PRIVATE MONEY LENDING 101

The Complete Guide to Profitably Lending Your Money for High Returns in Real Estate

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Private Money Lending 101

The Complete Guide to Lending Your Money for High Returns in Real Estate in the United States

Discover Exactly How You Can Earn 8% to 12% in the Highly Profitable Business of Distressed Property Investments and Never Have To Deal with Tenants, Toilets or Trash

Private Lending Report

In this report, you will learn everything you need to know to become a Private Lender in real estate investing. You will learn how to secure your funds, evaluate deals and make transactions and best of all; you will learn exactly how you can significantly increase your returns over your current CD, Money Market and even Stock Market rates. You will learn how others are earning 8% to 12% on their money as a Private Lender.

If you have any questions along the way, don't hesitate to contact me directly. My name is Justin Lee, I am a full time real estate investor, marketer and entrepreneur.

I founded my real estate investing company, JL Investing, LLC in 2003, and at time of publishing this report we've done over $50 Million in real estate transactions across the USA.

Currently JL Investing, LLC has done business or hold assets in Washington, California, Arizona, Oklahoma, Pennsylvania, Maryland, Virginia and the District of Columbia. We have worked with Private Lenders from around the world, including: Canada, England the United States.

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What is Private Lending?

In our case, we are going to be talking about Private Lending in real estate. This is when regular people, like you and I, lend our money to a real estate investor to buy a piece of real estate.

The funds to close on the purchase and make repairs (your money) are secured by a 1st mortgage (lien) against the house that you and the real estate investor choose for your investment.

Basically, Private Lending is your opportunity to become the bank and earn the high interest rate that the bank is earning on your money when you own a CD or have funds in a Money Market account. It's your opportunity to eliminate the middleman and increase your returns.

What Kind of Interest Do People Earn as Private Lenders?

It depends on you, the lender, and the real estate investor that you lend your money to. In general Private Lenders are paid anywhere between 6% and 15% interest for the money that they lend, depending on whether you, the lender wants to receive payments monthly, quarterly or upon the sale of a property.

Why Would Anyone Borrow Money at 10% to 12% Interest When Banks Charge Much Less?

Real estate investors commonly borrow money at these rates. Why? Well, because it's not the cost of the money that is ultimately important to successful real estate investors, rather, it is the speed and availability of the funds.

A more detailed explanation:

Real estate investors buy distressed properties at steep discounts for profit. Many times the properties purchases are so distressed that banks take a long time to evaluate a loan package. This usually kills the deal.

Speed is a real estate investor's best friend.

The best real estate deals are made when the real estate investor can close fast and pay cash. So, when banks delay and are too slow to fund, real estate investor lose great deals. Because real estate investors buy for profit, paying a high return on money borrowed is really just akin to giving a little profit away to the lender that helps get the deal done.

It's a win/win opportunity for both lender and borrower. The lender (that's you!) gets the opportunity to earn high returns secured real estate and the borrower (the real estate investor) gets to keep their business profitable without the limitations and delays usually imposed by traditional banks.

How Do I Evaluate Whether a Private Money Loan is a Good Investment or Not?

It is fairly simple to evaluate the risk and the potential opportunity of a Private Money loan. Here's a detailed explanation.

Real estate investors generally buy properties at huge discounts and borrow funds well below the market value of the property securing the loan.

Equity and your maximum loan-to-value (LTV) are your safety net and your primary point to consider in every deal. Here's how you do that:

First, determine the After Repaired Value (ARV) of the property being considered for the loan. The ARV can be determined by reviewing comparable properties provided by a real estate agent or by a property appraiser. (Your private investor will often furnish you with this data, but you should always verify the data and do your own due diligence).

Second, after you determine the ARV, you must consider the estimated fix-up or repair costs. This should be provided to you by the real estate investor (by way of his contractor) you are considering making the loan to.

Now, if you are unsure whether the estimate being provided to you is accurate; you should ask for a licensed contractor to provide a bid. Once you figure out the ARV and the repair estimate, you're nearly finished.

Third, you must consider the purchase price of the property. Once you know these three numbers, you can evaluate your total LTV, which should not exceed 70% to 80%.

How Can I Determine the After Repaired Value (ARV) of a Property Before I Make a Loan So I Really Know My LTV?

A professional appraisal or comparative market analysis (CMA) must be ordered and complete on each property by a licensed property appraiser or licensed professional real estate agent. An appraisal/CMA is a written estimation of the properties fair market value in a fixed up condition. This report should be ordered for you by the real estate investor and provided to you free of charge.

By obtaining this estimate of the repaired fair market value, you will have access to the relevant and important facts of the property. This report will make both you and the real estate investor well equipped to handle the private money loan. In some cases, when you are working with an experienced real estate investor and with their team of licensed sales agent professionals, it is acceptable to review a thorough CMA in lieu of an appraisal.

If you have any question in evaluating the validity of the value estimate provided to you ask the real estate investor for a thorough explanation. And, when in doubt have a third party real estate agent provide an additional estimate.

How Do I Know if the Repair Costs to the Property Are Accurate?

One of the first things in becoming comfortable with the repairs that are going to be done is to become comfortable with the real estate investor you plan to make the loan to. Ask questions and ask to see other projects the real estate investor has done – before and after pictures of other projects are great checks.

Ask for a construction scope of work and a construction estimate before you make the loan. The scope of work should identify what work will be done, that the work will be done to code and that the work will be done in a reasonable timeframe.

You can ask for an inspection. Many real estate investors perform their own inspections. This is because when the real estate investor is buying at such huge discounts and is buying significantly distressed properties; there are “problems” with most of the property. The main concerns as a private lender are not whether the water heater or air conditioning works, the real estate investor is likely estimating the costs of replacing these items in most distressed purchase, but rather structural problems are usually the bigger ‘gotcha’ in a distressed real estate investment deal.

If the real estate investor is very experienced, they will often inspect the foundation and roof on their own, however, in many cases, it is worthwhile to have a contractor and/or property inspector do another third party inspection.

You can require that your real estate investor have a third party inspect the property before you make the loan, especially when you are just starting or if you have questions as to the ability of the real estate investor to adequately inspect the property on their own. The cost of this inspection should be born by the real estate investor.

Remember, it is the job of the real estate investor to show you that the deal is "good." It is not your job to work hard and figure it out on your own. If your real estate investor doesn't have the system or ability to earn your confidence and clearly show you what construction is going to be done, what the condition of the property is in the distressed state and how they are going to get the property repaired, you may want to reconsider making the loan.

Before making the loan, you should feel 100% confident that your real estate investor knows construction (or has a contractor engaged as part of their team that knows construction) and can show you exactly how they'll get the job done.

What Should My Maximum Loan-to-Value (LTV) Be?

Your LTV, which is the ratio of the amount of money you lend to the value of the property after repairs are made, should generally not exceed 70% to 80%.

In some cases, it can be acceptable to deviate slightly from this range, however, as a Private Lender, it is important to remember your biggest security (your safety net) is the fact that you lend much less than the property is actually worth.

In other words, the higher your LTV, the "riskier" the loan. Traditional banks, i.e. first mortgage lenders usually lend up to 80% LTV. As a Private Lender it is usually in your best interest to lend at a lower LTV. When you find a good real estate investor to make Private Loans to, you will rarely find highly leveraged (high LTV) deals. If you do, you should reconsider the true strength of the deal and the skill of the real estate investor.

Real estate investors that find "deals" that require higher LTV loans from Private Lenders are usually not deals at all.

Find an experienced real estate investor that knows how to buy at huge discounts. Do this and the inherent risk of the investment goes down.

Example:

Purchase Price + Repairs = Loan Amount

Loan Amount divided by ARV = LTV%

ARV: $230,000
Repairs: $30,000
Purchase Price: $114,500

Your calculations:

$114,500 (purchase price) + $30,000 = $144,500 (loan amount)

Then, $144,500 (loan amount) divided by $230,000 (ARV) = 62.8% LTV

If your loan meets the forgoing formula (plus or minus) your risks are reduced and you are likely making a good private money loan. In this case, your LTV is 62.8% and therefore less than the 70-80% threshold for a good investment. This would be an outstanding deal to consider funding as a Private Lender.

Now that you have the formula to evaluate whether your loan is a good investment or not, it's time to explore several things to consider as you enter the world of Private Lending.

What Additional Things Should I Consider When I Make A Private Loan?

There are two basic things to consider as part of your funding package aside from the LTV that is securing your loan.

First, when you fund the loan, you should receive a Lender's Title Policy. This protects you and your loan against defects in title in the United States. Because all of your private loans will be funded at an attorney's office or a title company, getting a lenders policy is a very simple process. Simply ask the real estate investor to include this as part of the funding package. You can read more on this under the Title Company section below.

Secondly, you should be named as Loss Payee on the real estate investor's property casualty insurance. This protects you in the event of an insurance claim loss. In order to claim the loss and cash the check from the insurance company, the real estate

investor will need your signature. Ask the real estate investor make this a part of the closing packet with the insurance company.

What is Title Insurance and Do I Need It?

When a real estate deal closes, there are generally two types of title insurance issued – an Owner's Policy and a Lender's Policy.

Title policies are essentially insurance policies that protect the owners and lenders on real estate transaction against possible problems with title. Remember, no matter how carefully title is researched, it is possible that problems can arise. In rare cases, a closing is performed, a loan is made and then some time in the future someone discovers a problem with the title. That could affect the legitimacy of the closing and potentially be a problem.

However, with a title policy both the owner (with the Owner's Policy) and you as the Private Lender (with the Lender's Policy) are protected against defects. When traditional banks fund loans, it is a standard part of their long and complicated closing instructions that they require the title company to include a Lenders Policy.

This is often overlooked in private money loans because they are "cash deals" and many times the private lender doesn't ask for a lender policy.

Now, if you are working with a good real estate investor, the real estate investor should suggest and make sure a Lender Policy is in place to protect your loan. But, if they don't, you should know the risks and benefits of having this policy or not. Here are several things that could be the cause of a title defect (or problem that was missed at closing) and would be covered under the title policy:

- Forged and fraudulent signature or signatures obtained under duress
- False impersonations
- Paperwork completed under expired, revoked or false powers of attorney
- Conveyance after the death of an owner
- Homestead rights of a spouse
- Improperly probated wills and/or undisclosed heirs
- Mistakes in the interpretation of wills and/or trusts
- Deed by corporations without proper legal authority
- Misrepresentation of marital status by seller
- Clerical errors in preparing and recording legal documents
- Survey and easement errors

An insured title, i.e. when an Owner's and/or Lender's Title Insurance Policy is in place, protects against future attacks on title and protects the rights of the insured. Title

insurance ensures that you have ‘clear and marketable’ title to the property and if there are any problems or costs associated with resolving the problems, they are borne by the insurance company.

Any loss resulting from defects in title are paid by the insurance company up to the limits defined in the policy.

Title insurance is bought with a one-time fee or insurance premium and paid for at closing. When this premium is paid, the risk of title defects is transferred to the insurance company. The cost of the Owner’s and Lender’s Title Insurance Policies are paid by the real estate investor.

This is important because no matter how well a title is researched, it is possible that certain things could be missed, misinterpreted or fraudulently conveyed. With a Lender’s Title Insurance Policy, you are protected.

So, the advantages to you when the real estate investor buys title insurance are:

- You receive no fault recovery of loss
- All claim costs are paid for you to repair any found defects
- You receive broad coverage including coverage over neglect by the closing agent or attorney
- The cost is a reasonable one time premium and can be paid by the real estate investor

What Type of Insurance Needs to Be In Place When I Fund the Loan?

Property casualty and fire insurance are absolutely necessities for real estate investment transactions. In general, the policy will protect you in the case of a loss or damage to the property if the damage is the result of the following type of events:

- Fire
- Lightning
- Explosion
- Earthquake
- Impact
- Collision
- Riot
- Theft or malicious acts
- Subsidence

The policy must be a “Landlords” policy and, when under construction, must be setup to cover vacant property. This is a much more expensive policy than the traditional landlord policy because of the greater risk to the insurance company for vacant property. Insurance premiums are usually paid a minimum of the first 3 months and then paid quarterly thereafter.

After construction is complete and the property is sold, the policy is cancelled. If the property is rented, the policy is converted to a traditional occupied policy and the monthly cost is reduced. For example the policy of an occupied property might be $500 to 700 per year where as for a vacant property the policy might be as high as $2,000 per year.

A good real estate investor will account for this cost when they evaluate and present a potential property for a private loan consideration. The cost of property insurance is paid for by the real estate investor.

As noted above, you should be named as the lender, Loss Payee on the policy. If the policy expires, you as the lender can force the activation of the policy, maintain coverage and charge the expense back to the real estate investor.

Your risk here is if you don’t have insurance and the property burns down, you are at risk of great loss. Make sure the investor has property insurance in place when you make private loans.

Do I Need to Close with a Title Company or Attorney?

For your protection and for the reasons noted above under the title insurance section, it is highly recommended that you only fund a private money loan when the real estate transaction closing is being held by a professional. Some states use attorneys to close real estate transactions and other use title companies. Depending on the state in which you are making the loan, you will close with one or the other.

The closing costs associated with using a title company or attorney are paid for by the real estate investor.

Will the Real Estate Investor Make Any Money Before the Property is Fixed Up or Do All the Profits Come at the Sale or Lease?

That depends. Successful real estate investors build profit centers into each real estate deal that provide cash flow to cover overhead and expenses. It costs money to run a successful real estate investing business. Most real estate investors build additional profit centers into each phase of the transaction: acquisition, construction and management.

This is something that you as the private lender want your real estate investor to do.

Why?

Because real estate investors that make money will be in business long term. When you make a private money loan, you want to make a loan to a real estate investor that knows how to make money; knows how to efficiently and profitably run a business; and also knows how to create consistent cash flow in their business. A business without cash flow is a business about to fail.

You are making loans to real estate investors that run a real estate business. If they don't have cash flow, they run the risk of going out of business. Make sure you are dealing with a real estate investor that knows how to create regular, repeatable income and your success, as a private lender, will be enhanced.

What Happens if the Real Estate Investor Stops Paying on the Private Money Loan?

As the private lender, you have a certain number of rights if your borrower stops paying.

You could:

- Call the loan due and accelerate payment (call for an early payoff in full)
- Foreclose and take the property
- Go after the borrower legally

Every state has its own nuances when it comes to collecting on a loan that is in default. As the private lender, the importance of hiring an attorney to help you weed through the foreclosure process should not be overlooked. This will make sure that you do everything correctly and that you protect your loan in the most cost effective manner possible by doing everything according to state law.

If you proceed with an attorney and begin to force the hand of the borrower, all fees of the attorney, interest payments and penalties are due if the borrow wants to reinstate

the loan. This should be stated in the Promissory Note so that there is no question as to the validity of the fees in the foreclosure proceeding.

Once you gain legal title or possession to the property, because you have a low LTV, you can simply list the property at a discount and sell it quickly to recoup your loan money.

What if a Renter is in the Property When and the Borrower Stops Paying?

Your closing agent can prepare an “Assignment of Rents” that can be signed by the borrower at closing. This document can be created at little to no cost. An assignment of rents allows you to collect the rents instead of the borrower in the case of the borrower being in default.

What Paperwork Is Involved in Becoming a Private Money Lender?

The paperwork is quite simple, yet provides strong legal protection for your private money loan. There are two documents that set up your loan terms and security. The first, a Promissory Note, is signed by the real estate investor as evidence of their promise to pay your loan back. The Promissory Note identifies the terms of the repayment, the length of time of repayment, the interest rate, the payment schedule, etc.

The second, the Mortgage or Deed of Trust (depending on what state the loan is in) is signed by the real estate investor and recorded in the public records by the closing attorney or Title Company to secure your loan against the property. Some states use mortgages and other states use deeds of trust.

Now, just so you don’t get confused, a “deed of trust” is NOT the same as the Deed. The Deed is the evidence of ownership. It is recorded in the public records and shows that the real estate investor owns the property.

The Deed of Trust is then a second document that is recorded along with the Deed and shows evidence that you have money invested and secured against the property. It’s is your safety net that if/when the real estate investor sells the property you have a piece of paper on record that notifies the world that you are owed money and you will get paid.

How Do I Actually Fund the Private Loan – Where Does My Money Go?

Let's start the answer to this question with a statement:

Never give money directly to the real estate investor!

It's just poor business practice, and a really bad idea. When you are ready to make a private loan, your money will go from your bank account directly to the closing agent (attorney or Title Company) in the form of a cashier's check or a wire. The real estate investor will not touch the money until after all of your funds have been properly secured by the real estate. The closing company will assure that this happens.

At closing, the closing company will make sure that the real estate investor signs the Promissory Note, the Deed of Trust and that everything gets properly recorded and documented.

What Do I Need to Do to Monitor My Private Loan?

The main thing you want to do is to simply make sure that when you fund the loan, that is when you actually part with your money, that your funds are being secured with a Promissory Note signed by the real estate investor and that the title company is recording a Deed of Trust on your behalf for your money.

You will also want to receive proof that property and title insurance have been placed on the property to secure your investment.

Once this happens and this all happens simultaneously as you fund the deal, your money is immediately secured by the property. The next thing you want to do is make sure that the real estate investor that you made the loan to is actually doing the fix-up. To do this, it is usually recommended to do a drive-by every so often just to see the progress.

There is no need to schedule a drive by with the real estate investor. Surprise inspections keep you comfortable and the real estate investor honest.

What If The Loan I Make Isn't Close To Me?

If the loan that you've made isn't within easy driving distance to you for an inspection, you have a couple of different options.

The first is to ask the investor for pictures or videos of the property, and the progress that has been done. Alternatively, you can always hire an independent person (contractor, appraiser or realtor) to do a "drive by" of the property. They will probably charge you a nominal fee to do so.

Your investor should be tracking the progress of the project, and you can just as easily get the progress reports from the contractor managing the project.

How Do I Get Paid When the Loan is Due or the Property is Sold?

A pay-off letter will be prepared, either by you, your attorney or by the real estate investor (approved by you) stating the final pay-off of your loan. This payoff letter is sent to the closing company that is handling either the refinance or the sale of the property so that they can collect and disburse funds directly to you at closing.

Here's an example of how the numbers on a typical private loan will work:

After Repaired Value (ARV): $230,000

Estimated Repairs: $30,000

Purchase Price: $114,500

Total Private Loan: $144,500 (purchase price + estimated repairs)

LTV: 62.8%

Loan Terms: 12% annual rate, interest only, with a 1-year balloon (meaning the loan must be paid off in 1 year or less)

Actual Loan Length: exactly 6 months (assume for purposes of this example the real estate investor borrows the money, fixes up the house, and then resells it and closes that transaction exactly 6 months later)

Total Interest Paid to You: $8,670 (1 year of interest would be $144,500 * .12 = $17,340. Since this loan was only for 6 months, interest would be exactly half of that amount, or $8,670)

Your Total Payoff: $153,170 ($8,670 in interest + $144,500 original loan amount)

So, in this example, you made a $144,500 loan to a real estate investor. The real estate investor paid you a 12% annual interest rate on your money and the loan was out for exactly 6 months.

Each month you earned $1,445 in interest, and after 6 months, you were paid back $153,170 for your initial $144,500 loan.

Did The Real Estate Investor Still Make a Profit?

Absolutely! If you noticed, this example used the same numbers as the example at the beginning of this report. You'll be happy to know that these numbers were actually based on a real deal that we closed with a private investor, just like you!

Even after paying an interest rate of 12% (well above market rates!), after the property was sold, the private investor was repaid their original loan amount, plus all of the interest due to them.

Almost immediately after closing this private loan, the Private Lender on this deal made another loan with the same real estate investor, earned the same high interest rate and had another win/win deal.

Final Thoughts

If you have any additional questions related to your interest in becoming a Private Lender or if you would like to learn how and where to find real estate investors that have opportunities for you to consider making a private loan for, please feel free to contact me directly:

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In closing, as a private lender, you need to be comfortable not only with the real estate investor, but more importantly, the value of the property, and the amount of equity in the deal should the real estate investor not be able to repay.

As a private lender if you are forced into calling the loan due, you want to be sure that there's enough equity in the deal that if the project were to go badly, you would get the property back, and still be able to quickly sell it for a profit.

Doing your due diligence and lending at the correct LTV is the only way to ensure that your private lending deals are "win/win" for everyone involved.