This document will outline the private lending process from the perspective of a potential new lender trying to get an idea of what private lending looks like in total. This is also good information for active investors that want to use private funds to close additional properties and projects.

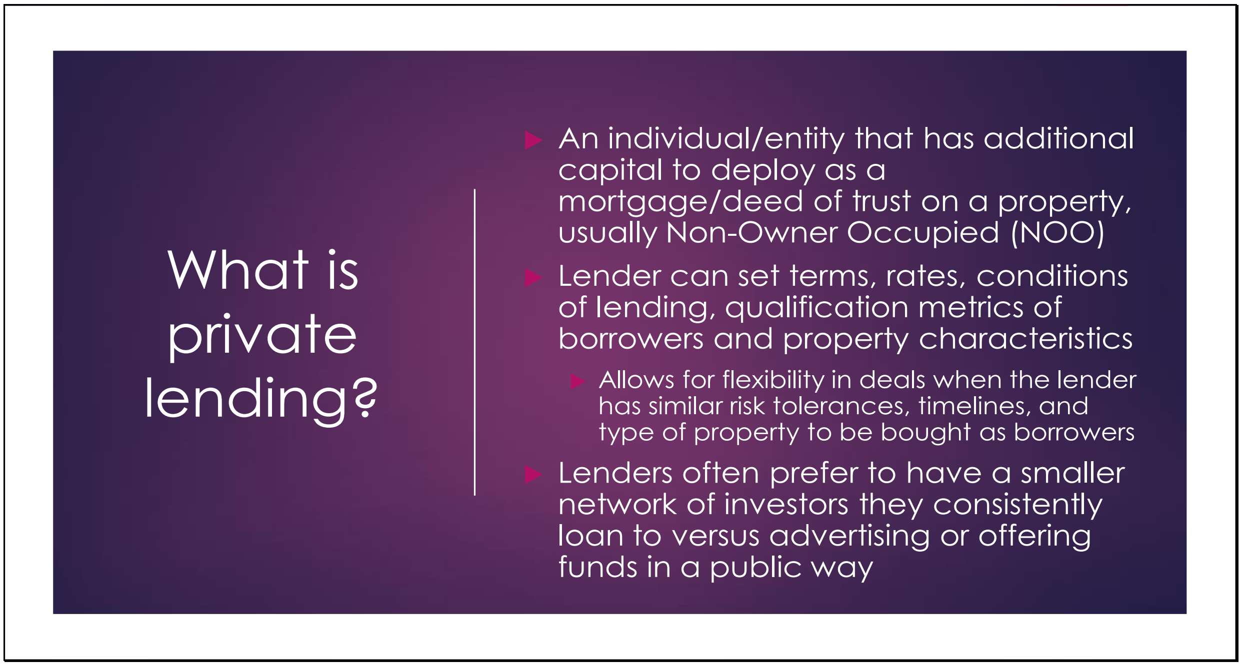
There is a video you can watch that will run through this presentation located on the YouTube Channel for Private Lending Lessons, our educational arm to our company that teaches other investors how to do private lending or work with private lenders.

The link to join the Private Lending Lessons Facebook group to participate in educational opportunities and networking events:

https://www.facebook.com/groups/privatelendinglessons

If you would like to schedule a Zoom call – please book some time on my calendar:

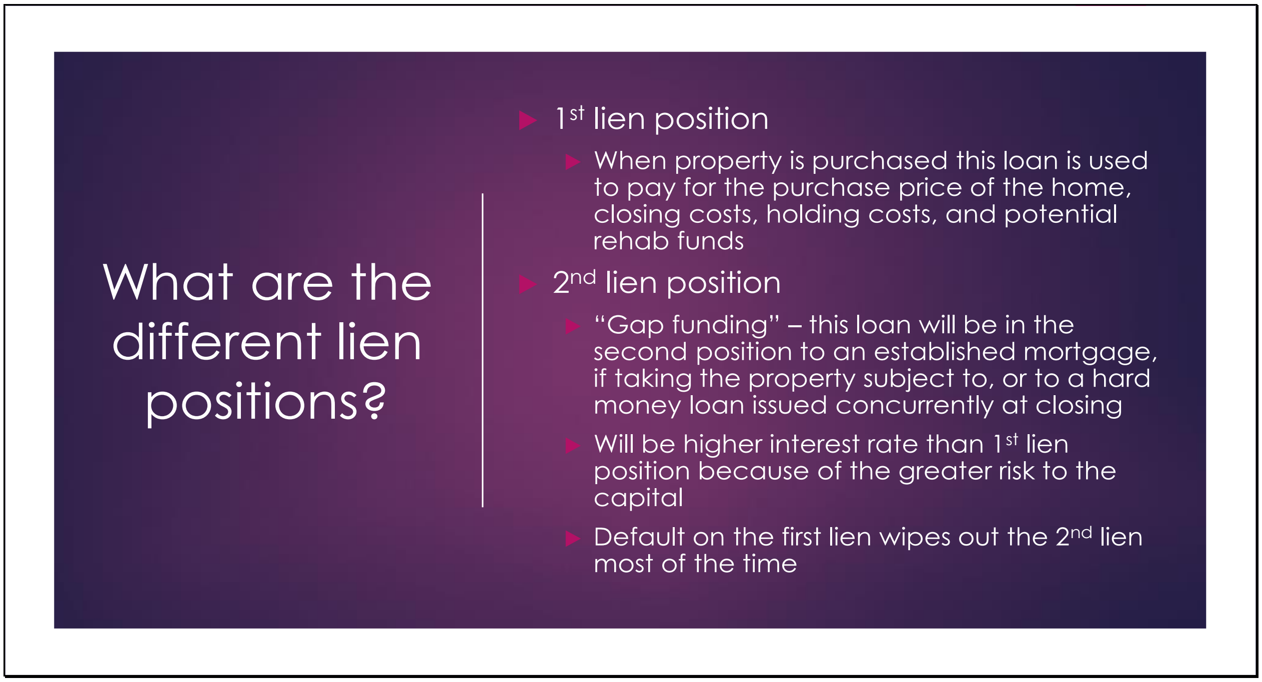
https://calendly.com/alex-iri/30min



Private lending often gets interchanged with the term hard money lender. In my opinion, those two things are similar but still quite different. That difference largely centers around where the money being lent is coming from and who has final say in where that money will go. Private lenders are often lending out their own funds, or funds they have direct control over, such as pooled funds from investors. Private lenders have “in-house” underwriting that is usually the private lender themselves, or a dedicated team member that is employed by the private lender’s company. Private lenders are free to evaluate each borrower and deal according to their personalized lending criteria that suits their risk tolerances, goals, or lending standards.

Hard money lenders often are either brokers for larger companies that dictate the terms of the loan, the borrower qualifications, and the types of properties the loan can be used to purchase. The rates and origination points are often set with no room for negotiation of amounts or when they are going to be paid. Also, loans will not be funded that don’t meet all of those underlying requirements.

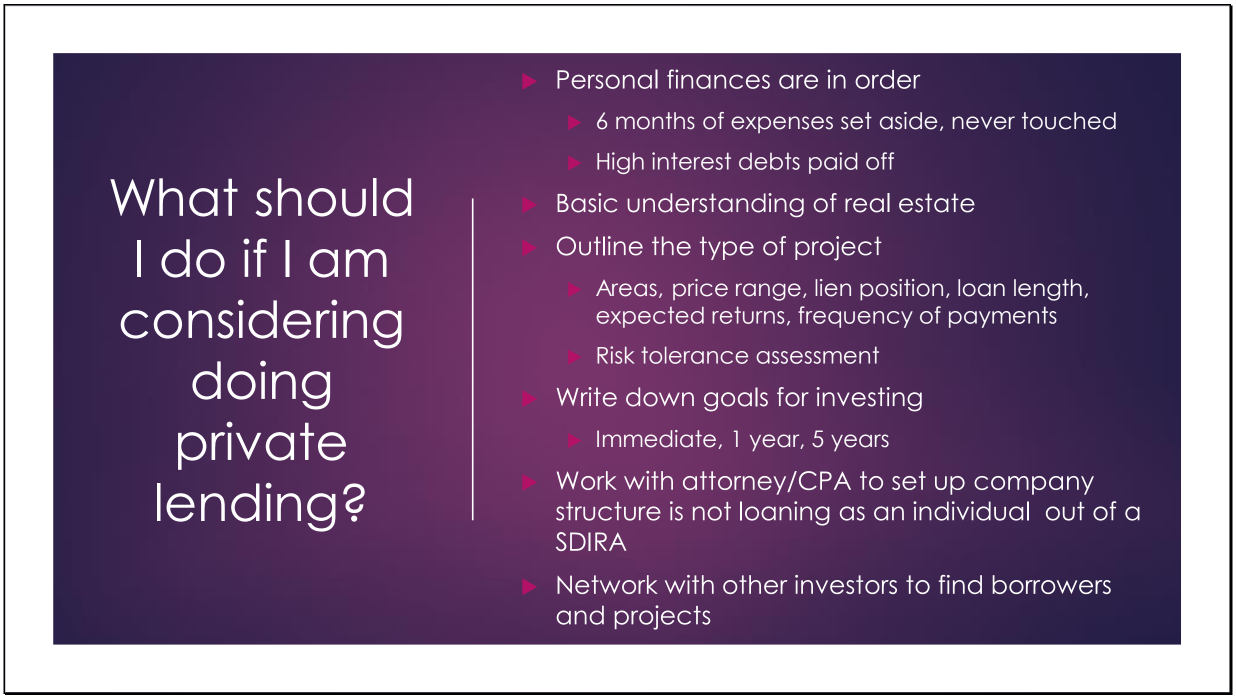
One method of lending is not necessarily better than the other, they each have a place in the marketplace for active investors. Private lending is more relationship based, so extensive networking and a track record are often required to find a private lender willing to work with you as an active investor. The flexibility can also be a bonus and a downside because it is very hard for a private lender to make clear cut terms without knowing anything about the project or the borrower. Also, certain aspects of the property or borrower may be weighted differently from one private lender to the next. Hard money lenders often have higher levels of liquidity available to them, so when you have a deal closing quickly, they are more likely to have funding available and the slow down may be the underwriting part of the loan process, which we will go over in detail in a few minutes.



There are generally two types of lien positions for secured lending in real estate – First lien position and Second lien position (often termed gap funding). First lien positions are going to be the first mortgage on the property that is often taken out when the property is purchased, or if the property is owned outright by the seller (meaning they do not have a mortgage on the property currently), the mortgage will be the superior lien. There are liens that can arise throughout the course of owning a property that can take precedent over a first lien position – such as mechanics liens, tax liens, and HOA liens. As a private lender being proactive to make sure these items are paid will help eliminate a lien holder taking a superior claim to your first lien position.

First liens may include funds for the purchase of the property, renovation costs, holding costs, and closing costs. How those funds are dispersed at the closing table are negotiated between lender and borrower, but frequent terms are that a borrower will have to bring some percentage of a down payment (5% to 15% of the purchase price), plus pay the closing costs associated with purchasing the property out of their own funds. In addition, renovation costs may be reimbursed to the borrower after the supplies and materials have been installed and a contractor has signed a lien waiver after payment. This means a borrower will need to have some funds in reserves for down payment, closing costs, and to pay some percentage of the renovations out of pocket before being reimbursed by the lender.

Second liens will be junior to a first lien holder. An example is a home equity line of credit for a traditional primary residence borrower. For investment properties, this second lien position is often called gap funding. Second liens can be used to potentially catch the first lien position up if the borrower is buying a property subject-to, renovations, holding costs for the first lien, and even the down payment and closing costs for the first lien (if allowed). Second liens are viewed as riskier because if the property were to fall into foreclosure by the first lien, or another superior lien, the second lien holder will be paid after and if there are any funds left over after the property has been sold or taken over by the first lien holder. For anyone seeking gap funding or thinking about offering gap funding, equity in the deal is often the main driver of that decision to fund the deal. A property that already has a first lien on it for 70% or more of its' value potentially will not have enough equity in the deal should something not go as planned and the first mortgage falls into foreclosure. Interest charges, legal fees, and other lender fees can eat up the equity in a deal very quickly, so if you are looking to do gap funding, assess the level of equity in the property in terms of dollars and percentages.



There are some things you will want to make sure are in place before you consider doing private lending. These will vary depending on your risk tolerances and goals. Since private lending is a relatively illiquid investment – do not invest with funds you may need during the time of the loan. To help buffer that need, I suggest having at least six months of expenses set aside for you to access in case you need it for life events, such as job loss, major medical expenses, the ability to participate in other investment opportunities and other life events. In addition, make sure any higher interest rate debt is also paid off. It makes no sense to loan out funds for 12% a year, when you are paying 18% on debt with another account. Set yourself up for success and get your own financial house in order. These are also really good guidelines for active investors seeking to have private lenders work with them to fund their deals. Private lenders will want to see ample assets to pull from for renovations (and inevitable overages that come with renovations) or longer than projected hold times. Lenders will want to see lower debt levels for personal debt but also an ability to pull from revolving credit if needed, such as lines of credit or credit cards.

The next step is to also have some basic understanding of the type of real estate you want to fund. If you are looking to fund fix and flips in a specific market, you will need to learn the various metrics associated with fix and flips, such as typical renovation costs, average days on market for that area, average construction types that are common in that area, among other things. You can work with experienced active investors and have them talk you through their business model and processes to get an idea of what some red flags might be, areas to pay attention to, certain numbers that might be important, and different laws and considerations.

The third step in getting started in private lending will be to establish your risk tolerance for investments. Do you like the idea of using $30,000 to earn possibly 24% return on your money doing gap funding? Are you going to sleep better at night if you are in the first lien position and you know the borrower has put down 10% of the purchase price, paid several months of interest up front, and will be paying for all the renovations out of pocket? Establishing your risk tolerance is less science and more gut feeling. The easiest way to establish that risk level is what I refer to as "the pucker factor". If someone is explaining a deal option and you start thinking "oooooh noooo", then you can figure out that is right where your comfort level stops. The next step is to figure out is this a reasonable place to have a risk level, or are you genuinely worried about a very material risk. You can ask ten different private lenders about a deal and chances are you will get ten different answers on if and how they would fund the deal. The best way to establish where your risk tolerances might be would be to talk with other private lenders about their possible deal structures, pros and cons of various situations, and getting their feedback. You can do something like this at one of monthly networking events in Private Lending Lessons, or posting a question in the group for discussion.

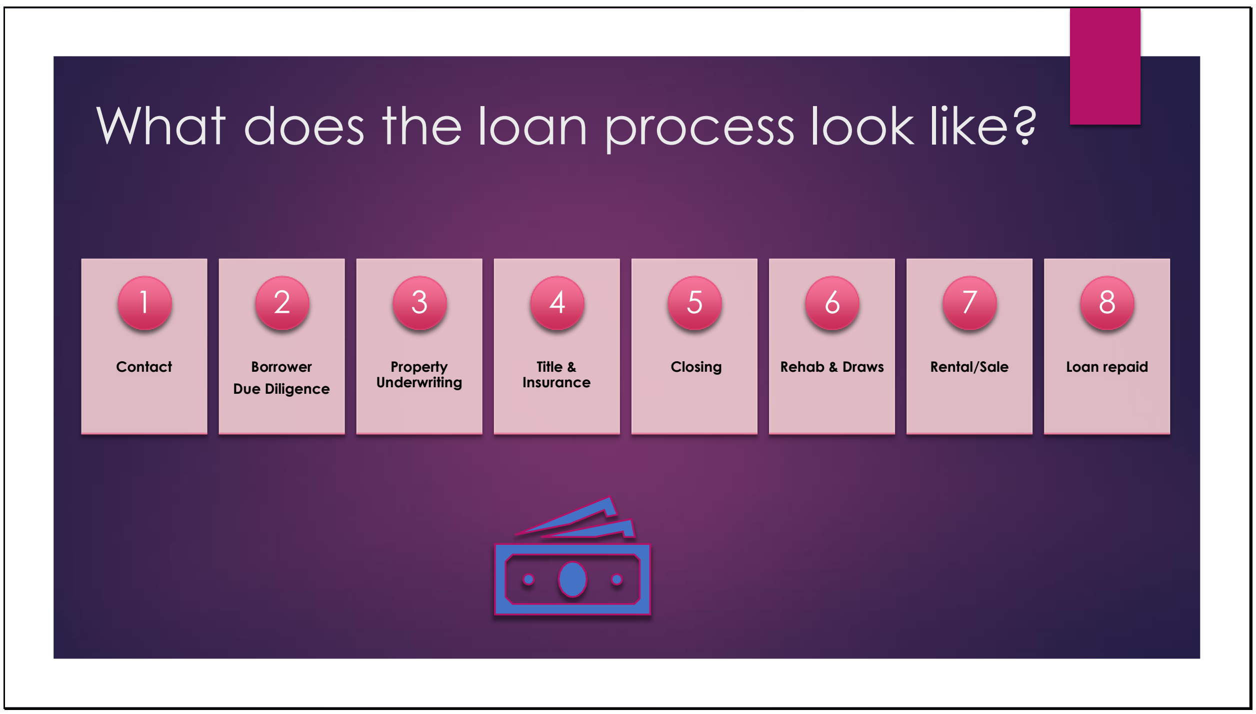
If you have made it this far, then you might be ready to get started private lending! Most importantly in this entire endeavor is making sure you are covered legally. To do this, the best and safest course of action is to hire an attorney familiar with lending in the state you will be lending in (if that is different than the state you currently live in you will want to speak to an attorney in your own state as well). There may be lending licensing requirements for you as a lender in your home state, no matter where you are lending funds. The state the property (and hopefully the borrower!) are in will dictate the limits for rates, fees and the foreclosure process. These are the aspects you will want to know from your attorney and have documentation drafted that covers you to the best of the law's ability.

Lastly, it is worth mentioning again, network with other investors who are doing private lending! There are quite a few ins and outs (as with any type of real estate investing) that you will want to know about before you have a borrower sign on the dotted line and you have wired funds to a closing attorney. It is also worth the time and expense to do some tax planning with a qualified tax professional to make sure you do not have any end of the year surprises due to the tax man.

There are some loan details that will need to be ironed out during the initial conversations you have with a potential borrower or lender if you are an active investor:

1. Property Profile
    a. What type of properties are you willing to lend on? This should include size, location, construction type, price ranges, and exit strategies.
2. Length of the Loan:
    a. A private loan can be anywhere from 1 day (transactional funding) to a few years (which is more common with investors who are loaning funds out from a retirement account).
3. Payment Frequency:
    a. Are you expecting monthly payments? Are you ok getting quarterly payments for longer term loans? Are you willing to roll the interest of the loan into the payoff of the loan? Having the payment frequency set for what you would like as the lender will help guide the conversations with a borrower.
4. Origination Points:
    a. Will you charge origination points? Will those be paid at closing? Will they be rolled into the proceeds of the loan (so you actually fund less money to the closing attorney)?
5. Rates:
    a. What rate are you expecting to get as a return on your investment? Are you happy with an 8% return if you are in the first lien position and the borrower has a lot of experience and a lot of cash into the deal in the form of down payment and renovation costs? Are you expecting a higher return? What are the current market rates in your location for lending?

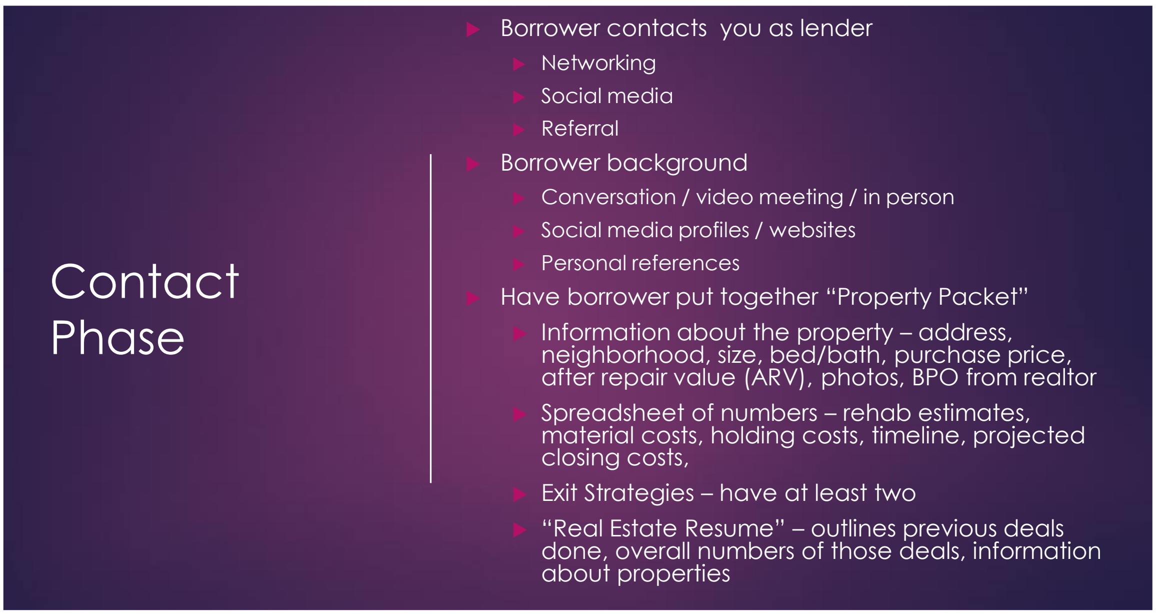
6. Fees:
    a. What fees are you going to charge a potential borrower? Will you charge a draw fee? What about an underwriting fee for your time assessing the deal? What about a document prep fee to cover your attorney fees for drawing up your documentation for that loan?
7. Personal Guarantee:
    a. Will you require a personal guarantee for any loans that are issued to a business entity? Will you require all partners in that business entity to do a personal guarantee on the loan?



The private lending process can be broken down in 8 stages:

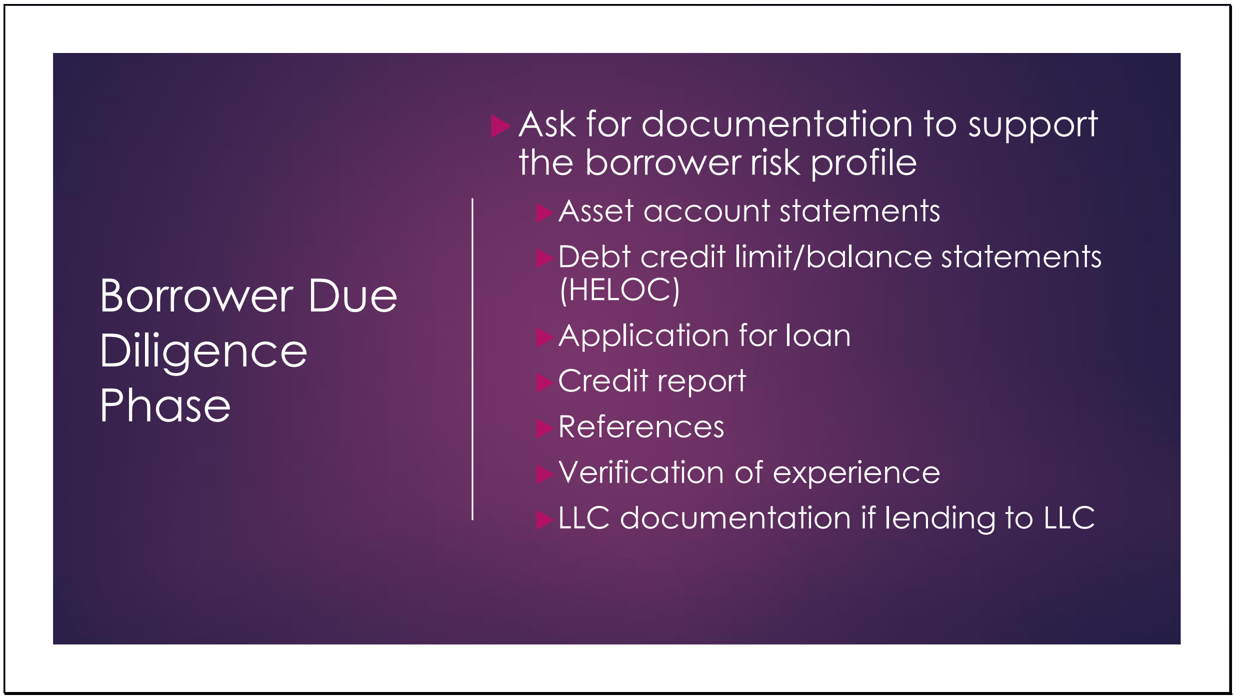
1. Contact – initial contact between private lender and potential borrower
2. Borrower Due Diligence – establishing the risk level of the borrower
3. Property Underwriting – establishing the metrics for the property such as after repair values, feasibility of exit strategies, scope of work costs, and timelines.
4. Title & Insurance – Getting a title report from a closing company/attorney, and being added to the appropriate insurance policies (builders risk/home owners insurance/lenders title/flood)
5. Closing – the process of getting the cash to closing and having it dispersed appropriately

6. Rehab & Draw – After closing, dispersing funds if available, borrower communications about project progress, and paperwork required for draws
7. Rental & Sale – depending on exit strategy (buy and hold or fix and flip for example), there may be significant holding times (for example seasoning requirements by a conventional lender for a refinance in a buy and hold).
8. Loan Repayment – the favorite part of every lender, when you get your investment back, and sometimes the interest that has accrued.



The initial phase is the contact phase – where a borrower and lender first start talking about doing an investment together. This can be done through chatting apps, text messages, phone calls, in person at an event, or video conferencing. Sometimes a potential borrower may come across a private lender from a referral within their network. The conversation usually revolves around getting to know more about each other, experience, expectations, common practices, and maybe dive into deal specifics if the potential borrower has one under contract.

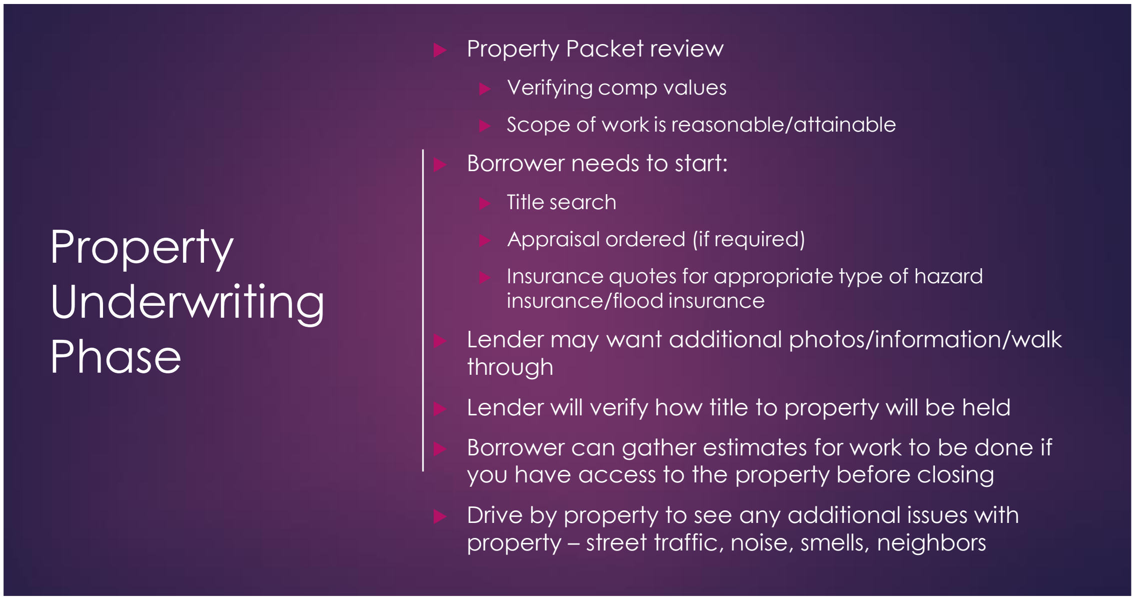
The borrower should have some set of documentation and data already prepared. They could have a digital folder where scanned copies of the contract and other pertinent data are sharable. At a minimum the borrower should have information about the property itself such as size, information about after repair value, some comparables for the exit strategy (long term rent, short term rental revenue, or sale). Another handy document for a potential borrower to have would be a "Real Estate Resume", which would be a living document that can be updated with additional deals as they are completed. The real estate resume will encompass information about what you are willing to pay a private lender investor, your track record, team members, maybe even a spreadsheet for scope of work costs and timelines. As a private lender establish early on WHAT information you want and HOW to get it. Borrowers will end up texting you 75 photos and 16 videos if you don't. Ask me how I know.



The second phase would be borrower due diligence. After you are comfortable with an initial conversation and some rough numbers of the deal, you can get more concrete information from the borrower in the form of statements for assets, debt levels, maybe you have an application you want filled out to help standardize things, ask for professional references of other investors or real estate professionals that have worked with your borrower, and verifying the experience of the borrower by looking through public records for deeds, mortgages, or business entity formation information.

Again establish what documentation you want and how you would like to receive it. Take into account that much of this documentation might be sensitive, so safeguarding the information of the borrower should be taken into consideration. There are secure encrypted file transfer services online that will allow a borrower to upload documentation into the secure system and you to be able to access it by logging into this secure system. There are also services that would allow you to pull a credit report as a potential lender, with the borrower's knowledge and written permission of course. Ask the borrower for professional references they may have worked with and make contact with those references. Have an idea of questions you might want to ask before the phone call, or even come up with a reference check list that each reference will have to fill out (either by you interviewing them over the phone or sending the information to them electronically for them to fill out).

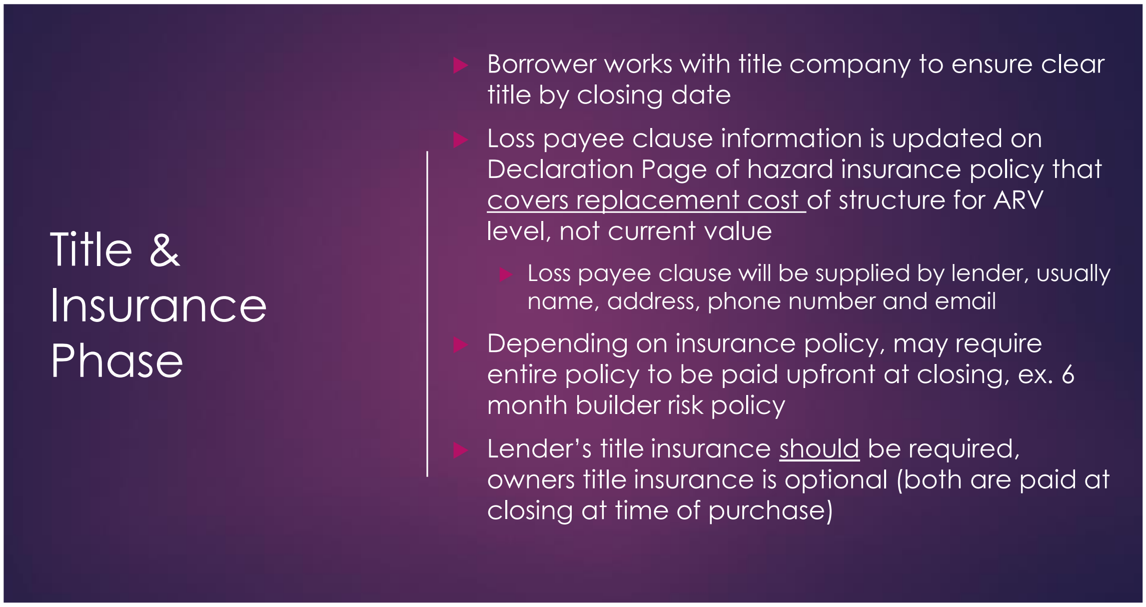
I would also establish expectations for communication through the project with the borrower during this phase. Are you expecting daily updates? Weekly? Video walk throughs? Don't need updates just mail a check once a month? Make sure the borrower knows explicitly what your expectations are for updates about the project before agreeing to fund the deal, and even better get it in writing!



The property underwriting is where many private lenders spend the majority of their energy when evaluating a lending opportunity. This makes sense since private lending in real estate is about having secured debt, meaning it is backed by collateral. In this case, the collateral is the property itself. Many private lenders want to make sure they are never above a certain percentage of either as-is value or after repair value. Evaluation of the collateral is a whole book by itself, but establishing good numbers for your risk tolerance is crucial here. Establishing the scope of work as appropriate for the type of property, area, exit strategy, and pricing can be one of the more challenging aspects of the project, especially if you do not have a construction background. You might want to have a conversation with a contractor to take a look at photos or videos if you are unsure, or pay a home inspector with a construction background to walk through and verify things.

During this phase, the borrower should have gotten a title search started with a title company or closing attorney. That may take a few days to a few weeks to get back depending on the complexity of the title and property. It can take even longer to get clear title, so make sure this process has been started. The borrower or the lender may obtain either a full appraisal, get a BPO (Broker's Price Opinion) or CMA (Comparative Market Analysis) to establish "as-is" values or after repair values. If you are local, you may drive by the property or request to walk through the property yourself.

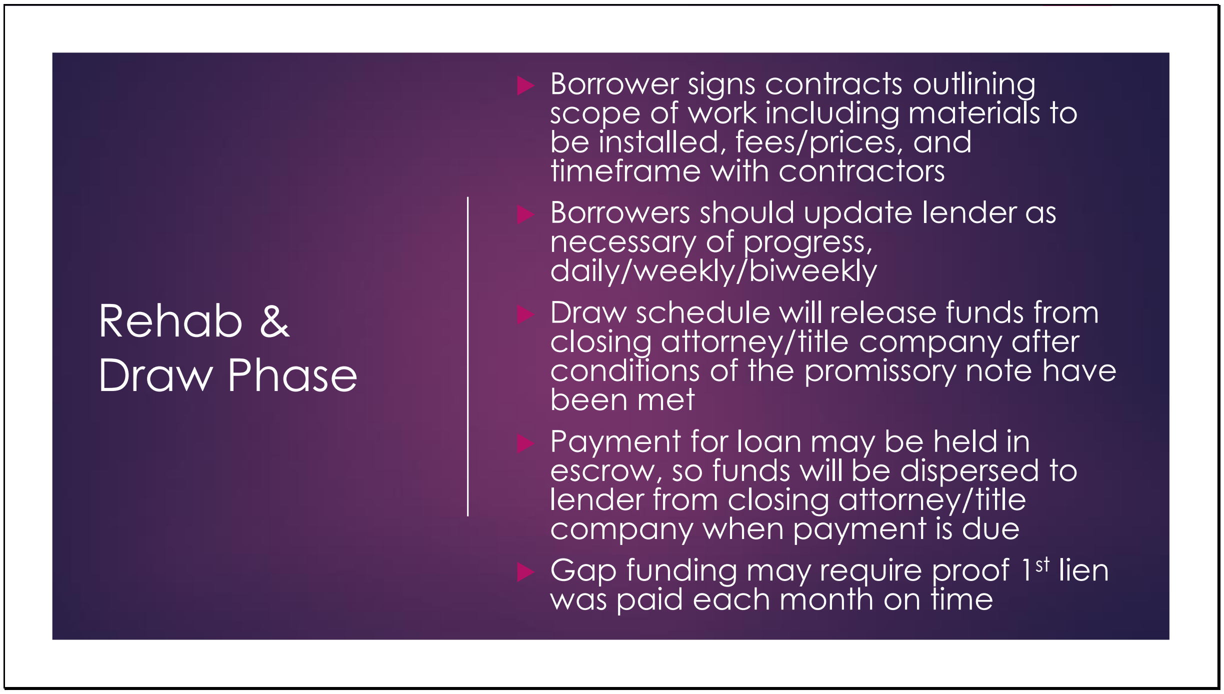
You may also want to verify how title is going to be held to the property in this step. Is the property going to close in the name of an LLC? Is it going to be a partnership between two people? Two business entities? How are they holding title?



This part of the loan process tends to either get glossed over or not done at all because many times when borrowers buy their primary residence, this part is done by other entities on their behalf. During this part of the loan, you as a lender will want to examine the title policy to make sure you are aware and comfortable with the exclusions in the title policy. You will also want to make sure you are added as a mortgagee/loss payee on the insurance for the property, either builder's risk, home owners insurance and/or flood insurance. This protects your interest in the property as a lender should the property burn to the ground during ownership of your borrower. Seeing the insurance policy and declaration page will give you an idea of how much the structure is being insured for in the event of a total loss. Are you ok with the structure being insured for its' current value? What happens if it burns down 1 day after renovations are complete? You will also want to have a lenders title policy issued at closing, which again protect you as a lender in the transaction should the title to the property have an issue after closing. I usually encourage a borrower to also get a simultaneous owners policy to protect their interest in the property, especially if they are going to be putting a significant amount of capital into the project in renovations or expansion.

This part of the loan process is where you get the opportunity to cross the T's and dot the I's to the documentation and the deal. You will want to review the documentation provided by the closing attorney for completeness and accuracy. Double check the numbers on the closing statement (often called HUD-1) to make sure the appropriate charges are on there, such as lender fees, origination points, prepayment of insurance and taxes if required, and any liens that are required to be paid so title can be cleared for the sale. If funds are to be held in escrow by the title company, make sure that information is also provided and accurate. The HUD-1 will outline how much cash the borrower may need to bring to closing and the seller may be receiving at closing. If you have any questions about where the cash is coming from or going, now is the time to ask! You will also be revieing the promissory note (keep the original signed document), and the mortgage/deed of trust (depending on state), and a title policy. There are some additional documents you may require to be signed at closing such as a non-owner occupied statement (showing the property will not be occupied by the borrower) or other statements/affidavits that you may want signed (such as an outline of the draw disbursement process so the borrower is made fully aware of the process).

The closing company/attorney will require certified funds to be brought to closing or funds to be wired to the escrow account ahead of closing. Make sure if you are wiring funds to the closing company that you contact the company directly from a phone number that you found. You will want the closing company to read the closing instructions to you and email a copy of their wiring instructions to you. When you contact your financial institution or custodian (if lending from a retirement account) they will want to make sure this information has been verified by you directly. Do not attempt to wire funds when you are in a rush, cannot concentrate, or trying to do multiple other things. Take your time and be aware of the timeline from wiring to receiving at the closing company.

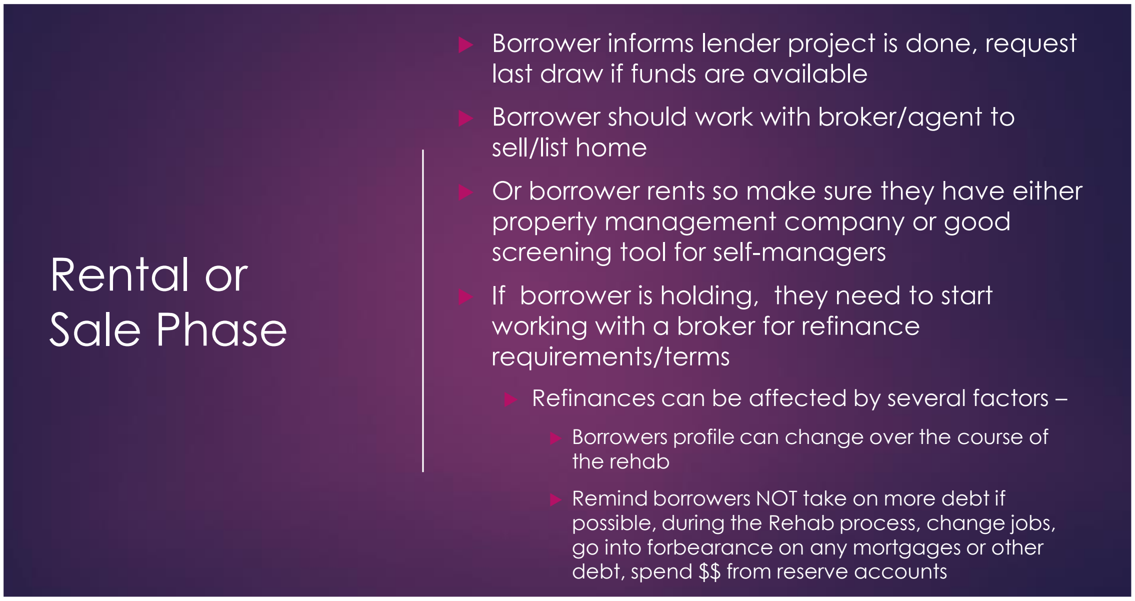


Now the fun begins! Up to this point it has been a lot of paperwork, not the real process of getting the property up and running. The borrower will be working with contractors and vendors for goods and services for the property. Make sure you have made the borrower aware of your communication expectations for any n major developments that may alter the timeline or the scope of work to the property, some lenders might be hands off and don't want to know and just send the monthly payment in, other lenders may want a weekly update.

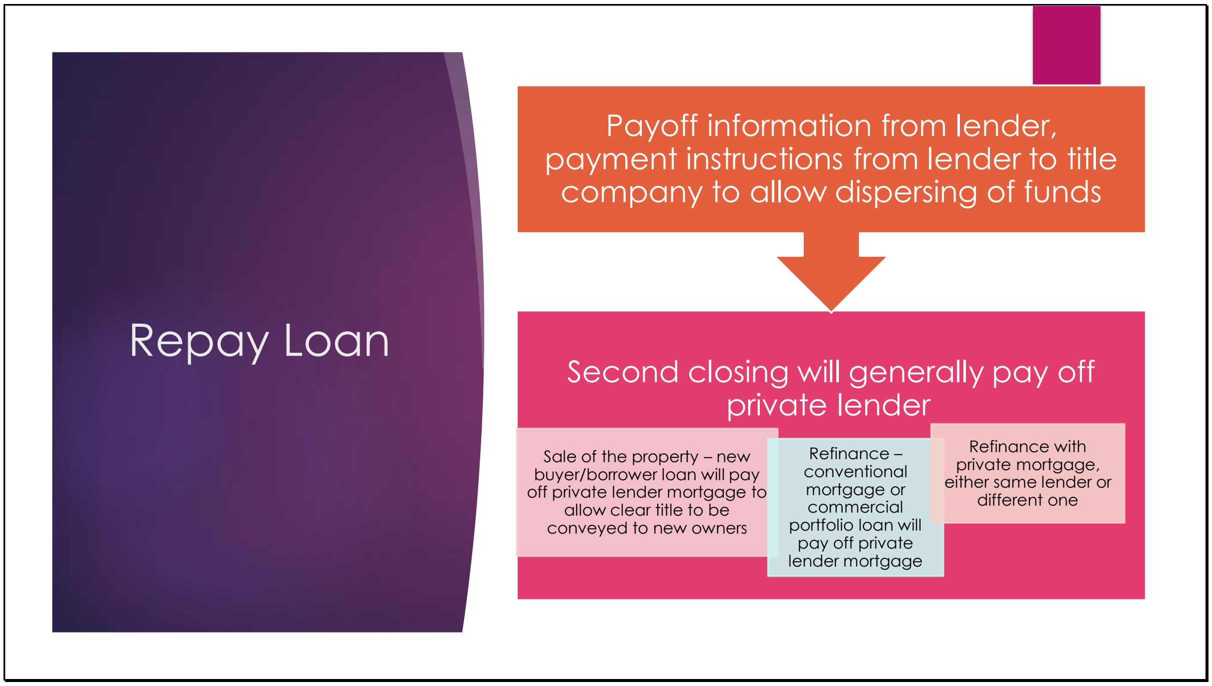
Some lenders may require a certain number of payments to be held in escrow, so the first few months of payments are made for the borrower by the title company. While this initially lowers any funds that could be reimbursed for rehab, it also makes it less to worry about as far as monthly payments because they are reserved at the closing table for the lender. If the closing company holds 6 months in escrow and the borrower sells it in 4, the borrower will be credited for those escrowed funds.

If you are funding a second lien on the property, you may require monthly proof the first lien was paid in full each month. The borrower could either set up access for the lender to obtain that information with the mortgage company or provide proof the funds were sent to the mortgage company each month.

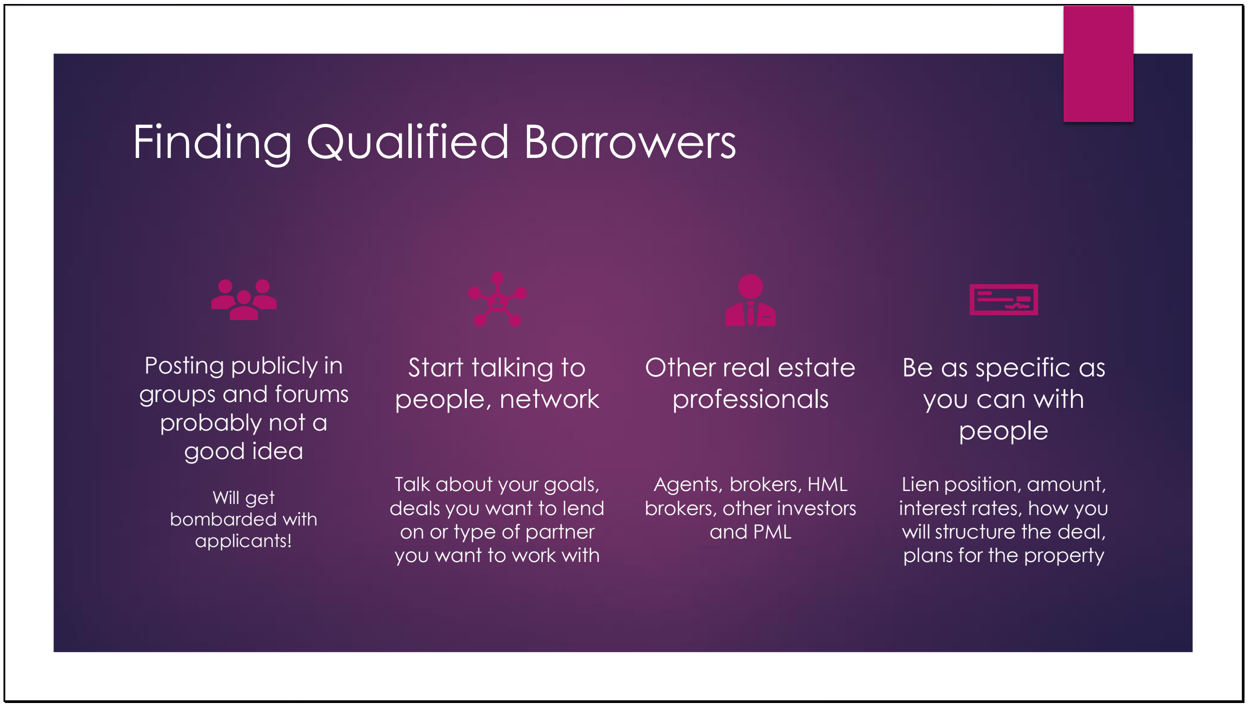
Also during this phase the borrower should start shopping around and talking to lenders on the conventional side if their primary exit strategy requires conventional financing. Conventional lending standards can fluctuate with the market conditions, the type of lender, or type of loan. Knowing the important details such as seasoning requirements, cash out refinance limits, upper limits for debt to income ratio for the borrower, asset and credit score level requirements are important to know, hopefully before the borrower closes with your loan.



During this phase of the loan process, the property has been fully renovated and potentially stabilized by putting in qualified paying tenants if the property has an exit strategy of being a rental for the borrower. The property could also be listed on MLS if the exit strategy is a sale. These types of updates should be shared with the lender. In additional, any remaining renovation money that has been held in escrow can be dispersed once the required metrics have been met. Discussions for timeline for sale or refinance can also be happening to give the lender an idea of when the funds might be available to the next deal or next borrower. It also allows the lender to be able to get a preliminary pay off statement established.



Every lender's favorite day is loan repayment day! This usually happens on one of two ways, the borrower refinances into conventional or commercial financing or the property is sold and the loan is repaid by the buyer's proceeds. The lender will submit a payoff information to the closing attorney that is handing the sale or refinance of the property. This should include both amount and how to get the funds to the lender (wiring instructions or mailing address for a check). Wiring may take a few days to be available in the lender's account to be dispersed. If a check is being mailed it may take several days to arrive and the lender's financial institution may hold the funds for up to 14 business days depending on the amount. When looking to your next investment opportunity, keep these timelines in mind to physically get access to your funds.

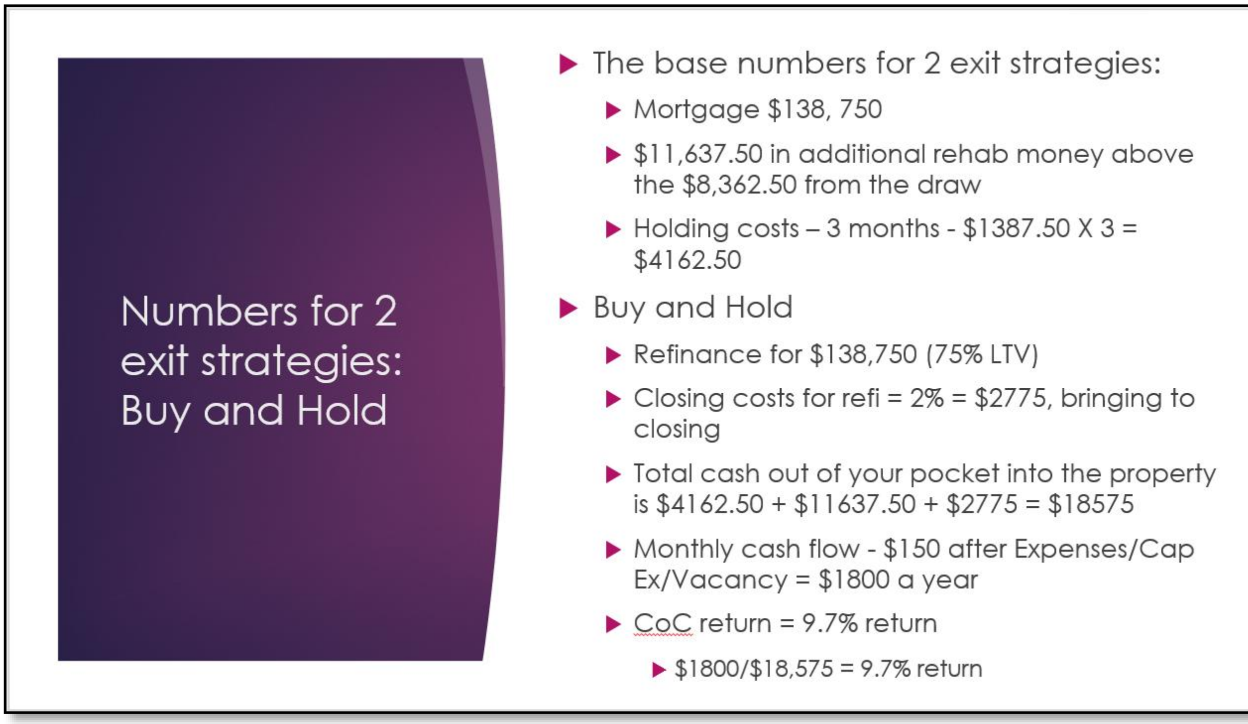


A very common question is how to find qualified borrowers when you are a new lender. Often publicly posting you are a private lender in a public forum like a Facebook group may not be the most prudent way to find borrowers. You will be inundated with requests for funding for everything from industrial spaces, new townhome developments, apartment complexes, fix and flips in Alaska, and so much more. Before you decide to dip your toe in the water of private lending, have a very clear idea on the type of property you want to lend on, where you want that property located, and how long you want your funds tied up at a minimum. The more metrics you can make the easier it will be to sift through lending opportunities.

The best way to find potential new borrowers is to network with other active investors in that community and get a feel for what they are doing, what the average price of the homes are they are buying, what are they selling them for, what is the average time the properties sit on the market, or whatever your focus is for lending. You can also network with other private lenders that might have some trusted borrowers that they would normally fund a deal for but possibly don’t have the funds available in time. (This by the way is an abundance mindset, something that should be incorporated to your daily practice in many aspects of your life).

In an attempt to show cash flow through a deal, here is a possible private money deal. A potential borrower has a single family home under contract for $125k and you as the lender are fairly confident the property will appraise for $185k when renovations are complete by having your realtor do a BPO for you.

You as a private money lender will lend up to 75% loan to value of the after repair value. The lender will reimburse rehab expenses up to the 75% after inspection of the work done that was agreed upon ahead of time in the scope of work. This could be any level of completion for work, but the borrower will need to provide either receipts of the materials/labor or an actual inspection by the lender themselves or a home inspector/contractor professional possibly. The lender is also charging 1% origination fee, so $1250, offering the loan for up to 12 months, at a 12% interest rate. At closing the borrower will need to pay the closing costs, including lenders title insurance, and then roughly 2% of other costs, along with a yearly premium for hazard insurance for the property that is insured for the after repair value not the current value, and has the private lender as the loss payee on the insurance declaration page.

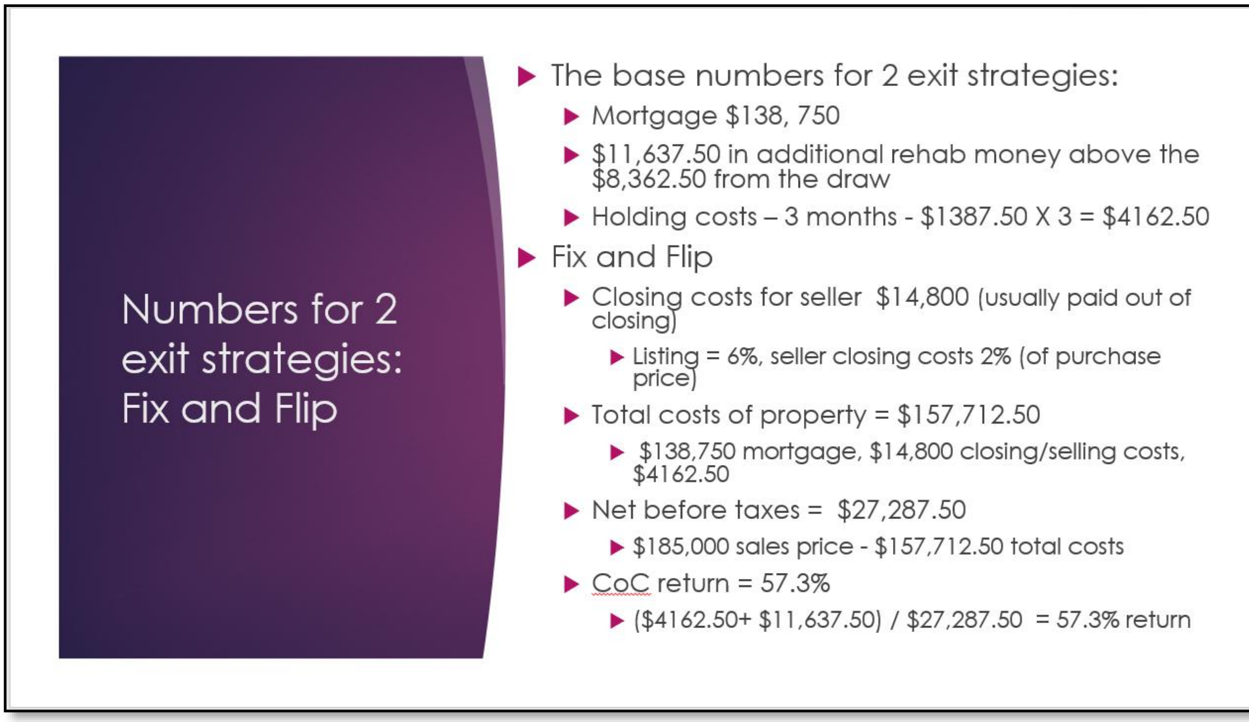


While in this instance, the lender didn't require funds to be brought to closing, the borrower still needs to have their own funds or at least access to them through HELOC, credit cards, savings etc and then those sources can be reimbursed from the rehab draw.

The $8500 is held in escrow with the closing company and will be released when the lender gives the ok. If the borrower's rehab amount goes over the $8500 then those funds are reimbursed to the borrower when the property sells.

Current conventional lending is only doing a refinance of about 75% of the ARV, generally about 70% with a first time borrower or an unseasoned cash out refinance, which in this case will only cover the original private money loan, and will require the borrower to bring additional funds to the closing table for the refinance closing costs, in this case estimated to be about 2% of the loan amount.

At the end of the day after the second refi – the borrower will have $18,437.50 locked into the property's equity. So after this deal the borrower will have basically $20,000 less in liquid assets than what they started because they converted the liquid assets of cash or the opportunity cost of having used the debt – into equity in a rather illiquid asset – the rental. If after all the payments associated with this property, plus cap ex reserves and vacancy rate – the borrower should get $150 a month. That leads to a 9.7% cash on cash return. There are many metrics, but this to me is the easiest for people to understand because they are seeing the money leave their bank account and coming into their bank account. I'm also avoiding calculations for taxes when looking at cash on cash returns because everyone's tax situation is unique.



Now looking at option 2 – Fix and Flip

The borrower will have out of pocket expenses of holding costs and rehab for a total of = $15,662 that's the $4100 for holding and $11500 for the rehab expenses not covered by the draw reimbursement. Closing costs will be paid out of the selling closing so those costs will not be out of pocket expenses.

Again, the amount of money the borrower will have taken out of their bank account and put into the property is $15,662 and then when they subtract the closing costs – theyget a net of $27,287.50 which gives a cash on cash return of roughly 57% on this project. Again we are ignoring taxes because that's a complex topic beyond the scope of this talk.

If a borrower can present this data to a private money lender it shows that that they are a minimum have thought through the project from a financial standpoint. For example in this case, in the fix and flip scenario – if the borrower went over budget even 20%, then there is still room in the deal for the active investor to make some money. If they needed to hold it longer – even 2 months longer – there is plenty of room in that scenario to still make a profit.

The potential borrower could also present where those "sunk" funds would come from by showing account balances from reserve accounts, or paperwork to show amount of HELOC available, etc. The less vague they make the deal the better.

As with any style of real estate investing, having a team around you to help support you and the borrower is going to be crucial for success. Private lending is very collaborative, between the borrower and lender, the lender and the attorneys and title companies, insurance companies, and borrower with contractors. Everyone is working towards the same goal, get the property closed, get the property renovated, get the property rented, get the property refinanced or sold.

We already mentioned the importance of having a real estate attorney that is familiar with lending. The next person to have on the team is a tax professional to make sure you fully understand the tax implications and address any paperwork or tax payments that made me needed on a more frequent basis than annually. Also have a few agents in your back pocket to help with CMA's or even list a property never hurts in case your borrower ends up in a bind or you take over title to the property. In addition, having a conventional mortgage broker or community bank you like working with will be crucial for both referrals and in the event you need to take the property back from the 2nd lien position, essentially buying out that first lien position. Having a great property management company for referrals for investors also helps add value to the borrower as a lender, which is again good for everyone's bottom line. Expect to have a few contractors or handymen in your proverbial rolodex as well, because those services are always needed. Again you can build these connections through your existing networking and making phone calls to those various vendors.

The link for the group Private Lending Lessons is:

https://www.facebook.com/groups/privatelendinglessons

You can also reach me on LinkedIn at:

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