Silverback Universal

Private Mortgage Lending

ASSET BASED LENDING

What is Private Mortgage Lending?

Definition of Private Mortgage Lending

Private Mortgage Lending, sometimes also referred to as "private money", is the term used for loans secured by real estate that are funded by private parties and are typically offered at higher interest rates than an FDIC insured bank. Private Mortgage Lending underwriting guidelines are almost always less invasive and time consuming than the guidelines followed by a traditional bank or financial institution. Borrowers seek Private Mortgage Lending loans when they are unable or do not have the luxury of time to wait for financing from more conventional sources. This can be due to several reasons, which are discussed in the next section.

Why Borrowers Choose Private Mortgage Lending Loans

The question often arises as to why borrowers would seek a private money loan for real estate at the high interest rates that private money demands. The immediate assumption is that these are high -risk ventures and the borrowers do not have the creditworthiness that would allow them to borrow from traditional and conventional sources. There are in fact a wide variety of factors that determine whether a borrower would be a candidate for a private money loan. Let's look at several more common reasons below:

- ✓ Quick Funding of a Time Sensitive Loan
  Banks and conventional financial institutions frequently take 90 days or more to close a loan due to strict regulatory requirements and a tedious due diligence process that must be adhered to. A Private Mortgage Lending lender can often fund a loan within a week.

- ✓ Reduction of Red Tape and Paperwork Hassles
  Traditional lenders require substantially more documentation than private money lenders and have more stringent loan committee processes and guidelines. Borrowers must often submit confidential financial information and complete an abundance of paperwork to find out if a loan will be approved. A Private Mortgage Lending lender focuses mainly on one aspect of the loan (collateral) while a bank will scrutinize the credit, financials, job, etc. of a borrower.

- ✓ Flexibility and Creative Problem Solving
  Private money lenders are more creative with complex loan situations. They can offer options like cross-collateralization of other properties or offer more flexible terms than traditional lenders. The property may also have issues that

make it difficult for conventional lenders to finance such as the need for improvements to increase the occupancy of a building, or partially completed construction, etc. Additionally, traditional lenders will not lend on raw land due to their strict underwriting guidelines and are known for limiting the amount of investment properties a borrower can have in their portfolio.

✓ Return on Investment

Many borrowers such as builders, rental property investors and property "flippers" have a specific goal in mind when looking for a loan speed at which they can get their loan funded. These individuals are focused on making a profit and the simplicity and minimal time it takes with a private money lender can far outweigh the higher cost involved for financing. Time is money.

✓ Nature of the Loan and Market Conditions

The constant change in market conditions and laws that govern the real estate market force conventional financial institutions into taking even more time and have become even more conservative with approving loans. Private money lenders on the other hand can assess the property or project's risk and charge an appropriate fee for the perceived risk. In essence, private money lenders are equity based and the most important component of the loan funding is the evaluation of the real estate. A borrower's history and level of commitment plays a part in determining the viability of the loan but is not as paramount to the decision ma kingprocess.

✓ Borrower Circumstances

Again, these are not just limited to credit problems or a past or current bankruptcy as is most often assumed. There may be tax liens or other liens that need to be paid, or the property may be entering into foreclosure for a variety of reasons. The property may be held up in probate or involved in a divorce or other family situation. There may be unemployment or a medical emergency. The list is endless, but the principle is basically the same; private money lenders lend on the value of the asset first, and the strength of the borrower second. Ultimately, the decision resides with an experienced underwriter to evaluate the "whole st01Y" when evaluating a potential borrower. Private money is used by a wide variety of borrowers ranging from very high net worth individuals to sophisticated real estate investors and developers, all of whom prefer the speed and simplicity of the loan process.

The Loan Process

Requirements

Depending on the type of lender, the due diligence items required from the borrower can vary greatly. For instance, it is well known that banks or other conventional lenders can require documentation that most of the public feel is "overkill" and tedious. In addition, traditional lending sources quite often require documents, or updates, all the way up to the actual closing of the loan. On the other hand, a Private Mortgage Lending lender is well-known for requiring much less documentation and will often only need the information to be provided at one time. Whereas a bank is looking closely at the borrower (credit, financials, etc.) and property being pledged as collateral for a loan, a Private Mortgage Lending lender is placing the greatest emphasis on the equity in the property.

Timeframes

Private Mortgage Lending lenders, because of their documentation requirements and quick underwriting process, can often fund loans in as little as 5-7 business days. In some instances, a Private Mortgage Lending lender can even fund in a matter of hours. As mentioned earlier, with the myriad of requirements to qualify for a traditional bank loan and the fact that there are several individuals involved in the loan approval process, the typical time to fund can be anywhere from 30-90 days.

Steps

The steps involved in the loan process vary greatly between a Private Mortgage Lending lender and a bank. The following is a list of the six primary steps taken by a Private Mortgage Lending lender as it pertains to a residential (1-4 units) loan. As it pertains to Source Capital Funding, Inc., we can provide an approval within 24 hours and funding in a matter of days. In addition, we will highlight the differences in this process as compared to a bank. The six steps include Pre-Qualification, Loan Application, Processing, Underwriting, Approval and Closing.

1. Pre-Qualification

This occurs before the loan process begins and is usually the first step after initial contact is made. In a prequalification, the lender gathers information about the borrower and property being used as collateral for the loan. The property itself is typically the single most important factor when determining whether to move forward in the loan process. Other factors, to a lesser degree, include borrower credit and financial stability.

2. Loan Application

The "application" is the beginning of the loan process and usually occurs the same day or following day after the Pre-Qualification. The borrower completes a loan application, auth01ization for lender to check credit, letter of explanation and proof of income and employment and submits to lender for Processing. At this time, all parties should be clear as to what the loan request is and a solid understanding of what the borrower's situation is and how the lender can help. It is important to note that the lender is required to submit a Good Faith Estimate (GFE) and a Truth-In Lending Statement (TIL) to the borrower within three days of receipt of a completed loan application. These documents help the borrower understand all costs associated with the loan and terms.

3. Processing

Once the loan application is completed, it is assigned to a loan processor. It is during this process that a credit report is ordered, and an appraisal obtained on the subject property being used as collateral for the loan. The loan processor's main duty is to ensure all the documents submitted by the borrower are complete and accurate. This includes verifying the borrower employment status (W 2s and pay stubs), assets (checking, savings, 401K, etc. accounts), and outstanding debts (credit cards, auto payments, student loans, etc.). At this time, if there are any issues or questions regarding the information provided, the processor will ask the borrower for additional clarification and documentation. Once the processor has an entire package completed, he/she will submit to the underwriter to initialize the underwriting process.

4. Underwriting

An underwriter’s main task is to assess the risk in a loan. In the mortgage underwriting process, an underwriter reviews or "underwrites" all aspects of the loan from the borrower's finances, employment and credit to the real estate being used as collateral. In short, the underwriter is responsible for determining whether the package submitted by the processor is deemed as an acceptable loan for the lender's portfolio.

Underwriters typically look for the following "3 Cs" to Underwriting:

- Collateral — What is the value and type of property being pledged as collateral?

- Capacity Does the borrower have the resources and means to debt service the loan and payoff at term?
- Credit — Are there any issues with the borrower's credit hist01Y?

For a Private Mortgage Lending underwriter, the focus is predominantly based on the collateral, as it is the single, most important item that secures the loan. The ability to repay (capacity) and the credit history (credit) of a borrower are important but is not what provides the lender the most security; the equity in the property is paramount. Unf01tunately for a borrower, jobs, financial situation, life events (marriage, divorce, birth, death, etc.) can change in a manner of minutes and all these factors can have a significant impact on the loan. Hist01ically, real estate values do not have the instant volatility as a borrower would and thus, the values are weighted more heavily than a borrower's income, job, etc.

In summation, an underwriter wants to make sure a loan amount does not exceed a property's value. Otherwise, a lender may not be able to recover a loan's unpaid balance, in the case of default.

5. Approval

If approved, the lender will send the borrower a commitment letter. This letter outlines all terms and conditions for the loan and the borrower will be given a set amount of time to accept the offer. If the terms are agreed upon by the borrower, the lender may ask for a few additional items from the borrower including, but not limited to, proof of hazard insurance, any HOA information, payoff demands from other creditors, property tax information and title and escrow contacts (if not opened already).

6. Closing

The closing process involves three parties the borrower, lender, and escrow agent. Each party has a specific role. For the borrower, closing is synonymous with signing loan documents. During this time, the borrower will have to review, sign and date numerous legal documents. this process may seem tedious and redundant, it is necessary to protect all parties.

The lender is responsible for sending all loan documents to the escrow agent to arrange for the borrower to sign and for wiring the loan proceeds to the escrow agent for delivery to the borrower.

Keep in mind that the lender has worked directly with the borrower throughout the loan process and is intimate with all details regarding the loan, so the loan documents are typically error free, thus saving valuable time. The escrow agent is responsible for ensuring the borrower properly executes all the necessary loan documents required by law as well as working with a title agent to secure a title insurance policy.

Once the loan documents have been signed by the borrower, the escrow agent sends the original documents to the lender (except for the Deed of Trust) and the lender wires funds to the escrow agent. The most important step in this process is for the escrow agent to record the Deed of Trust (mortgage) with the County Recorder in which the property is located. The recordation if this document provides public notice that there is a lien (loan) on the property. Once the Deed is recorded, the funds are released to the borrower and the loan is closed.

Glossary of Terms

The following are the most common terms associated with private or "'hard" money and the loan process:

Appraisal
A carefully documented estimate of property value. A licensed appraiser who analyzes recent sale prices of similar/comparable properties prepares this.

Asset
Items of value owned by an individual. Assets that can be quickly converted into cash are considered "liquid assets." These include bank accounts, stocks, bonds, mutual funds, and so on. Other assets include real estate, personal property, and debts owed to an individual by others.

Assignment
The written transfer of an interest in a lease of mortgage. The lessee, or assignor transfers the remainder of the term, and the assignee becomes liable to the original lessor for the rent. For example: When ownership of your mortgage is transferred from one company or individual to another, it is called an assignment.

Broker
A broker is an intermediary who handles paperwork & forms, negotiates rates, legal items and serves the borrower.

Closing Costs
The expenses which borrowers incur to complete the loan transaction. These costs may include title searches, title insurance, closing fees, recording fees, processing fees, & other charges.

Deed of Trust
A three-party security instrument conveying the legal title to real property as security for the repayment of a loan. The three parties included in a deed of trust are the borrower, lender, and trustee

Equity
A homeowner's financial interest in a property. Equity is the difference between the fair market value of the property and the amount still owed on its mortgage and other liens.

Escrow
An item of value, money, or documents deposited with an impartial third party to be delivered upon the fulfillment of a condition. Escrow acts as the custodian for the documents and funds involved - and makes disbursements, delivers documents, and effects the consequential changes to the title record of the subject property.

Private Mortgage Lending
A Private Mortgage Lending loan (also known as rehab or bridge loan) is financing from a private individual or group that is based on the current equity in the home.

This money can be used for the purchase of real estate by investors. People having trouble obtaining loans from conventional sources generally seek after Private Mortgage Lending loans. With Source Capital Funding, Inc. can receive funding in as little as 5-10 days.

Lien
The claims of debt, judgment, mortgage, or taxes brought against a property. Examples of types of liens would include judgments, mortgages, and unpaid taxes.

LTV - Loan to Value:
The simple ratio of the requested loan amount against the market value of the property being used as collateral. A property valued at $200,000 with a loan request against the asset of $ 100,000 would have a loan-to-value ratio of 50%.

Market Value
The current value of property as determined by factoring in location, assets, demand & supply.

Notice of Default
A notice sent to the wrongful party as recognition of a default made. This is the first phase of the two-step foreclosure process in most States.

Origination
I. The starting date of a loan.
2. The process leading to the start of a loan.

Points
A fee paid upfront on a loan that is incurred at the time of the loan. A point is equal to 1 % of the amount of the mortgage.

Position
The position defines the order in which claims against the security will be satisfied in the event of a foreclosure. Most lenders prefer to lend only in the first position, but some lenders will go in a 'Subordinate" position (second, third, etc.) in exchange for a higher rate of return. Source Capital Funding, Inc. only funds in first position.

Pre -Qualification
This usually refers to the loan officer's written opinion of the ability of a borrower to qualify for a loan, after the loan officer has made inquiries about debt, income, and savings. The information provided to the loan officer may have been presented verbally or in the form of documentation, and the loan officer may or may not have reviewed a credit report on the borrower.

Pre-Payment Penalty
The penalty (if any) that a borrower must pay to a lender if a loan is repaid "early." For example, on a loan with a six-month Pre-Payment Penalty, if a loan is repaid in six months or more, no penalty is assessed. However, if a loan is repaid in less than six months, the penalty is equal to six months interest less the interest already paid.

Principal

The amount borrowed or remaining unpaid. The part of the monthly payment that reduces the remaining balance of a mortgage.

Rate

The percentage compensation to be paid by the borrower to the lender at fixed intervals (usually monthly). Rates are quoted as annual charges. Interest rates vary with both the state of the economy and the perceived risk involved with a particular loan. Most first position loans placed by Source Capital Funding, Inc. range from 9-1 1% per annum.

ROI

Return on Investment. To calculate your Return on Investment for your Private Mortgage Lending Loan you must take your profit from the completed deal and divide that by the sum of your down payment and total interest payment. Private Mortgage Lending deals have a much higher ROI than paying all cash because of your ability to leverage your capital.

Security

Although almost anything may be used as security, or collateral, to effectively secure a loan, Source Capital only places loans that are secured by real estate.

Terms

This refers to the length of a loan and the amortization. All loans funded by Source Capital range from 1-7 years with interest only payments (no amortization). Once the term of the loan is due, the principal amount borrowed is due in full.

Title Insurance

Insurance that protects the lender (lender's policy) or the buyer (owner's policy) against loss arising from disputes over ownership of a property.

Trustee

One who holds property in trust for another to secure performance of an obligation, the neutral party in a trust deed transaction.

Underwriting

The process that lenders go through to evaluate the risks posed by a particular borrower and to set appropriate conditions for the loan. This is based on the criteria of assets, credit, income, employment, etc.

Value

There are different ways to establish the value of a security, and one or more may be used in any given situation. Among these are the following: (a) previous transfer price(s) for the property, (b) tax assessed value, (c) appraised value, as assigned by a paid and impartial licensed appraiser, (d) a Market Value Analysis (MVA) provided by a realtor, (e) transfer prices for comparable properties, (f) an income analysis, (g) an evaluation of the cost basis for the property.

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