expensive than traditional sources (10%+ interest

rate and 2 points+ in origination fees), borrowers should have a significant financial upside for using these sources. The benefits should outweigh the loan cost.

WHAT ARE TYPICAL TERMS FOR HARD MONEY LOANS?

Terms and requirements for these types of loans will vary from lender to lender. Lenders may charge an up-front application fee, due diligence fee and commitment fee. Make sure to understand these fees when selecting a Hard Money Lender because these fees may be non-refundable. Generally, a HML will fund a loan for 50% LTV on raw land and up to 70% LTV on the finished product at an interest rate of 10%+ and for a period of six months to three years.

Lenders will also charge between 2 and 10 points as an origination fee to be paid out of proceeds. Loans can be either interest only or amortized. Some lenders will fund interest, origination fees, rehab money, etc.; others will not. Ultimately, when selecting a HML, borrowers will need to understand how these options best fit into their plans.

WHY IS HARD MONEY A GOOD FINANCING OPTION?

Institutional Lenders (ILs— banks, credit unions, etc.) fill a need for cheap money. Everyone is glad they exist and fulfill their needs. Borrowers would love to use them on all real estate deals. However, there is a market out there

that ILs cannot fund. That is where Hard Money Lenders come in and why they exist. They fulfill a need that ILs cannot fill due to government regulations, stricter underwriting guidelines, lower risk profiles, longer funding timelines, etc.

When deciding whether to apply for a Hard Money loan, consider these top ten reasons:

- 1. Speed** — Most Hard Money Lenders (HMLs) can fund in less than two weeks after receiving all the necessary documentation while most Institutional Lenders (ILs) can take 60 days or greater, if at all.
- 2. Low Documentation Requirements** — HMLs’ documentation is often less than the paperwork required by ILs. HMLs still require some documentation, but they fund based on the value of the property; it is the asset that is under consideration, not the borrower.
- 3. No Credit Issue** — HMLs typically do not require borrowers to have good credit. For example, one client was able to obtain funding even though the borrower had a recent bankruptcy, foreclosure and a FICO score under 500. ILs almost always require a decent credit history.
- 4. Flexibility** — HMLs give maximum flexibility in structuring the loan (i.e. term, interest reserve, draw schedules, cash-out, financing carry, etc.). ILs typically have much stricter terms.

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5. **Gap/Bridge Financing** — HMLs are usually very experienced real estate lenders who understand that projects do not always follow the given plan. If a gap in funding exists and the loan and supporting documentation make sense, HMLs will typically fund. ILs' guidelines are typically not flexible, and they turn down gap loan requests if borrowers get off schedule.
6. **Loans to Foreign Nationals** — HMLs will loan to foreign nationals as long as they are secured in the property. Most ILs have difficulty lending to non-US citizens under the terms required.
7. **Higher Risk Profile** — HMLs will fund pre-development, church, non-profit and other riskier loans due to their understanding of the process and value of the collateral. ILs typically will not fund pre-development loans or make loans to institutions which impact their profile in the community. For example, no IL wants to foreclose on a church; the publicity is terrible.
8. **No Personal Guarantee** — HMLs do not always require personal guarantees since loans are made based on the value of the property. ILs almost always require personal guarantees.
9. **Flexible LTVs** — HMLs decide what Loan-to-Value (LTV) they will accept based on their affinity for the project, cross collateralization, possible equity participation, etc. ILs have very strict underwriting criteria and turn down loans from the beginning if the LTV is too high.
10. **Subordinate Liens** — HMLs will make loans in a first, second, third or lower position as long as the value of the property is there. ILs might do

a second, but almost never a third. Typically, ILs want to be in a first position.

WHAT ARE HARD MONEY LOAN EXPECTATIONS?

So there is a good deal with a great LTV, and the loan can't go to an Institutional Lender because of bad credit or the need for funding in two weeks or faster. Armed with knowledge of the concept and value of Hard Money lending, the broker sends the loan to a HML. The bottom line is that the finance cost will be more expensive than an IL, but the deal will close.

Each deal is unique. Deal terms vary, and nothing is set in stone. Lender criteria adjust based on the specifics of each deal so borrowers will need to be flexible. Here are a few of the expectations to keep in mind when applying for a Hard Money loan:

1. Title insurance is a must.
2. All delinquent taxes, judgments, and other liens on the property will typically be taken out of the proceeds unless specifically excluded.
3. Insurance typically will add the lender as co-insured.
4. Fund control is always set up on construction, development and any loans which have budgets.
5. Borrower will pay all closing costs, fees, etc., out of proceeds.
6. Many lenders require that the property be put into a single asset LLC to which the loan is made.
7. Borrowers should be prepared to assign rents.
8. Interest, in most cases, will be reserved or prepaid, at least partly.
9. Some HMLs require an up-front application fee, due diligence fee and commitment fee. Make sure you understand these fees, how they will be used, and if they are refundable.

10. Almost all lenders require borrowers to have money in the deal. Additional collateral may be required by cross collateralizing other properties to keep the LTV acceptable.

The funding process generally includes the following steps: LOI, documentation checklist, commitment letter, due diligence, ordering of the preliminary title report, opening escrow, drawing and signing documents, recording of documents, issuance of the title insurance and distribution of funds.

One final suggestion is to try every institutional and conventional lender first. After understanding that the loan doesn't fit into their underwriting criteria and after the loan request keeps getting denied for various reasons, keep Hard Money Lenders in mind. HMLs are a valuable option for many types of real estate transactions. Good luck!

Weston A. Jones is the Principal Broker for Mentor Financial Group (“MFG”), a private Hard Money commercial real estate lending and investment company. Founded in San Diego, California, with a branch office located in Scottsdale, AZ, MFG specializes exclusively in fast Hard Money trust deed investments, primarily in Arizona, California and select opportunities nationwide. Mr. Jones founded MFG and is dedicated to developing the world class customer service, underwriting and processing framework that the industry demands. Mr. Jones received his MBA with a concentration in Finance and Real Estate at the Harvard Business School and is a licensed California Real Estate Broker with a CPA designation. For more information, contact Mr. Jones at (619) 987-9433, email weston@mentorfsg.com, or visit www.mentorfsg.com. ♦