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Episode 11 – Funding Your Deals

Andrea: So the coolest part about private funding to me is that you can make your friends, family, and other people money.

-- Intro/Music --

Andrea: Hi, and welcome to Spouses Flipping Houses, Episode 11.

Doug: Number 11.

Andrea: We have a really important subject today.

Doug: Very important, essential.

Andrea: Essential. How to fund you deals.

Doug: We talked a little bit about it in a prior episode, but we are going to go in-depth a little bit more, get some more detail, squeeze the juice out of this topic.

Andrea: Yeah, because it's one thing to find a property and have a seller say "yes" or a bank say "yes," and then what?

Doug: Then what, what do you do?

Andrea: You got to buy it somehow.

Doug: You're looking at that bank account going, "Uhh, I can't buy this house. What do I do?" So we will get into that for sure in our main topic, but before that, we just got home a couple of days ago from our Mastermind meeting which was amazing.

Andrea: Absolutely amazing.

Doug: Yeah, it was a little bit of a fire hose, if you've heard that, of information that just comes at you, and you kind of have to hold your mouth open and hope to get a mouthful of water there. Because it is just an overwhelming three days of just great content and information, but Masterminds in general are one of those things where they can be great for any business that you're in.

Sometimes you just feel like your business is on cruise control and has hit a plateau, and maybe things are going well, but you're not really growing, you're not really changing, progressing, or learning, and you get kind of in a rut.

And when you get together with other people who have businesses similar to yours, but they're maybe a level, or two, or five, or ten ahead of you, and you're seeing what they're doing, it just inspires you to just get going.

Andrea: Yeah, so inspiring. One of the things I love about Mastermind meetings or even going to real estate investment clubs can do the same thing for you, and most towns or large cities have come kind of a real estate investing club that you could Google search and find to go attend these meetings.

But one of the things that I really love about this is that when we first started real estate investing or even way back when we were just learning about it, we read all of these books on entrepreneurial mindset and just getting your brain focused and all of the things you need to do to prepare yourself to be successful, and a lot of them said that your income will be the average of the five people that you hang out with the most.

And so basically, their point is to be careful who you are hanging out with and spending time with, because that is going to rub off on you. And that really bugged me.

Doug: Yeah, it always kind of rubbed us the wrong way. Like what, you're telling me I have to hang out with only people who make a lot of money if that's what I want to do?

Andrea: Well and they've proven that it can be true for some people. It's not true for us, and our friends are our friends regardless.

Doug: Because we like them.

Andrea: I don't care what their income is, but I do see some validity in hanging out and spending time with people that inspire you and keep your focus on track. It doesn't have to be your best, closest personal friends, but even just going to these club meetings or Mastermind meetings keeps you focused.

Doug: Yeah, it keeps you focused, draws you up or keeps your mind sharp on those topics. For me, it's just inspiring. Even just clubs where you've heard something maybe ten times, but that day for some reason it struck a chord a little bit more than in the past, and you just think, "Wow, that's something that I'm going to put into our business. It's going to help us and be inspiring."

Andrea: Yeah, and what's a website they can go to if they want to look for real estate investing clubs in their area?

Doug: I would just go to Google and search "Real Estate Investing Club."

Andrea: Or REIAs. A lot of times they're called REIAs.

Doug: Yeah, REIA, which is R-E-I-A. It stands for "Real Estate Investing Association," so that's a nationwide organization. There's REIA clubs in most big cities and stuff. So yeah, they can go to REIA or just search "Real Estate Investing Club," or go to meetup.com.

I think there's a bunch of little ones probably everywhere, little meet-ups for real estate investors in your city. So check those out. It's definitely worth going, especially if you're new, to meet people who are in this business, and you guys can collaborate, work together, sell each other properties, buy properties from each other, or just learn.

Andrea: Bounce ideas off of each other, I think. Sometimes just feeling like you can ask somebody who knows what they're talking about: "Hey, am I on the right track here?" And have them say, "Yes" is all you need.

Doug: Yeah, so good stuff. We are glad to be back in it though. Main topic today is funding your deals. So, you've got a deal, now what do you do? So we're going to go over what we have narrowed down to be the four primary sources for funding your real estate deals, and we're going to go a little more in-depth in these topics. So what is number one?

Andrea: The first one is bank financing. So this is probably what most people think of first if you're a new investor and you don't know all of your options, you may think that this is your only option. To go to Wells Fargo, a Bank of America, whatever, and try to get a loan through them.

Doug: Most people think of it when they think of lenders; maybe this is the only thing they know of is that you go to your bank to get a loan. That's just what you do. And if you're buying a home to live in, and 95 percent of the population when they're going to get a loan to buy a house, this is a great way to go.

Andrea: So there are pros and cons to all of these options that we're going to talk about, and the pros to bank financing would be that usually they have the best interest rates. You can get a long-term fixed amortizing loan, which is fantastic for rentals. If you're doing rental properties, that is a huge plus.

And a pro and a con to bank financing could be the down payment. Sometimes you can get a low down payment loan depending on the loan structure. Sometimes you need more like 20 percent and that can be a deal breaker.

Doug: Yeah, so there are different loan programs, different down payment things, just like Andrea was talking about. And we're talking about investment properties specifically here, so there are construction loans or loans for properties that need fixing up, like the FHA-203K loan, which I've never used, but that is a loan specifically for someone buying a home that needs a lot of repairs.

And they can still get good bank financing on it, but it's just a lot of hoops to jump through. So some of the cons for bank financing— well first of all, Andrea mentioned the pros. I mean to get a loan with a low interest rate today, which is what four to five percent interest. Historically, we are at rock-bottom interest rates, and to lock that rate in for 30 years is phenomenal, in my opinion.

If you're going to have a rental property, and you can get one of these loans on that rental property, because rates could be eight, nine percent. They have been that high and higher in recent history, so financing is the deal of today's market. So if you can get that on a rental, I think it's a great thing to do.

But the cons of trying to get a bank loan, especially for a flip project, are number one: it's so slow. We sell properties a lot to people getting bank loans, and what would you say our average escrow time is?

Andrea: You know anymore these days if somebody puts 30 days on the contract, I'm like, "Yeah right. We'll see." And if a lender does get it done in 30 days then that's fantastic right now. It used to be that was the norm, like you're expected to get it done in 30 days. But now, it's just taking longer. So 45, 50 is kind of the norm.

Doug: And it's not all the bank people's fault that are doing it. I mean there are so many hoops you have to jump through and regulations that the Feds have imposed, and waiting times, and just an enormous amount of red tape you have to go through. And it just takes time. So it's not fast. That's definitely a con. It's paperwork heavy.

We just closed a loan, which could have been considered in the category of this bank financing, and the paperwork needed— if you've done this recently you know— is just unreal. They're going to want every single piece of paperwork pertaining to your income, your financial history, your kids' birth certificates. You name it; they want all of it, and they're just being overly cautious due to what happened in the crash.

But they certainly are being overly cautious in my opinion, so yes the paperwork is crazy. You don't want to be doing that over and over. And another con is that you're going to be limited. Say that you're getting these four rental properties, and you're limited to four loans max, and then maybe ten for some programs. But the qualification process for numbers five through ten is just unreal.

They want, I don't know, there's lot of massive reserve requirements and all kinds of different things, so it's really difficult to get that many loans. Another con is that they don't typically lend to corporations, and if you're a house flipper then you typically want to buy in a corporation, not your own name. And then also, they're credit and W-2 driven, so you can be a self-employed person that has great income, but if you're not receiving a W-2, and you can't prove that with pay stubs, they don't even want to talk to you.

And maybe there are some programs that are coming back that people say you can get loans still, but it's just a challenge. Say you have bad credit for some reason; that's another thing. You're going to have a difficult time getting one of these loans.

Andrea: So basically bank financing is good for people who maybe already have a job and you want to use this to acquire a rental property. It's really not the best for flipping, unless maybe you're only going to do one a year, and that's assuming that the person selling you the property is willing to wait that period of time while you get the loan.

Another option for you through bank financing is if you were to already have a line of credit on your home that you can pull out real quickly, but with flipping, speed is everything, especially if you're buying direct from a seller. They want to close, generally, fast. So this is probably not going to work, bank financing, for flipping.

Doug: Yeah. So the second source of funding is what's called a "hard money loan." Andrea do you want to explain that to us?

Andrea: Sure. So hard money loans are used primarily for construction and short-term loans, and they're usually smaller lending companies. They are not backed by the Feds, so their underwriting standards are different. It's not a Fannie Mae or Freddie Mac loan. Their money usually comes from hedge funds or private individuals, private groups, so they're able to make up their own rules basically.

So they can make it a simpler process, but they are taking higher risk, so they get a higher return for that. You pay a little bit more, but generally a little bit easier.

Doug: Right, and some of the pros of a hard money loan are that they are fast. That's exactly the biggest difference to me anyways, if you're a house flipper, is depending on how good your hard money lender is, it can be as short as three, five, seven days. Typically it will probably be more like ten days, two weeks, but still, way faster than getting a traditional bank loan, which is very important in real estate investing. Sometimes speed is everything.

Another pro is that they're flexible. So your hard money lender, once you get to know him and prove yourself, they can be flexible with you. Like sometimes properties are hard to access, you know hard to get in. Maybe there's a hostile situation in the house and you just can't get inside, and you have a few pictures to go buy, but if you're a trusted person they've lent to and they have some other information, they'll still fund the deal for you.

Not everyone of course, but a lot of them will. And that's due to your relationship and due to some other factors, so that's definitely a positive when working with a hard money lender.

Andrea: So then the cons would be that they are definitely more expensive than regular bank financing, so you're usually going to pay for hard money 10-15 percent interest rates plus two to four points plus fees. And the points are basically a percentage of the loan amount, and then fees on top. They have different closing costs. They have their own underwriting process that they go through.

You pay for that. So it's definitely more expensive, quite a bit more expensive. Another con would be that it's a short-term loan, so they usually want to be paid back in between six months to a year. And then if you go over that, you might end up paying even more, some kind of a penalty or an increased interest rate, however they might have it set up.

So if you have a delay in your process, let's say for example, we had a property that we did down in San Diego and getting permits through the city took so much longer, and we didn't end up going over a year, but it took a lot longer than we thought. So you have to have a hard money lender that might be willing to be flexible with that or has term that are going to work for you. So that could be a con.

With all of those things said, we use hard money quite often. We really prefer it because of the speed and all of those things. Hard money lenders, I think, are great.

Doug: Yeah, and I think the majority of house flipping people utilize hard money loans in some way or another. Another thing I forgot to mention is that it's typically driven more by the property and project and less by the borrower's credit or their qualifications.

Now they will qualify you to whatever standards they have a little bit, but they're more based on the value of the property, what you're going to do to improve it. They're looking at that as a house flipper should and minimizing their risk based on the deal itself.

Andrea: Right, and that's huge.

Doug: Definitely. You want somebody to look at the deal that way.

Andrea: Right.

Doug: The third avenue of funding is called private funding. So private funding is basically just people, private individuals who lend you the money for your deals. I mean that's the easiest way to explain it.

Andrea: And this would be our favorite option for financing deals. So the pros are that it is fast and typically very easy because the paperwork is just going to be whatever it is that you set up between you and that individual. Whatever agreements you guys have, so fast and easy, not a lot of paperwork.

The terms are totally negotiable, so whatever works best for both parties. And you're not going to have all of the closing costs and things you have from a hard money lender. Points and those things are all totally negotiable.

So the coolest part about private funding to me is that you can make your friends, and family, and other people money. So it's awesome that we can do this business, and make money, and be successful, but if you can help other people to be successful and make money along the way, even better. That's so awesome.

So we've had lots of family members and friends that we know that have invested with us, and they make a much better return with their money than they would in a savings account, CD, or anything else, and they're very happy.

Doug: Yeah. We pay them off, and they're calling us the next week like, "Okay, when's the next one?" They're ready for it, and obviously I want to put a caveat here. Don't take Aunt Judy's life savings if you're brand new and just put it all in some property. Don't do that. Be responsible. Make sure you know what you're doing before you put friends and family's money at risk, because that is sort of what you're doing.

And you know, we always go with the belief that listen, you're going to get paid back before we do. If this project goes south, we're still going to honor your loan and pay you back, and if we lose money, we lose money. That's just part of it.

Andrea: Yes, if you don't have integrity, don't do this.

Doug: Don't do it! Literally, if you don't have integrity, don't do this. You won't have friends and family before long if you do. But like Andrea said, it's definitely a win-win for people, especially if people have money sitting in the bank. I don't even know what it's earning, if it's earning anything.

I mean it's really a negative if you count inflation in there; it's losing value over time. So if you can give them a good return that is still affordable for you, and it makes sense to do these deals, man that's just a win-win. So definitely we love private funding.

Andrea: Oh wait, there's one more thing we had under the pro category. Let's say you're buying a house direct from a seller, and sometimes they can provide the loan for you. So they can carry back while you're fixing up their property to sell it or whatever you plan to be doing with that particular deal.

Or sometimes maybe you can take over their loan in the short-term while you're fixing up the property, so there are some different options there that can be beneficial.

Doug: Yeah so when we're talking to sellers, often times we'll kind of look at that angle because it could benefit them even more. They could get more money for their house. You can pay them more, in a sense, because you're not having those costs to other private lenders or mortgage brokers and things like that. It definitely can be a win-win. So the seller-financing aspect of private financing we utilize a lot as well.

And now the cons: you know, we're not attorneys. Let's say that, number one. So we don't know all the laws and stuff, and there are laws with borrowing money from individuals.

So you definitely need to check the SEC laws, check with an attorney, or do some research in your state, your area. Find out what the laws are with this because you don't want to be breaking the laws on borrowing and lending money.

Andrea: For sure you cannot go advertising for this. It needs to be something that you do privately between people that you know.

Doug: Yeah, we do know that much. You can't go throw an ad on Craigslist saying, "I'll pay you x-percent. Come invest in my deals!" That's a direct solicitation for money, and that is not allowed unless you have all of the licenses and you're an actual lender.

So do not do that. It has to come organically from people you had a relationship with prior or you know in some way you did not bring about that.

You did not ask about that loan; they came to you, or something like that. So definitely be aware of those missteps because you don't want to go down that road. And also another con might be that it can be limited.

Let's say you have two great private investors, but they only have so much money, and at some point your business and your growth might want to do four or five more deals, and they just don't have any more money to lend you even though they'd like to. And then you run out.

So the more sources you can get of this, the better. But that's one con, that you always need to be looking for new private money sources who want to invest with you. Anything else on that one?

Andrea: No, that's good.

Doug: Ok cool. So the fourth and final one is kind of a new one. It's crowd funding, and we have not used this source before. Basically the easiest way I know how to describe crowd funding is— I don't know if you've heard of KickStarter on the Internet, and that's different.

That's where they're just kind of donating to some cause or project, but it's essentially an online portal where investors are accredited investors (and look that one up because you have to be an accredited investor usually), and they can go to a website and pool money together to put towards an investment, and then they get paid a return when it closes out.

So some of the pros for this, and again we have not utilized this one, these are kind of assumed pros. This is kind of a new thing. I'm assuming the rates are fairly competitive to hard money loans, so you're probably going to be paying more than a bank loan, but it could be similar to a hard money loan, maybe less. I'm not sure.

Because they're utilizing new technologies it could be an easy process. I'm thinking that they're probably streamlining the processes, so you enter some basic information about the property and yourself, and they've got all of your information on record after a time, and then maybe the process is an easy one to use.

So I just foresee that being one of the possible positives to this type of funding, and probably there's an unlimited amount of sources out there since this is a growing industry. So potentially you could find all of your deals this way.

Andrea: And so the cons to crowd funding would be the fact that it is still new. So there could be some kinks that show up along the way that we don't know about yet.

We have actually never used crowd funding, so just keep that in mind that it is new. So maybe not everything is worked out with all of that quite yet.

Also, the turn times, so for example with private money and hard money lenders, they can fund your deal in under a week most of the time. Crowd funding, I’m not sure if they’re able to pull off the turn times that you’ll need.

Doug: I would guess not that quickly. Yeah, maybe more comparable with hard money loans, like a two weeks or something, but I doubt in under a week you’re going to get funding for a deal you may need at some point.

Andrea: So just something to keep in mind.

Doug: Something to keep in mind. If you want to check out some of those crowd funding sources, I did some research and found a couple that seemed to be legitimate online. One is fundthatflip.com and another kind of big one that had some press a while back is called realtyshares.com. So check those out if you’re interested.

So that’s funding in a nutshell. Well, hopefully we dove into enough to give you some good idea of what types of funding are available and commonly used in real estate investing.

Andrea: If you have any other questions about this, feel free to shoot us an email through our website, spousesflippinghouses.com. We also have a couple of free gifts for you there that you can download.

One is an e-book on working with your spouse, and there are lots of tips there. And then the other one is a deal analyzation course that Doug has put together. It’s a three-part deal analyzation course.

It is awesome. I cannot even emphasize this enough. He has gone through how to break down a deal for a flip and how to break down a deal for a rental property that you want to keep, a step-by-step guide. How to comp out these properties, how to know if you have a deal or if you don't.

He goes through so many things that you need to know. It's absolutely so valuable. We may be taking this off the website soon, so if you're interested, get it know.

Doug: We put a lot of work, both of us, into those gifts, so grab them while we can because we might be making some changes with what we're giving away for free there. So yeah, great! That's pretty much it. I think this episode will be coming out right before Thanksgiving, so if you're listening to it, have a Happy Thanksgiving, enjoy the family, watch some football.

Andrea: Eat lots of turkey and pie.

Doug: Stay out of the malls on Black Friday and just have a great week. We will catch you when you get back.

Andrea: Talk to you soon.