7 REASONS
to use
PRIVATE INVESTORS

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Introduction

One trait that all successful entrepreneurs share is creativity. This is true in the world of real estate investing, just as it is in other types of businesses. Among other things, successful real estate investors design advertising to attract home buyers and sellers; they institute efficient and cost-effective systems that make their businesses run more smoothly; and they are innovative in rehabbing their properties in order to gain a competitive edge and maximize their profits. These efforts are all aimed at the operations side of the business, however. Creativity can also be useful on the financing side of things.

Many real estate investors get locked into traditional financing avenues and don't consider that there may be another option--more specifically, private lenders, which is the topic of this eBook. When I began using private lenders to finance my real estate business, it changed my whole mode of operations. I now have cash readily available whenever deals present themselves, giving me a tremendous competitive advantage. On top of that, I can offer my lenders a great return on their money, so everyone wins.

Private lenders are just everyday people. They may be family, friends, former business associates, or folks with whom you have recently established a relationship. Some may have a substantial amount of money to lend; others may only be able to meet the minimum loan amount you require.

Monies raised using private lenders can be used to fund everything and anything, including wholesales, rehabs, luxury homes, office buildings, strip malls, and warehouses. Even investors who think they don't need money from external sources can benefit from building a private-lender network. Some of you may have considerable savings and, thus, a lot of available cash on hand. A number of you may have a substantial line of credit that you believe will suffice. But bear in mind that you may need to use the ready cash you have on hand and/or the credit line for emergencies or unexpected investment opportunities. You want to maintain a certain level of liquidity to meet these precautionary and speculative needs.

Regardless of your present financial circumstances, I urge you to investigate private-lender funding sources. They will enable you to put together profitable deals more quickly, easily, and cheaply than alternative sources offer, as I explain in this book. There are a number of Security and Exchange Commission (SEC) regulations you must abide by when seeking private lenders. however.

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1: You Control The Money Flow

When you rely on a mortgage, a line of credit and/or credit cards to fund your business operations, you put yourself at the mercy of the bank or other financial institution. If you quit or lose your job and/or your income doesn't satisfy the bank's requirements, you will be unable to borrow the money you need. And the rules can change, both with the economic climate and at your bank's discretion. I found that out early on.

When I first started out, I borrowed the money I needed to purchase properties from a financial institution and charged the rehab costs on my credit card. After the rehab was completed, I refinanced the house and paid off the card. I found a savings and loan (S&L) in my area that was friendly to real estate investors, allowing the seller to carry back a second on the property. But the S&L got audited, and it could no longer extend these types of loans. So, I found another bank. I financed 4 properties through it, and then it quit loaning me money.

When my funding was initially shut down, I obtained a $100,000 line of credit to tide me over. But that's not a lot of money, and you can quickly max the line out. When it's used up, you could be out of business. Moreover, a line of credit limits your borrowing ability, which in turn limits the cash you have available for larger projects. And the bank can call the line of credit due every year. Too, you need a job to get a line of credit, as I mentioned earlier; lose your job and the bank won't lend you money.

You might be tempted to take on one or more partners as a means of financing your business.   They might have some available cash to inject into the business, and they could also tap their own available credit lines for more money to support operations. However, you also lose control when you go this route, too. Your partner will want a say in how things are run, and the two of you may not see eye-to-eye on some issues.

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I've been in a couple of partnership arrangements, and I liken them to a new-born puppy. They're cute and cuddly in the beginning. Everyone gets all excited about the new venture. But then it can grow into a big, ugly dog. One of my partners was supposed to take care of the rehabbing while I handled the paperwork and financing part of the business. A year later we had 18 houses with 18 mortgages, none of which had been rehabbed enough to rent. So, we had a lot of cash outflow and no cash inflow. The monthly mortgage payments were eating up our rehab money.

I was in another partnership with a guy who wanted to start investing in trailers. He found a trailer, but he didn't have the money to buy it, so I funded its purchase, and I funded the rehab of it, too. Unfortunately, I wasn't paying close attention to what was happening because he had the trailer put in his name, sold it, kept the money, and quit taking my phone calls. Of course I took him to court and won, but he filed for bankruptcy, and that wiped out my judgment against him. Lessons learned. No more partnerships for me. Private-lender money is a much cheaper source of funds.

Having other folks in control of my financing was a source of unneeded stress, and I got rid of it by going to the private lender market. You never know when the money supply is going to get tight and/or a mortgage meltdown will occur, and not being in control of the money flow yourself puts you in jeopardy. Partnerships can be tricky. Raising money by tapping private lenders puts me in the driver's seat. And I don't have to beg for money anymore; it's just a phone call away.

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2: You Make the Rules

When you borrow money from a financial institution or a hard money lender, they make the rules. If you have a less-than-stellar credit rating, you may be out of luck unless you go to some loan shark, who will charge you an obscene amount in both fees and interest. In addition to a good credit rating, banks and other financial institutions will require that you maintain a certain debt-to-income ratio, which effectively limits the number of properties you can acquire and/or the amount you can invest in a single, higher-cost project.

While hard money lenders focus on the value of the property rather than your creditworthiness, the loan-to-value they offer is also limiting. They want to ensure that they will get their money back in the event you default on the loan, so their loans will typically be in the 50 to 70% loan-to-value range. You won't be able to obtain the funds needed for rehabbing the property from these lenders. And even legitimate hard money lenders who fall short of the definition of "loan sharks" charge a high rate of interest.

Some lenders restrict the types of properties in which you can invest the borrowed funds, and some base the amount of financing you can receive on a property appraisal—for which you, the borrower, must pay. The original condition of the house can make it hard to get a loan. One bank wouldn't lend me money on a home that didn't have a furnace. But this is what my business is about—buying nasty, stinky, poorly maintained houses that, nevertheless, have good bones—and rehabbing them. I know more about what it will cost to rehab a property and what its after-repaired value will be than the loan officer sitting behind the desk at a bank or mortgage company.

You will have to pay a higher interest rate if you are seeking a mortgage on a property that is already collateralizing a first mortgage when you are dealing with financial institutions and other hard money lenders. And sometimes the interest rate you pay will be based on the amount of money you are borrowing; the greater the loan amount, the higher the rate of interest. Moreover, there is often something that you sign that prevents you from pooling the funds borrowed from one lender with funds received from another lender

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When you use private lenders, you make the rules. You can obtain the funding you need even if you have poor credit, and there is no maximum debt-to-income requirement that must be maintained, so the funds you can borrow are unlimited. You can stack up the mortgages. The way I sometimes structure it is to give bigger chunks of money the 1st position and the lesser chunks a 2nd position. I can obtain all I need to purchase a certain property; I just have to record the mortgages in the proper order.

Alternatively, you can simply pool the funds that you obtain from private lenders to buy that $75,000 house. In many cases, however, you may have to register the offering (i.e. what dollars you want to borrow from private lenders) with the SEC or apply for a Reg D exemption from registration before you can pool the monies.

I have 3 basic rules I've established when I seek funds from private lenders:

1. The lenders do not get to approve my purchases.
2. High-money lenders do not get paid a higher rate of interest.
3. I do not pay a higher rate of interest on second mortgages.

Nevertheless, I value my private lenders and treat them generously. I offer a higher interest rate to those who are willing to wait until the house sells to receive any payments. And if the closing on a house is delayed for more than a couple of weeks, I pay my lenders 4% per diem in the interim. They would have been earning money on those funds elsewhere if they hadn't lent them to me, so I don't want them penalized. I treat them the way I myself would want to be treated.

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3: You Create The Terms

When you seek to borrow from a **financial institution** or a **hard money lender**, you are a ***terms-taker***. It's a take-it-or-leave-it deal on your part. The lender tells you how much it is willing to lend, what the interest rate will be, the time frame over which the loan must be repaid, and the upfront fees that must be paid.

You will be told what the payment schedule will be—whether the payments must be made monthly or when the property is sold; whether they will include both principal and interest; whether or not there will be a balloon payment at the end, and if so, how much it will be. These loans often require that taxes and insurance be escrowed, too.

Most of the time, you will be required to put up some of your own money to buy the property; the typical down payment required by financial institutions is 20%. A hard money lender may want you to put up 15 to 50% of the purchase price. A down payment requirement, like the maximum debt-to-income ratio that financial institutions impose, limits the number of deals you can make. Twenty percent down on an $80,000 house means you have to come up with $16,000 out of your own pocket to purchase that one property.   And you often have to sign a paper stipulating that you didn't borrow any of the down payment money and provide documentation to prove the money came from a source other than a loan.

You're in charge when you deal with **private lenders**. You are the ***terms-maker***. You tell potential investors the minimum amount of the loan you can accept. Maybe it's $1,000, $5,000, $10,000—it's all up to you. Remember, with the proper steps you can pool the money you get from your private lenders and invest the funds in a single property; you don't need to raise the entire purchase price of a property from just one person. (As I mentioned in the last chapter, you do have to abide by certain Securities and Exchange Commission (SEC) regulations whenever you seek loans from private lenders, and state laws apply as well.) You must register with the SEC if you are going to pool money or advertise.

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You tell your potential investors the interest rate you will be paying and explain the payment schedule to them. As I mentioned previously, I offer my lenders a higher rate if they are willing to wait until the house sells before receiving any money at all. However, I don't pay more on higher loan amounts, and I don't pay more on second mortgages. I set up any monthly payments I make to lenders such that they are due on the 15th of each month. I receive rent checks from my tenants on the 1st, and I send my lenders their checks on the 15th.

You don't need a certain credit score to obtain a loan from a private lender, and there is no maximum debt-to-income requirement, no down payment, and no other fees. Moreover, you don't have to deposit money for taxes and insurance into an escrow account. You're not restricted to buying only certain types of properties or properties that meet specific conditions that a lender has established—however arbitrarily. And there is no limitation on the amount of money you can raise from your private-lender network. This gives you the freedom to invest in as many properties as you wish, regardless of cost.

In summary, as a ***terms-maker***, you

- determine the minimum loan amount;
- establish the interest rate you will be paying;
- control the repayment schedule;
- face no credit score requirement;
- have no debt-to-income requirement;
- need no down payment;
- need to pay nothing into an escrow account;
- have an unlimited source of funds;
- are not restricted in the types of properties you can purchase with the funds.

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4: You Can Obtain Cheaper Funding

When all the costs are considered, private lenders are a cheaper source of funds than any of the alternatives. When you obtain a loan from a bank or other financial institution, you have to pay some money upfront (i.e., “points”) to obtain the lowest interest rate offered. Those loans that have “zero origination fees” come at a price—the interest rate on the loan is higher. In short, you pay—one way or the other.

As a simple example, assume you obtain a $10,000 one-year loan from a bank with a stated interest rate of 10% and upfront fees of 3%, or $300. The fees you must pay at the outset effectively reduce your usable proceeds to $9,700, and you are paying not just $1,000 (= 10% x $10,000) for the use of that money, but $1,300 when you take the points into account. This jacks up the interest rate you’re paying. It’s not 10%; it’s $1,300/$9,700 = 13.4%!

The various closing costs, which you must also pay at the outset, can be substantial when you obtain a loan through a financial institution or mortgage broker. And there is often a pre-payment penalty clause in the loan agreement, which means that you will either have to pay a penalty or continue making the specified payments on the loan even if you sell the property right away and have the proceeds to repay the borrowed funds. In other words, you will be forced to pay interest on funds you no longer need.

In the case of a mortgage, you are typically required to make monthly payments into an escrow account to cover taxes and insurance, as mentioned in the last chapter. These items are billed semiannually in most cases. This is an opportunity cost for you since you could otherwise be earning money on those funds that are sitting in escrow.

In addition to being a limited source of funding, lines of credit also come with an opportunity cost attached. You are often required to maintain a certain minimum balance in an account at the financial institution that is extending the line of credit. This “compensating balance” is typically held in an account that pays no interest. In effect, that money is held hostage. Although the account has your name on it, these funds are not available for you to use.

While credit cards can be a convenient source of funds, the interest rates charged on unpaid credit card balances are hefty. And, as with a line of credit, the amount of funds that can be obtained is limited.

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Hard money lenders are the highest cost source. They charge a significantly higher rate of interest, and there are also high fees involved, which is why they tend to be used as a last resort.

When you seek funding from private lenders, you set the interest rate that you will pay. It does, of course, have to be high enough to be competitive with what these lenders could earn elsewhere, but you avoid all the added, and sometimes hidden, fees that, in essence, raise the effective rate of interest that you are paying, as illustrated earlier.

While you will still incur some closing costs, they will minimal compared to what you pay when you borrow money from a financial institution or hard money lender. And there is no compensating balance requirement and no need for you to set aside money in an escrow account for taxes and insurance. Although you definitely want to ensure you have the funds available to pay these bills when they are due, you can be earning money on them in the interim.

Perhaps most importantly, when you use private lenders, you will not have to worry that something will go awry at the last minute, leaving you unable to close the deal and forcing you, at the very least, to forfeit your earnest money deposit. It his my experience that private lenders rarely back out. If they do, I'd just pick up the phone and call the next lender on the list and the funds would be on the way to closing. The most expensive funding you may ever find is not being able to close.

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5: You Can Put Together Deals More Quickly

In the business of real estate investing, when a deal comes along, you want to be able to move fast. I know a number of investors who watched a deal slip through their hands while they waited for a bank to approve their loan, myself among them.

Several years ago, before I had established my network of private lenders, I happened on a foreclosure. A property valued at $150,000 was being sold for only $70,000. I'd hit the jackpot! It was almost too good a deal to be true. I didn't have the available funds sitting in an account, so I scrambled to my bank. I tried to extend my lines of credit. I did everything humanly possible to accumulate the funds necessary to take advantage of this bargain. But all of this took a while, and by the time I had secured the financing I needed, someone else had purchased the house—someone who had ready cash and was able to close within days. I lost a potential $80,000 profit.

This particular lost deal, by the way, is what turned me onto private lenders in the first place. I had been advised to establish relationships with private lenders early in my real estate career, but I stupidly continued to go to banks and jump through their hoops to obtain my funding. Lesson learned—and a very expensive one at that.

When you have a network of private lenders, you can make an offer and set a closing date immediately. You don't have to deal with all the paperwork that financial institutions and mortgage brokers require, filling out forms and providing the requisite documentation: pay stubs, tax returns, and sometimes even marriage certificates and/or divorce papers. Nor is this the only time-consuming element involved when borrowing from financial institutions. Once you've supplied everything they request, you are forced to sit while they take their sweet time approving the loan. Meanwhile, a profitable opportunity slips away.

Speed is one of the greatest competitive advantages you can have in the real estate business. With an army of private lenders in place, you will have immediate access to funds and be able to take action on a good deal while someone else is waiting for his bank loan to come through.

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6: You Can Structure More Profitable Deals

The fact that private lenders are a cheaper source of funds than the alternatives results in more profits for your pocket. The ability to obtain the funds you need more quickly also leads to great profitability. For one thing, you can close more deals. Let's say you can earn $10,000 on each transaction. That means you will add $50,000 more to your bottom line if you can close ten deals rather than being limited to five.

In addition, having the funds available to make a cash offer on a property enables you to earn a profit from Day 1 because you can generally buy the house at a greater discount from list price when you come in with an all-cash offer. This said, if the house was priced fairly to begin with, you could even turn around and sell it at the higher price without doing a thing to it if you wished.

You can also buy properties that a financial institution may refuse to lend you the money to purchase--properties on which you know you can make a good profit after rehabbing, like the house I found that didn't have a furnace. Banks also tend not to want to lend money to buy houses that don't have windows or roofs, but some of these can prove to be very lucrative investments when all is said and done. Using private lenders to fund your business enables you to take advantage of these "diamonds in the rough."

More profitable exit strategies can often be structured when you use private lenders. You can use land contracts and lease options to your benefit. You aren't restricted to a cash sale as you can be when you borrow from some hard money lenders.

You can also use the money you borrow from private lenders to purchase defaulted paper, which offers a new source of income. When a homeowner stops making the payments on his or her mortgage, the "paper" is said to be in default, and many times a bank will sell these notes at a discount to avoid having to foreclose on the property. The "paper" is backed by real estate, just like those stinky, ugly houses we buy. When you purchase the note you become, in essence, the banker. You may be able to work with the borrower and restructure the loan to make the payments more affordable, or you may decide to foreclose on the property yourself and become the new owner, enabling you to do whatever you wish with it. You may even be able to sell the note to another investor at a profit. You're in the driver's seat.

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7: You Have Greater Flexibility

I've already mentioned the fact that you do not have the restrictions that both financial institutions and hard money lenders impose on the type and condition of the property that you can purchase with the borrowed funds when you use private lenders. You can pool the money of a number of private lenders to invest in a property as long as you abide by state and federal securities laws when doing so, and there is no limit to the amount of funds you can borrow—which translates to no limit to the number of properties you can buy. And you also have more exit strategies available to you when you use private-lender financing.

Nor are you subjected to a lot of less-than-desirable conditions as you are with some of the alternative sources of funds. For one thing, private loans do not affect your credit score, no matter how many loans you have outstanding or how much you have borrowed. Private lenders don't ask about your credit, nor do they report the loans to any credit agencies. Maintaining a healthy credit score affords you greater flexibility in other circumstances wherein a good credit rating may be required.

Just as you don't have to jump through hoops to obtain private-lender loans, you do not have to continue to jump through those and more hoops while the loan remains outstanding as you do when you use financial institutions and hard money lenders to finance your business. Some bank loans and line of credit arrangements require that you provide the lender with profit and loss (P&L) statements on a regular basis. Moreover, that maximum debt-to-income ratio condition that was necessary to obtain the loan in the first place can remain a requirement throughout the life of the loan. Furthermore, additional loan covenants may impose maximum and minimum limits on other financial ratios, which can have the effect of limiting the way you handle your business operations.

Most importantly, you have total control. If you find there is something about your private lender program you don't like, you can change it. It's your program. For example, you may start out accepting loans for $1,000 and decide that keeping track of all those small loans is too time-consuming. All you have to do is establish a higher minimum loan amount on future private borrowings—set it at $5,000 or $10,000, whatever you wish.

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Similarly, you have the ability to decide whether you want to make monthly payments on the loan or a single balloon payment in the end, paying off the loan when you get paid—i.e., when you sell the house. You make the terms and you can change the terms.

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In Conclusion

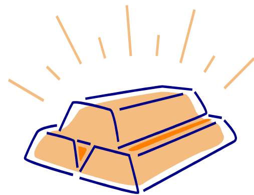
Regardless of your current financial situation, establishing a private-lender network is a primary ingredient for success in the real estate investment industry. When you use private lenders, you are in total control—of your business operations, the money flow, and the terms of the loan. This is not the case when you borrow from financial institutions and hard money lenders or take on a partner.

Finding private lenders is not difficult. Learn the techniques, and they are yours to use for a lifetime. You will no longer have to go begging for money, and you will be able to make deals quickly and with confidence. You won't have to worry about not having the money to close. Available funds will be just a phone call away. After you have attracted just a couple of private lenders, word of mouth will soon bring more into your network, providing you a continuing stream of investment funds.

And it's a win-win situation. Your private lenders will be able to earn more on their money than they otherwise might, and you meet a great group of people, some of whom may open your eyes to other opportunities to increase your cash flow.

Discover the key to true freedom and big money in real estate investing. Private lenders are out there waiting.

To Your Wealth,



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