

Hard Money Loan Terminology

YOU MUST KNOW THESE TERMS!

Getting involved in real estate finance can present a whole new vocabulary. We've compiled the following list of terms which you are likely to hear as you venture into hard money real estate finance. **I have starred the most commonly used terms for these loan types!**

The Terms:

****After Rehab Value (ARV):** The amount that the investment property is expected to be worth after all of the planned renovations are completed.

****Appraisal:** A professional assessment of how much a house is currently worth or going to be worth, after a renovation is completed.

****As-is Value:** The value of a property as it exists legally and physically, as of the effective date of value.

****Bridge-loan:** A bridge loan is a short-term loan used until permanent financing is secured or an existing obligation is removed (property sold and lien satisfied). This type of financing allows the user to meet current obligations by providing immediate cash flow.

****Commercial Use:** Property that is only used as a business – having no residential component.

Corporation: An entity in which individual owners are not directly responsible for any debt incurred by the company. In corporations, independent stockholders own parts of the company, but are not directly related to the actions of the company.

****Cross Collateralize:** A lending technique when an asset or assets are used as collateral for a loan on a different property.

Crowdfunding: A group of investors, who don't necessarily know each other, buy a percentage interest in an asset and/or loan through a single portal.

****Debt to Income Ratio-** The formula for the debt to income ratio is the applicant's monthly debt payments divided by his or her gross monthly income. The debt to income ratio is used in lending to calculate an applicant's ability to meet the payments on the new loan.

****Debt Service Coverage Ratio (DSCR)**

The DSCR or debt service coverage ratio is the relationship of a property's annual net operating income (NOI) to its annual mortgage debt service (principal and interest payments). For example, if a property has \$125,000 in NOI and \$100,000 in annual mortgage debt service, the DSCR is 1.25.

****Default:** Failure to abide by the terms of a loan (such as payment due or duration of loan), and such failure continues for more than 30 days.

****Distressed Properties:** Properties that are in poor condition or under siege financially (which may include foreclosure); they usually represent great opportunities for fix and flip investments.

****Draw Schedule:** A payment plan for construction or renovation projects. This schedule helps lenders determine when they are going to distribute funds to their borrower based on the value of the work completed.

****Entity:** Either an LLC, a corporation, a sole proprietorship, or a partnership; not an individual.

****Escrow Account:** An account run by a third party in a transaction between a lender and investor. The escrow agent works for both the lender and borrower, by carrying out loan agreement instructions. Money is placed in an escrow account, to cover property taxes and homeowner's insurance. The disbursement of funds is conditioned on consummation (or termination) of the loan agreement.

****Exit Strategy:** How the borrower plans to pay off the loan, as well as turn a profit. Having a clear exit strategy is an important part of developing your overall plan for the project which will help determine the best type of financing for the deal.

Foreclosure: The process by which a lender legally takes control of a property because the borrower defaults on the loan.

****Guarantor:** A person who agrees to assume responsibility for any remaining owed amounts on a loan should there be any.

****Hard Money Loan:** A loan typically secured by a hard asset such as residential or commercial real estate. Such loans usually have high interest rates relative to bank loans. Hard money lenders typically look more to asset value rather than at the credit characteristics of the potential borrower as the primary loan underwriting factor. Hard

money lending is very useful to those who are in need of quick financing since these loans can be closed in as little as a few days. Hard money loans have higher interest rates due to their higher risk and quick service.

Holdback: Portion of a construction loan amount that is not released until a certain stage (such as completion of the foundation) is reached.

Holding Costs: Costs attributed to owning an investment property for a period of time. This includes interest payments, property taxes, house maintenance, insurance and utilities.

HUD-1: A form created and distributed by the transaction's settlement agent at the settlement of a real estate purchase that lists all of the transaction cash flows between property buyer, seller and lender.

****Interest Rate:** The amount expressed as a percentage that a borrower has agreed to pay a lender as the price of borrowing a sum of money. If the interest rate is 10% for one year on a \$100,000 loan, the borrower will pay \$10,000 for the use of money for one year. ($\$100,000 * 0.1 = 10,000$).

Lien: A legal claim on an asset filed with the county clerk. A lien is typically filed by a lender as evidence of its claim upon an asset until such time as the associated loan is repaid.

Liquidity: A measure of the speed that an asset can be sold.

LLC (Limited Liability Company): An entity where individual members are protected from financial liability in excess of the amount a member has invested.

Loan Officer: Loan officers' help borrowers work out their loan agreement and recommend the best plan of action for completing the loan.

****Loan Points:** An origination fee. One point is equal to one percent of the principal loan amount. If the loan is \$100,000 with 2 points, then the borrower will pay \$2,000 in origination fees.

Loan Term Summary (LTS): Document that helps avoid any hidden costs. The LTS outlines all of the conditions of the loan including amounts, penalties, and deadlines.

****Loan to Value (LTV):** This is a ratio derived from the formula $(\text{Loan Amount}) / (\text{Appraisal Value})$.

****Maturity (Loan Term):** Maturity date refers to the final payment date of a loan or other financial instrument, at which point the principal (and all remaining interest) is due to be paid.

MLS (Multiple Listing Service): A database where real estate for sale is listed for a given area or region. Brokers from this area work together to compile this list.

Private Lending: An individual or group of individuals that lends to real estate investors. They usually lend their own funds.

Proof of Funds: A document provided by a lender that is intended to document that a borrower has the available funds to complete a transaction.

****Property Flipping:** Buying a property and then renovating the property in order to increase the value of the asset such that it may be sold at a profit.

Real Estate Broker: Person or firm that helps their clients buy and sell their real estate for a fee.

Real Estate Investor: Someone who purchases properties with the intention of making a profit, either through holding for rental income or reselling it at a premium to cost.

Refinance: Replacing an existing loan with a new one. Typically, people refinance to get a lower interest rate on their loan and/or to leverage real estate value for cash.

REO (Real Estate Owned): A process where ownership of a property was transferred from an original owner to the owner's lender through the foreclosure process.

Return on Investment (ROI): A measure of the amount of return on an investment relative to the investment's cost. This is a % derived from the formula: $(\text{Net Profit} / \text{Cost of Investment}) \times 100$ | for example, if your net profit is \$100,000 and your investment costs are \$300,000, your ROI would $(.33) \times 100 = 33\%$.

****Scope of Work:** This is an outline of all the renovations scheduled to be completed before the house is sold, as well as their anticipated costs. The SOW also gives a timetable of when the service provider expects each component of the rehab to be completed.

Short Sale: This occurs when a seller is selling their house for less than they owe on their mortgage. In order for this to happen, the bank or lending company needs to approve of the sale at the lower price. Short sales are a popular way to find investment properties because of their lower purchase costs.

****Title:** Proof of legal ownership of a real estate asset.

****Turnaround Time:** The amount of time it takes from when the investment property is purchased to when it is sold.

****Underwriting:** The assessment of risk and reward for a potential investment. Underwriters determine the credibility of the potential investor and determines if their investment is going to be able to make enough money to be profitable for all parties involved. Hard money underwriters are typically more concerned with the profitability of the deal than the credit history of the borrower.