

# Financing Alternatives Based on Exit Strategies

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***“Always Know Your Exit Before You Enter Into A Deal!”***

## **Step One: Gather Information from the Motivated Seller**

First, You Need to Know this information:

1. Current Loan Balance(s) and type
2. Current Monthly Payment and interest rate
3. Is the loan in default? How much?
4. Does the monthly payment include taxes and insurance?
5. Does the property need repairs? How much?
6. How much and when does the Seller need his equity?
7. After Repair Value
8. Monthly rental value
9. Time of year
10. Your own experience and financial position

Then consider:

1. Does it fit into the MAO formula (Maximum Allowable Offer) for cash deals?
2. Can I get it far enough below market to flip to another investor for a quick wholesale profit?
3. Is there a current loan in place I can take over or is the seller willing to help finance?
4. What type of repairs are required and how much will they cost?
5. How much equity (profit) is available in the deal after paying all costs associated with selling it?
6. What is the cash requirement to acquire, reinstate loans, rehab, closing costs, holding costs, etc.?
7. Will it lease for more than the total monthly payment including taxes, insurance, and homeowner's fees and still give me a fair cash flow?
8. Can I sell or lease it in its current condition?
9. Does it only need cosmetic work that a handy owner-occupant might be able to do?
10. Do I need to sell for cash to cover living expenses or can I keep it for long term to build wealth?
11. Are the property taxes and insurance escrowed?
12. Do I have my own source of funds or do I need to “buy” the funds from some other source?
13. Do I have enough experience to handle a deal like this?
14. Is there enough equity (profit) to make it worth my time?
15. How can I increase my Return on Investment (ROI)?

## **Step Two: Determine Your Exit Strategy (What are you going to do with the property?)**

1. Buy, Rehab, and Sell for Cash
2. Wholesale to Another Investor
3. Wholesale to Owner-Occupant
4. Keep and Lease as long term rental
5. Lease with the Option to Buy
6. Sell on a “Work for Equity” Program
7. Sell with Owner Financing
8. Joint Venture with a Partner
9. Dead Deal – There is nothing you can do with the lead

*The more exit strategies available, the better the deal!*

## **Step Three: Determine the Financing Alternative Based on your Exit Strategy**

*“It’s not always the cost of the money, but the availability of money when you need it!”*

### **Common Financing Alternatives:**

1. Take title “Subject to” existing loans/liens
2. Use Your Own Funds
3. Seller Financing: Short Term and Long Term
4. Private Lenders
5. Partners
6. Hard Money Equity Loans
7. Banks and Mortgage Companies/Brokers: New loans or Refinance existing loans
8. “Rehab to Perm” Investor Financing

### **1. Take title “Subject to” existing loans/liens**

- My favorite strategy
- Best use of leverage at the lowest cost
- Best Return on investment
- Could be risky if loan is called due
- Seller will usually cooperate
- Works better using Land Trusts
- May be difficult to get other financing to subordinate to first lien

### **2. Use Your Own Funds**

- Very limited
- Must have available cash or savings
- 401K
- Cash Value of Life Insurance
- Credit cards (must be disciplined)
- Personal Line of credit (If you can get one)

### **3. Seller Financing: Short Term and Long Term**

- Depends upon the equity in the deal
- Limited amount of Sellers can provide financing, particularly for rehab

- Usually requires funds for rehab or holding costs
- Often can take title “subject to” existing loans (Due on Sale Clause)
- Seller knows the property (collateral)
- Below Market Rates: Little or no interest on their equity
- Most sellers are not very sophisticated regarding finance and the time value of money
- No points
- No appraisal
- You structure terms: loan to value, length of loan, interest rates, payment frequency, etc.
- Substitution of Collateral Clause
- Subordination Agreement
- Seller can refinance to get cash out and let you takeover loan
- Usually no credit checks
- Very small closing costs
- Know their motivation to sell

#### **4. Private Lenders**

- Friends and family: Cash on hand, Self-Directed IRA’s, Lines of credit
- Usually have a limited amount of funds, sometimes not enough for your deal
- You will need to understand finance and be able to educate them about it
- May be hard to find and/or difficult to convince
- They know you (could be good or bad!)
- No points
- You structure terms: loan to value, length of loan, interest rates, payment frequency, etc.
- Interest rates higher than seller financing and closer to Market Rates
- Tend to be flexible
- May allow Comparative Market Analysis instead of appraisal
- Usually no credit checks
- Treat them good and they’ll tell their friends and family about you

#### **5. Partners**

- Usually one provides money and the other does all the work
- Someone must have knowledge of the business
- Usually split profits 50/50 – this can be expensive money without some type of “value add”
- Partnerships are like marriages: some work and some don’t
- Need solid partnership agreement delegating duties, responsibilities and procedures regarding if and when the property is liquidated

#### **6. Hard Money or “Equity Lenders”**

- Often use their own money or lines of credit, wealthy individuals, and/or banks
- Can do “No Money Down” transactions: they will finance acquisition, rehab and closing costs
- Very familiar with and understand our business
- Virtually unlimited funds; can handle larger deals; sometimes have a minimum loan amount
- Many equity lenders available
- Each equity lender has own guidelines for their individual lending program
- Usually charge a 2 to 5 Point fee for their services
- Above Market Rates: Interest rates 10-18%, more commonly around 12-14%
- Low loan to value – generally 60-65%

- Short term – 6-12 months; could be dangerous if house doesn't sell fast
- Generally Inflexible terms; big penalties for extending loan or can't extend loan at all
- Credit often not an issue; they mostly look at property for collateral
- Closing costs are higher: Require title insurance, appraisals, processing fees, inspections, attorney to draw documents, etc. May also require taxes and insurance to be escrowed
- Great for flips – Buy, Rehab, and Sell for Cash
- You can make a good living but you are NOT creating wealth

## 7. Banks, Mortgage Companies and Mortgage Brokers

- Banks and Mortgage Companies are usually a single source loaning and/or servicing their own funds
- Mortgage Brokers have relationships with multiple banks and mortgage companies and get paid a fee to “broker” your loan to these companies. They do not lend their own funds.
- Unlimited Funds but most bankers have a limit on the total number of loans or total dollar amount of loans you can have with them at one time
- Charge a fee for their services, usually 1-2 points
- Requires cash from the borrower = Your own funds
- Usually Can't do “No Money Down” transactions
- Credit score driven
- Market Interest Rates
- Many Variables to choose from: Loan to value: 70-90%; interest rates generally from 5.2% to 9%; fixed rate or adjustable; length of loan 15-30 years; escrow taxes and insurance
- May or may not have pre-payment penalties
- Used primarily for purchase of personal residence, second homes, refi's, loans for tenant/buyers
- Closing costs are higher: Require title insurance, appraisals, processing fees, inspections, attorney to draw documents, etc. May also require taxes and insurance to be escrowed
- Most are not familiar with our business of rehabbing
- Usually will not finance rehab properties unless you have a personal relationship with the banker
- Could have problems with length of ownership (Seasoning) if refinancing or selling

## 8. “Rehab to Perm” Investor Financing

- Finance up to 100% of Out-of-Pocket Costs for Acquisition/Rehab/Closing Costs
- Up to 80% Loan to “After Repair Value”
- Must be used for “Buy and Hold” exit strategy (either lease or lease/option)
- Market interest rates
- Must have 660+ FICO score and a minimum of \$15,000 liquid assets
- Full doc and stated income programs available
- Closing costs are more due to 2 closings but you don't need to use your own cash
- True No Money Down Investor Program

*Jon R. Kubas and his wife Amy began buying investment property in 1984 and have been living and investing in Houston, Texas since 1990. Jon is Past-President of the Realty Investment Club of Houston (“RICH” Club from 1993-1997), and is also a licensed Texas Real Estate Broker and Texas Mortgage Broker. Jon and Amy are experts in real estate investing and finance, and have spoken many times to Real Estate Investment Associations on numerous topics, most recently teaching their home study course, “Real Estate Wealth Systems: A Proven Cookie-Cutter System To Buying, Rehabbing, Selling, And Managing Single Family Houses”. They buy all types of property and also provide loans to both real estate investors and homeowner-occupants. For all your real estate needs, whether you want to buy a property for yourself, want a wholesale deal, have a property you need to sell, a deal to wholesale to us, need a loan of any type, want to lend us your money, or any other item relating to real estate or real estate investing, call them in Houston at 281-397-6200, toll-free at 1-800-424-8903, or visit their website [www.westwindsgroup.com](http://www.westwindsgroup.com).*