How to Finance a Rental Property

<u>FREE Guide courtesy of:</u>

Valleywide Investments, LLC

ValleywideInvestments.com

"Alternative High ROI Cash Flow Properties Since 2005"

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The most frequently asked questions we get about financing a rental property

1. **If I'm a foreign investor, how do I get a bank to lend me the money to buy**
    a. Check with an attorney local to the property. There are laws inplace for this already and banks have procedures for this already in place. Calling the bank after a legal advisor is the next step.

2. **Should I pay cash upfront then refinance?**
    a. This depends on you. Note that there is always the risk that you may not be able to refinance. Lenders are not always 100% going to refinance your property. Go into this knowing you may be fully vested for a period of time.

3. **Will a bank or lender examine my personal finances or the cash flow of the rental?**
    a. 1-4 unit property falls under residential and the investor/borrower finances are used to get the loan approved. Commercial lenders usually use a properties actual financials and cash flows to underwrite the primary loan.

4. **How many can I finance under my own name?**
    a. This falls under the type of bank standards. But most have to follow the Fannie Mae rules, so it can be 5-10 but changes quite often.

5. **How do I take title under a corporation or LLC, do I have to use my personal name?**
    a. This depends on the bank. Most conventional banks require you to personal title and guarantee the loan, no LLC's. Smaller banks may grant

allowances for this and portfolio lenders definitely allow LLC's to refinance or finance blocks of rental properties.

b. Private lenders don't care, but they will want a note personally guaranteed by you, unless you negotiate otherwise.

6. **What are the most common deal killers when trying to finance a rental property with a bank? Know these before applying so you don't waste your money on fees and appraisals upfront**
    a. Condition of property. Conventional banks are not going to finance rehab properties unless you try to use FHA's rehab lending program.
    b. No property insurance or cancels.
    c. Your income is too low
    d. You have bad credit
    e. You own too many properties in your personal name with existing mortgage on them
    f. The rental doesn't appraise for the needed value.
    g. Ask the lender for their own list too. They usually examine the investor more than the property.

7. **Should I use hard money?**
    a. No. Hard money is a bad option for cash flowing rented property purchases or refinances. You will pay from 9% to 18% plus fees and points. This will wipe out your cash flow. Hard money is for rehab properties and flippers. It is a short term option for investors that do NOT want an equity partner or want to give away 50% of the profits and equity.

8. **Should I use a private money lender?**
    a. Yes if you can find one that will lend their money at market rates. Even if it is 1 point above going rates, that may work for you. Let's say the current 30 year mortgage rates are 5%, and you find a local private money lender

willing to give you a loan for 6%. This still is not bad whereby you are 100% owner.

9. **How much cash will I need to put down?**
    a. The more the better with conventional lenders. Usually they are looking for 10-20% but some banks will do up to 95% now. With private lenders and hard money, you often do not need to put any cash down.

10. **How do I protect myself from lawsuits?**
    a. Read the section on "Asset Protection Options"

11. **Should I invest in duplexes or single family houses?**
    a. This depends on your appetite for risk. If you are ok with dealing with tenant turn over and management difficulties, then duplex and triplexes are great money-makers for you. If you like stability and liquidity, single family homes that are conforming in style and build, are one of the most stable, hard asset classes any investor could invest in as long as you DO NOT OVERPAY or over-leverage the property.

12. **How do I find a local private money lender if I have no money or credit?**
    a. You can easily find an existing lender by checking your county database for recently filed private mortgages or find your own by creating low budge online ads and direct mail campaigns to locals that are interested in investing some of their money into real estate as a debt investor/passive investor.

Section One:

Property types

Single family houses

Lenders love financing these, they are the most stable, liquid of all property classes. The poll of buyers and tenants is much greater versus apartments and duplexes.

Valuation is a lot easier too since there are more single family homes sales in most markets.

Lenders also know that they will be able to take back and resell a single fam home a lot easier and faster in the event of a foreclosure, compared to commercial or multi-family.

Biggest pros:

- Liquid and popular with renters and home-owners
- Lender friendly, easy to valuate
- Tenants stay longest and often buy home
- Very stable, less risk

Biggest disadvantages:

- Less cash flow
- Can cost more due to popularity and demand

Duplex/Doubles

These are side- by-side 2 unit homes or stacked up and down 2 units homes.

Generally these are quite liquid and are very popular with investors because one unit can pay all the expenses while the second unit is mostly profit.

Homeowner still buy duplexes, which they live in one unit and rent out the other, but this is a sub-niche of the home-owner marketplace, not the majority are seeking this. However, duplexes are very attractive to investors, for many reasons.

In addition, since these can still be sold to home-owners for full retail pricing, investors like that option if they ever need to sell, compared to trying to sell other investment property types over 4 units, are virtually impossible to sell to retail home-buyers.

Triplexes and Quads

These are 3 and 4 unit investment rental properties. Generally these still fall under residential. It is assumed that anything under 4 units is still residential so mst lenders classify it as 1-4 family residential. These are the easiest loan types. Over 4 units os commercial and apartment financing and requires different underwriting standards.

When trying to finance a commercial property, you have many options with loca institutionsand nationwide companies but just remember that small commercial properties (under 50 units, over 4) you will do best using banks and local commercial lenders while larger commercial properties fare better with big banks.

The underwriting process

Most banks follow the guidelines of Fannie Mae, Freddie Mae, FHA / HUD so that they are able to resell their loan to them after the finance the investor. Most banks do not hold loans, they sell them off to recoup their money almost immediately. These abnks are often referred to as conventional.

Banks that DO hold their own loans are called “portfolio lenders” and they are much more in the minority. Portfolio lenders are usually private equity firms, small community banks and credit unions and even individuals.

Sometimes portfolio lenders can bend some of their underwriting guidelines for relationship clients. Conventional lenders will not do this.

Financing versus all cash

Financing using today’s low rates is the best way to go.

- Low rates means cheap money, which is almost the same as paying cash, you are borrowing money at a low rate, so if the cost is low, the expense to you is low.
- Financing opens doors for investors that have lower cash reserves and want to use leverage.
- Financing is best for fix and flips, and long term rentals in NICE areas that hold value.
- Financing is most ideal for 1-2 unit properties.
- Paying all cash is best for investors with deep reserves that enjoy not have to service any debt. It’s also great for any future sale. Having no debt allows you to sell a lot faster versus asking high maximum priceg in order to pay off a mortgage or loan
- Most real estate entrepreneurs use leverage to build their real estate empires.

What the lender will be looking for

The lender will want to ensure that the property can be rented, is rented or in move in condition. They have their own inspections that are part of the appraisal that is ordered, so you will not be able to get traditional financing from a bank for rehabs or fixer uppers.

How do you get a loan on a rental property from a bank?

Knowing the guidelines in advance, approach local small banks and ask them what their criteria is for the property and for the investor-borrower. These will always fall under the classification of Non-owner occupied property

If you are out of state, some banks prefer YOU to be near them, while others don't care where YOU live but only as long as the property is NEAR THEM.

We have seen many investors from California finance their rentals in Cleveland using a small regional bank near them in California. So that would be more of a relationship-type of banking.

Private lenders are very flexible and accommodating for the rehabbers. However, their rates are much higher, often referred to as Hard Money Lenders. Hard Money meaning above 10%

Financing a rehab property is best done using a local private money lender. There are national "hard" money lenders but they will not have the flexibility that a local lender will have.

Private money lender:

This can be any person or company locally that invests their money into local properties as a debt investor or equity partner. Terms, rates and deals are all negotiable. They usually don't care about the investors' credit, mostly just the viability of the deal.

Section Two:

How do you find a local private money lender?

Some advertise on the web. We found our first private money lenders when we formed Valleywide back in 2004. This ONE person was responsible for our successful start and a turning point in our initial momentum. Had we depended on banks, our growth would have been severely limited. We have purchased over 350 rental properties in Cleveland.

Ask other area active investors

Check your county online database for recent PRIVATE MORTGAGE FILINGS and download the copies and see who the mortgagee is, they are the lender. The mortgagor is the borrower. An attached note should also be attached showing the terms and rate.

Check with attorneys and closing title companies, they are the ones that will usually close out the private transaction, and generally know who the main private money lenders are.

Create your own marketing campaign to find NEW ones. This is a great way to get your own terms. Right now real estate is doing well and lots of private money is trying to get into real estate investing, so you can conduct your own print, direct mail and online ad campaigns to get new people.

There is an INCREDIBLE amount of private wealth IN ALL CITIES of America right now. If you can find deals that make money, you will have lots of private money available to you.

We recommend doing some low cost Google Ad campaigns to a website you make to create your own leads, you only need ONE private lender, two at most. If you get really big and go into commercial, then you can start targeting private equity and hedge funds for loans, there is no limit. Obviously, the point here is, if you have no money, or you are unable to get bank financing (lowest rates) then the private market is your only option, but has the biggest opportunity to opening vast doors.

Large National Banks

- Chase
- Wells Fargo
- Citi Bank
- Bank of America
- US Bank

Great for investors that have great credit and qualifying income, it's best to use these banks to acquire a home equity line of credit on your personal home, which you can then use to purchase investment rentals at low rates (3-4%), otherwise large banks charge a premium for purchase loans on non-owner occupied properties, and refinances too.

Local small banks and credit unions:

These are great for small investors that need relationship-type of financing. They will be more flexible with your personal financing

Seller financing

Seller financing used to be very common in the 80's and 90's. But when the private capital markets exploded in the late 2000's and 2010's, very few sellers entertain seller financing offers. There are many reasons for this, but really, pretend you are a seller, if you get 10 offers on your home, all being near asking price, and 4 out of the 10 are cash offers, why would you even remotely consider seller financing? Most sellers want the money and want to move, fast.

Now, seller financing is still performed in the commercial property markets, for sophisticated sellers that don't need the cash now or have unique tax implications; but they are in the minority for sure. The same principal applies to the commercial markets as the residential. There is an incredible amount of private equity looking to purchase investment real estate right now. That is why if you are a seller of an apartment building, shopping center, etc. Most of your offers are going to be cash.

Your checklist when preparing to finance a rental:

Convectional lender requirements and points of interest

- Your personal finances will be examined; debt-to-income levels, credit score, assets, prior foreclosures, BK, etc.
- Your credit score will need to be above 620
- You will need to have a stable job or income for over 2 years that has a debt to income ration that meets the lenders standards, which you can get when you call to interview lenders, large and small banks all have this info ready for you.
- The subject properties appraisal and inspection report are important to a lender
- Condition of rental property; currently rented or needs rehab?
- Insurance will be mandatory by lender, and if there are repairs needed, the insurance company you select may cancel it until you repair any defects.
- There is a limit to how many properties you can finance under your personal name.
- Most conventional lenders require you to finance under your personal name.

Section Three:

Private lender guidelines:

- They usually don't care about your credit; it is almost entirely a relationship-type of banking. What seals the deal is if you show them how they will make money and that the asset has equity in it. They will want fist position on the mortgage lien, so that security assurance also is needed.
- Debt investors take a Promissory note and mortgage on the property and have no say in how you run your business or property. They have the same position as a bank. They generally accept what-ever the going rates are plus a little premium for being private risk-taker in your property, this can be in the form of a origination fee or added percentage on the rate.
- Equity investors will want to form a partnership and split equities an cash flow with you. They will have a say in how the properties is operated and what responsibilities fall under you or them
- If you can find great deals for fox and flip or great high ROI cash flowing rentals with good returns for the market, there are always private lenders for you to choose from.

Section Four:

Asset Protection Options To Consider

- For cash purchases and private lender financed property, always use an LLC to title property in. Some small banks and rental portfolio lenders allow you to do this but the big conventional banks will not.
- Get a good insurance policy with good solid liability coverage. This is your first layer of defense in the event of a lawsuit or accident that puts your property under legal danger.
- Be sure to have a tax mailing address that is not your home or out of state address. Use a local mailing address like a UPS store mail box or USPS PO box. You don't want "trollers" or tenants scanning public records to know you are out of state or where you live.
- When buying property using an LLC, be sure it is formed in the same state as the property and has an official statutory agent (they are online and charge a low annual fee) to keep your LLC compliant. If you are out of state, you can form an LLC in your home state, but you will have to also file a foreign entity registration in the state that the rental property is located.