Private Answers to Industry Woes

Turning to private lenders — or becoming one — is an alternative for numerous brokers

By **Timi Pereira,** president and CEO, Goldenomega.net

The disappearance of liquidity in the credit market has drastically affected the way mortgage brokers do business. Many have gone out of business; the rest are struggling to stay afloat in an economy where credit from large banks and financial institution has dried up.

Although many banks and other traditional lenders still advertise that they are making commercial mortgage, business and construction loans, they rarely approve anyone whose credit is below a certain score, whose property does not meet their specified loan to value (LTV), or whose loan scenario or personal financials have even a slightly negative aspect to them.

While the banks get pickier, borrowers in need do not get loans, and mortgage brokers lose potential commission. The economy is left worse for wear with every declined loan.

With the return of credit uncertain, there is a way for savvy mortgage brokers to increase their profitability, even in these difficult times. The answer lies in private lending and the efficiency gained by using smart technological innovations in the process.

Being a private agent

As a mortgage broker, how many times have you wished that you could make your own decision about a loan that is either outside the box or that a bank has turned down because of a lack of available funds? Entering the private-money world can put the decisionmaking process in your hands.

There are two ways mortgage brokers can get into private-money lending. One way is to continue brokering loans for clients and to pitch their deals to already-established private lenders.

Another way is for brokers to step up from just brokering loans to become a direct lender.

To become a direct lender, brokers can form a company and lend their own money, apply for a secured or unsecured line of credit from a bank, or find private investors to invest in loans. All these funding sources also can be used concurrently to fund separate fractions of a single loan, thus making a fractionalized loan. In this case, each funding source is tied directly to a specific loan.

Another funding option is available through a mortgage pool. There, all the investors pool their money together to form the fund, which is used to invest in different loans that a fund manager oversees.

To become a private-money firm, be sure to check on your own state's requirements for licensing and any limitations on how many beneficiaries can be on a single loan.

Satisfying disclosures

For private lending, the entire loan picture is presented to the private investors as an opportunity to invest in it. Investors receive copies of the appraisal and other disclosures about the borrower and the loan itself.

Keep in mind that some states have different disclosure requirements. California, for instance, requires that special forms published by its Department of Real Estate are provided to private investors before they invest and before they give any funds to a mortgage broker or escrow company to fund a loan.

As far as the loan security, private-money firms typically think like banks, but they also are entrepreneurs and are in business to make money. They typically look at the property more than the borrower's credit scores. They also look at borrower's ability to repay the loan and the loan's purpose.

And from the start, private lenders want to know the exit strategy: Will the borrower sell the property and pay off the loan, or will the borrower refinance the balloon payment due at the end of the loan's term?

In addition, private lenders will question whether the collateral's LTV is enough and within their state's legal requirements. If not, does the borrower have another property to pledge?

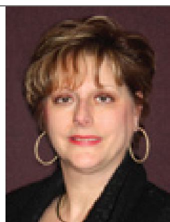
It is common in private-money loans for borrowers to have multiple properties, and each property may have multiple liens that may be paid off, remain on the same position or that will subordinate.

Using the proper tools

Crossing the threshold to become a direct lender using private investors' money or turning to already-established private lenders to fund your clients' deals can be easier if you have the right tools.

Private-money firms need specialized software that complements the mortgage industry's specific legal requirements. Using a word processor and a hodgepodge of documents

Illustration: Dennis Wunsch



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is risky and almost certainly puts a broker in legal jeopardy.

Further, servicing loans using a spreadsheet or a general ledger program — which is not designed to track loans, borrower payments or investor disbursements — is not a functional solution. Finally, traditional predisclosure loan-document-preparation software can fall short of providing the necessary documentation for private-money loans.

Software appropriate for the private-money industry should provide all the documents that must be sent to escrow. These include:

- **The appropriate promissory note for fixed, step or ARM loans;**
- **The mortgage or deed of trust;**
- **Escrow instructions;**
- **The arbitration agreement;**
- **The agreement to procure lender or loan-commission agreement;**
- **The capacity-to-repay disclosure; the oral disclosure;** and
- **Other pertinent documents to protect the mortgage broker and private investors.**

The software also should prepare documents specifically for private-money transactions for commercial and construction loans, from rehabs to complete ground-up construction projects. In addition, it should be able to handle all types of loans, from non-owner-occupied, commercial, construction, step or adjustable-rate mortgages for private-money loans.

Loan-servicing software also should automatically calculate payments received from the borrower and distributed to the investors via checks or direct deposits. Some software can offer online viewing for your borrowers' and investors' accounts via your Web site, as well.

Another important feature to look for is the software's ability to maintain trust-fund balances for each subsidiary ledger, as well as each borrower, investor and servicer, and third-party-payable parties.

Trust accounting is not the same as general-ledger accounting. Trust-fund accounting is the only way to manage funds received and disbursed to individual accounts.

The software should also handle escrows, underlying loans and loan expenses, insurance and lien tracking, and maturity notices. In addition, it should have many portfolio-management and trust-accounting-management reports.

Earning more money

Upon the loan recording, mortgage brokers likely will receive a larger commission than they would as a normal originating broker. In addition, if they also are the funder, they likely would service the loan on behalf of the investors, as well. As such, the income potential for entering the private-lending world is huge.

Private-money brokers who service the loans they fund also can profit from servicing fees, participation in the late charges and prepayment penalties with the investors, and collecting other miscellaneous fees, such as demand for payoff fees, beneficiary statements and reconveyance fees. For example, on a $2.5 million loan with 10 investors, a broker-turned-private-lender who also services the loan could potentially earn more than $100,000.

Further, the loan-servicing residual income will increase with every loan you make and service in-house. It will result in additional income with potential for growth and earnings, thus getting you through the difficult economy while also helping your clients land funds for their deals.

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