PRIVATE LENDERS AND 6 REASONS YOU NEED THEM

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Introduction

People new to real estate investing are often under the mistaken belief that they must rely on financial institutions and/or hard money lenders to fund their businesses. Nothing could be further from the truth. An appealing alternative exists—specifically, private lenders.

Some new investors are unaware of this alternative source of financing, however, and some who are aware procrastinate in establishing a private-lender network. I was one of the latter group. I had been advised to seek private-lender funding by more than one mentor when I first started my real estate investing business, but I dragged my feet—until the day came when I lost a deal that had the potential of profiting me $80,000 because I was relying on the financial services industry to fund the deal. That was a very disheartening eye-opener.

Once I began using private lenders to finance my real estate business, it truly changed my life. I now have all the money I need to do as many deals as I want at any given point in time, and I think I can contribute something valuable to the industry by teaching others about private lenders—what they are and why every real estate investor, no matter what his or her current financial situation is, should build a private-lender network.

I have written this eBook for this purpose. In it, I explain the differences between private lenders and the more traditional sources of funds and provide just a few reasons why using private lenders to finance your business will enable you to be more successful. You do yourself a tremendous disservice by failing to tap this abundant resource. Private lenders are your keys to financial freedom.

Chapter One: What Is A Private Lender?

Private lenders are the average Joes and Janes of the world. Some are retired while others are still members of the workforce; some have a substantial amount of money to invest while others have only a little.

Private lenders can be family members, friends, associates, or other individuals. Generally, they are not business organizations, as are financial institutions. I use the term "financial institutions" to refer collectively to banks, S&L's, credit unions, and mortgage brokers. These businesses specify the terms of the loan—the interest rate, the time frame, the repayment schedule, and any requirements that must be met for the duration of the loan, such as a maximum debt-to-income ratio. They charge loan origination fees and other fees that they refer to as "points," both of which serve to increase the rate of interest you are actually paying for the use of the money.

Most hard money lenders are also organized as businesses. They charge an even higher rate of interest and impose higher fees than do financial institutions. They

typically base their loan decisions on how much the property will be worth in the event of foreclosure—in other words, their profit potential in the event you default. Borrowers who lack the necessary credit score or who exceed the maximum debt-to-income requirement set by financial institutions often turn to hard money lenders as a last resort. Hard money lenders fill the gap.

Unfortunately, a lot of real estate investors who find themselves in financial straits don't realize that it isn't necessary to resort to these slightly-better-than-loan-shark lenders. Having a private-lender network serves the same purpose at a lot less cost. However, you have to have one established beforehand. Doing so can help you ward off any financial disaster you might otherwise face. You can't wait until the last minute if you don't want to have your potential profits devoured by the sharks.

It is necessary to comply with state and federal securities laws when building your private-lender network. I cover all the basics in one of the programs I offer. You can learn more at www.privatelendingmadeeasy.com/private-lending-basic-system/. It is well worth your while to become familiar with these laws. The benefits are numerous.

I expound on 6 of them in Chapters 2 through 7 of this eBook. When you use private lenders, you will enjoy:

1. a reliable source of funds;
2. a cheaper source of funds;
3. having no opportunity costs;
4. freedom from restrictions;
5. speedier funding; and
6. being a terms-maker instead of a terms-taker.

Chapter Two: #1 - A Reliable Source of Funds

When I first started purchasing investment real estate, I used bank mortgages, lines of credit, and credit cards to finance my business. At the time I also had a job in Corporate America. I soon discovered that if I wanted to continue to borrow money from financial institutions—either in the form of mortgages or lines of credit—I would have to continue in my current J-O-B, even though to say I found that job less than satisfying is a gross understatement. Attempting to climb the corporate ladder was not my cup of tea. But financial institutions won't lend you money if you're not gainfully employed. When qualifying you for a mortgage, they look at something called a debt-to-income ratio, and if you don't have a J-O-B—i.e., a reliable source of income—good luck.

Even if you do have a job, you're not going to be able to qualify for a mortgage or a line of credit unless you also have a reasonably good credit score. Moreover, these debt-to-income and credit score requirements aren't static; they change with changes in economic conditions and government regulations. And economic conditions and regulations also restrict the total amount of the loans financial institutions can/will extend to you. I learned all this early on through personal experiences, too.

I initially had a good relationship with an S&L that allowed sellers to carry back a second on the property, but after it got audited that S&L was no longer able to offer these loans. I then financed 4 properties through a bank before it stopped lending me money. I drew on a $100,000 line of credit to see me through, but $100,000 doesn't last as long as you might think, and when the money dries up, so does your business. Have you heard the saying, "It takes money to make money"? Well, it's particularly true in this industry.

Sometimes you may be able to obtain money from a hard money lender when your credit score is lacking and/or you don't have a job. These lenders are often more interested in the value of the property and what they stand to gain if they have to foreclose on the loan they make to you than on your ability to repay the loan. But, as mentioned in Chapter One, you will pay dearly for the money they lend you—both in terms of interest rate and upfront fees. Too, hard money lenders won't front you the funds you might need to rehab a property, and your only exit strategy will be to sell the property for the cash necessary to repay the loan. Forget about lease-options or land contracts (aka contracts-for-deed in some states).

You won’t have any of these concerns once you have established a network of private lenders. You can quit your job without worry. Private lenders don’t ask you about your employment situation; nor do they ask about your credit score. They don’t look at your debt-to-income ratio, and your cash flow will not be adversely affected by a tightened money supply policy and/or more stringent government regulations on the financial services industry.

Chapter Three: #2 – A Cheaper Source of Funds

In addition to being a more reliable source of funds, private lender funding is also a cheaper source of funds. As I mentioned earlier, both financial institutions and hard money lenders charge upfront points in addition to interest, and these points effectively increase the actual interest rate you're paying on the money.

For example, assume you borrow $20,000 for one year from a bank at a stated interest rate of 10% and must pay upfront fees of 4%, or $800. The fees you must pay at the outset effectively reduce your usable proceeds to $19,200, and you are paying not just $2,000 (= 10% x $20,000) for the use of that money, but $2,800 when you take the points into account. This jacks up the interest rate you're paying. It's not 10%; it's 2,800/$19,200 = 14.6%!

And there are closing costs on top of this that are specified in dollars rather than points—another way of disguising what you're actually paying for the loan. While there are still closing costs involved when you use private lenders, they are substantially lower. And there are no points associated with private loans—just a clearly stated interest rate, and one that you, by the way, determine, as I discuss in a later chapter.

Another source of funding that I have not yet mentioned in this eBook—and for good reason--is a partner. He or she can contribute money to the business from his or her own savings and may also increase the borrowing capacity of the company. This said, I have personally found partners to be a fairly expensive financing source.

I was involved in a couple of partnerships. In one of them, I handled the paperwork and financing while my partner was responsible for the rehabbing. Fast forward a year: We had 18 houses, all of them mortgaged, but none in rentable condition. The rehabbing process wasn't progressing as it should, and the monthly mortgage payments were eating up our rehab money. I made out okay financially when all was said and done, but I lost a friend in that deal.

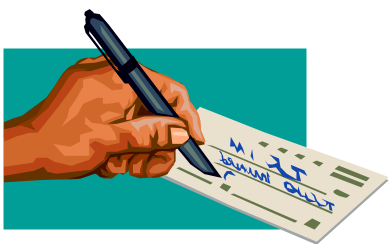
I lost money when I partnered with a guy who wanted to buy trailers and rehab them. I financed the deal. He bought and rehabbed a trailer—and then put the trailer in his name, sold it, and kept all the proceeds. Oh yeah, and he quit taking my phone calls—surprise, surprise. Naturally, I won when I took him to court, but that was for nil when he filed for bankruptcy.

So, I'm not interested in any more partnerships. When you take on a partner—even an honest one—you lose some control of the situation. And that loss of control can end up being very expensive. Besides, why split the profit when you don't have to? Private lenders are a significantly cheaper means to money.

Chapter Four: #3 – No Opportunity Costs

One set of costs that even some of the smartest businessmen forget to take into account are opportunity costs. Opportunity costs are the potential earnings you give up. When you borrow money from either a **financial institution** or a **hard money lender** in order to buy a property, you are required to put up some of your own money—i.e., a down payment. This is typically 20% of the purchase price when you're dealing with a financial institution and can range from 15% to as high as 50% when you're working with a hard money lender. This is your money that is tied up--money that you don't have to invest elsewhere.

Let's assume, for simplicity, that you want to purchase a $100,000 property. A bank or hard money lender may require that you invest $20,000 (at least) of your own money before it will lend you anything. You might have been able to use that $20,000 you had in savings to rehab that property fully—and then some—but now, instead, you might have to borrow the money needed for the rehab—and pay interest on it.



Moreover, when you obtain a mortgage from a financial institution, you typically must make monthly payments into an escrow account to cover future insurance and property tax bills when they come due. These bills are usually paid every 6 months. Meanwhile, your money is held hostage, earning no interest at all—for you, at least.

Admittedly, taxes and insurance payments vary depending on the location and the property, but let's assume an average monthly escrow payment of $300. That's $300 less a month that you have to invest. And speaking of monthly payments, when you borrow from traditional lenders, you are usually required to repay a portion of the loan and/or interest on the loan each month, too.

When you are borrowing from **private lenders**, you don't have these opportunity costs. No down payment is required to purchase a property, and there is no escrow requirement, either. This means that you can have all that money that would otherwise be tied up at your complete disposal. If you are buying a $100,000 property, you can borrow the full one-hundred-grand purchase price. You can opt to use your own $20,000 to pay for the rehab or finance that amount as well. And you can keep the money that you would have had to pay into a financial institution's escrow account. You can be earning interest on that money yourself.

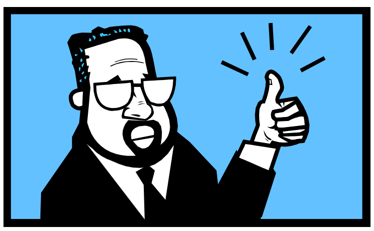
Furthermore, you can structure the loan repayment schedule to fit your needs. You can tell your private lenders that you will make monthly payments on the loan if you like—or even that no repayment will be made until the house sells, at which point the loan will be repaid in full with interest, which is the way a lot of my loans are structured. You are in control.

Chapter Five: #4 – Freedom From Restrictions

Before you can borrow the money you need to buy a house from a financial institution, the property under consideration has to be approved by the powers that be at that institution as worthy of being purchased. And the value of the property is of primary interest to hard money lenders, too, because they want to know what they will be getting if you are unable to make the requisite payments and they have to foreclose. But, let's face it, some of us buy some pretty nasty properties. Some the houses might not have windows or doors or roofs or plumbing, and financial institutions and hard money lenders are unlikely to agree to lend us the money to buy these types of properties.

They don't understand that, for a lot of us, properties like these are the heart of our business. We buy trash and turn it into cash. I once had a bank that refused to lend me money to buy a house that didn't have a furnace. It was an insult to my intelligence. I knew far better than that bank's loan officer what that house would be worth after I rehabbed it. I wasn't going to buy a house and spend money renovating it without being pretty sure I could earn a nice profit on it after all was said and done.

Now that I have a network of private lenders, I buy whatever I want. The decision is mine and no one else's. I am my own approval committee. And because I can accurately estimate both what the rehab will cost and the after-repair value (ARV) of the property, I can put together a lot more profitable deals than I could when I had to get a bank's approval on a property.



I'm also not limited in the number of properties I can buy. Financial institutions want you to remain within their specified debt-to-income ratio requirement for the life of the loan. That pretty much limits your borrowing capacity. And they sometimes impose other restrictions that can affect the way in which you operate your business. Additionally, there will often be a prepayment penalty written into the loan documents. So if you happen to sell a property more quickly than expected, you won't be able to use the proceeds and pay off that debt--thereby improving your aforementioned debt-to-income ratio and eliminating that interest payment—unless you pay them some money to allow you to do so.

None of these are issues when you borrow from private lenders. There are no ratio requirements that you need to meet, and the amount of money you can borrow is virtually unlimited. If a buyer comes along and purchases the property, you can use the proceeds to pay off the loan without penalty.

Chapter Six: #5 – Speedier Funding

Remember that $80,000 potential-profit deal I mentioned losing out on in the introduction to this eBook? I had come across a property that had gone into foreclosure and was being sold for $70,000; it had a market value of $150,000. Unfortunately, I didn't have the funds readily available, and I hadn't yet established my network of private lenders. I did everything I could to try to get the money, including attempting to increase my lines of credit. The loan approval process took so long that by the time I obtained the necessary financing, it was too late. Someone else had snatched up the property—someone who had the cash readily available and was able to close the deal in a matter of a few days.

I experienced inconvenient and costly delays on numerous other occasions while I was still relying on financial institutions for funding. It took me 4½ months to close on one house. I was fortunate that I didn't lose that deal, too. Now that I am using private-lending financing, all the money I need is at my fingertips—literally. The funds are just a phone call away.

Because of this, I can make offers with confidence and close deals quickly. I no longer have to complete mounds of paperwork and provide massive amounts of documentation before my request for a loan will even be considered—and then wait around hoping it will be approved. Being able to pay cash and close within days enables me to buy properties at a discount, essentially affording me a profit right off the bat.

The ability to move quickly on a good deal when you find one may be the greatest competitive advantage you can have as a real estate investor. Having an army of private lenders behind you puts you a step above the competition.

Chapter Seven: #6 – You're The Terms-Maker

When you borrow from a financial institution or a hard money lender, you are a ***terms-taker*****.** These entities tell you how much they will lend you and for what length of time, how much of a down payment you will need, what the interest rate will be and the upfront fees you will be obliged to pay. They also dictate the repayment schedule, typically requiring monthly payments.

As I mentioned in an earlier chapter, they often impose other restrictions on you, too, such as the need for you to maintain a debt-to-income ratio that is below a specified number—a number that they unilaterally establish. And more often than not, you will be required to make payments into an escrow account to cover property taxes and insurance bills when they come due.

When you borrow from private lenders, however, you are the ***terms-maker***. You determine the minimum loan amount that you will accept. For example, I don't accept investment amounts less than $5,000. But you can establish your own minimum amount--$1,000, $5,000, $10,000. It's totally up to you.

You also set the interest rate on the loan—although it does, of course, have to be competitive with what your lenders could earn elsewhere on their money. And you are the one who dictates the repayment schedule. You can decide to make monthly payments or make a single balloon payment at the end when the property sells. I offer a higher interest rate to lenders who are willing to wait for the house to sell before receiving any money. But I don't offer a higher rate on 2nd mortgages, nor do I pay more on larger investment amounts. In other words, if I stipulate an interest rate of 10%, then I pay my investors 10%, regardless of whether they lend me $5,000 or $20,000.

There are numerous other stipulations you can incorporate into the loan agreement that can make your life easier, too. For example, when I opt to make monthly payments to lenders, I set it up so that those payments are due on the 15th of each month because I receive rent checks from my tenants on the 1st of the month. This way I have the rent money deposited in my account well ahead of time to cover the payments I must make.

Another advantage of being the terms-maker is that you can change the terms on future loans. If you initially set a minimum loan amount of $1,000 and discover that the paperwork involved in keeping track of all the loans and lenders is too unwieldy, you can stipulate a higher minimum investment amount next time around.

When you raise money from private lenders, you do have to abide by state and federal securities laws, however, as I mentioned in Chapter One of this eBook. Once again, I discuss these in detail in a number of my programs on private lending, including "Private Lending Made Easy: The Basic System," which you can learn more about by visiting www.privatelendingmadeeasy.com/private-lending-basic-system/.

Chapter Eight: It's A Win-Win Situation

There are numerous benefits that accrue to you, the real estate investor, when you have private lenders—even more than I've covered in this short eBook. Nevertheless, a lot of real estate investors are reluctant to seek money from individuals, especially from friends, family members, and business associates, for various reasons—embarrassment and fear of rejection among them. None of the reasons are valid, however. Financing your business with funds from private lenders is a win-win situation.

In fact, I will go so far as to argue that you are doing your family members, friends and business associates a great disservice by not giving them the opportunity to invest in your company. And you do yourself a disservice when you don't add private lenders whom you may not have known earlier to your network because you miss out on meeting a great group of people, some of whom may introduce you to new ideas that can help your business.

Many private lenders have saved all their lives to accumulate the money they have to invest; others may have benefited from a recent inheritance or the sale of some property they owned. Regardless, they all want a high yield on their investment monies with limited risk exposure—and you can fill that desire. You can offer a much higher rate of return than they will earn on a bank savings account or certificate of deposit (CD), and, in contrast to a stock market investment, the money they invest is secured by real estate. If for some reason you default on the loan, they can sell the property and keep the proceeds from the sale.

My business skyrocketed once I began using private-lending financing, and I've made it my mission to teach others how they can obtain all the cold hard cash they need to succeed in the real estate investment industry, too. Check out the details at www.privatelendingmadeeasy.com/private-lending-basic-system/. You—and your future private lenders—will be glad you did.

To Your Wealth.

Alan Cowgill