DEFINING LOAN TYPES IN REAL ESTATE INVESTING

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Defining Loan Types in Real Estate Investing

Getting started in the real estate investment space can be challenging and understanding how different terms may apply to an investor's project is crucial for a successful result. To help investors navigate their way around a potential deal, we have created a set of useful terms and definitions that are used over a variety of real estate investment areas.

Defining Loan Types in Real Estate Investing will provide an overview of widely available options investors have to finance different types of deal scenarios. This collection of terms will offer investors essential knowledge to correctly select an appropriate loan type to fit their investment opportunity.

ADJUSTABLE RATE MORTGAGE (ARM)

A type of mortgage where the **interest rate is variable** and is adjusted periodically throughout the term length of the loan. The rate is often based on an index that reflects the cost to the lender borrowing on credit markets. ARMs typically have a short period of time where the rate is fixed before it enters the floating rate stage.

Understanding ARMS
ARMs are shown in two numbers: the first will show the length of time the interest rate will be fixed while the second will vary depending on what the lender offers. For example, a 5/1 ARM has a fixed rate for five years and the rate is adjusted every year starting year six until the loan is payed off. For a 2/28 ARM, the rate is fixed for the first two years and fluctuates the remaining 28 years of the loan.

BRIDGE LOAN

A **short-term loan** that helps a borrower get into a permanent loan. The scenario might require certain conditions be met before it can qualify for a permanent loan, such as rehab, or getting it leased out. A bridge loan is used while those conditions are being cleared so they can then get a long-term financing solution.

BUY AND HOLD

A scenario where a borrower is purchasing a property with the **intent to hold** long term. If done right, the property should generate a monthly cash flow, allowing the borrower to accumulate a steady flow of passive income.

CASH OUT

A loan scenario where a borrower already owns the property and **converts the equity in the property into cash** via a loan. If a borrower is not going to be receiving cash from the loan at the closing, it should not be considered a cash out. Cash out loans can include paying off existing debt on the property. The key is that the borrower would be walking away from closing with cash to qualify it as a cash out.

CONVENTIONAL MORTGAGE

1st lien mortgage product offered by banks and residential mortgage companies. These typically offer lower rate and cost less to close. However, they take longer to process and often won't lend all property types.

CORRESPONDENT LENDER

A mortgage lender that originates and funds home loans in their own name. Shortly after the loan closes, they sell these loans to larger mortgage lenders who service the loans and may also sell them to the secondary market.

DELAYED PURCHASE

Property owned by a person or company, If the borrower purchased a property within a specific amount of days of the closing date, lenders may be able to treat the loan structure the same as if the borrower was making a purchase rather than a refinance. This should help **improve the LTV** a borrower may receive. It also helps if the borrower has a hard deadline to close that they can't meet. They can purchase with their own cash and be reimbursed for their purchase.

EXIT STRATEGY

This is how the borrower plans to pay off the loan with either the sale of the property, or refinance.

FHA LOAN*

An FHA loan is a type of mortgage that is insured by the Federal Housing Administration (FHA). This type of loan can fund single family and small, 2-4 multi-family as long as the **borrower makes the home their primary residence**. An FHA loan will typically have lower down payment and credit score requirements but will include an annual mortgage insurance payment alongside the standard mortgage payments. A 203k loan* has the same requirements as an FHA loan but will also provide rehab funds.

Example Scenario: Owner Occupied, Small Multi-Family Purchase

One way where an FHA loan can help new investors is by allowing them to purchase an investment property and live in it at the same time. Unlike lenders who can only fund non-owner occupied properties, an FHA loan has no issue with the investor living in one unit and renting out the remaining units to tenants.

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FIX AND FLIP LOAN

A loan type where the borrower is receiving financing to purchase a property, rehab the property, and then sell the property for a profit. Typically, these are short-term, interest only loans.

GAP FUNDING*

In real estate investing, GAP funding is a smaller sized loan that investors acquire to **finance the difference** between the price of the property and the amount the 1st position lender is financing. This loan is typically used to cover down payment and closing costs.

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HARD MONEY

Private, commercial mortgage products that can finance certain scenarios and properties that a conventional mortgage won't lend on. Typically, hard money loans have higher rates and fees but **allow investors to purchase properties quickly** and have less regulations than a conventional bank mortgage.

HOME EQUITY LINE OF CREDIT (HELOC)*

A line of credit loan, typically against a person's primary residence that allows them to borrower and pay back the funds over a set period of time, similar to a credit card.

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INTEREST ONLY LOAN

A type of loan that only requires a minimum interest payment to be made monthly, rather than principal + interest.

Calculation

$$\frac{\text{(Interest Rate x Loan Amount)}}{12} = \text{Inerest Payment}$$

LETTER OF INTEREST (LOI)

A document outlining an agreement between two or more parties before the agreement is finalized. **Lenders may offer an LOI on the front end of the loan process** to let borrowers know that as long as the lender gets the items they need (good appraisal, title, and documentation), these will be the loan terms the borrower can expect.

NON-RECOURSE LOAN*

This type of loan is secured by collateral, usually physical property, and **the borrower is not personally liable**. The lender of the non-recourse loan can seize the property as compensation if the borrower defaults, but they cannot go after personal property. In a case where the seized property does not cover the full value of the loan, the lender has no choice but to accept the loss.

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PITIA OR PITI

Principal, Interest, Taxes, Insurance, Association: This is a short-term acronym used to convey what will be included in a mortgage payment. Fully amortized loans may include principal, interest, taxes, insurance and association dues. The acronym is shortened to PITI when no association dues are included in the mortgage payment.

PREPAYMENT PENALTY

A clause in a mortgage contract stating that a penalty will be assessed if the loan is paid off before the term length ends. The point of a prepayment penalty is to ensure that the lender recoups the cost of making the loan since it will not receive the long-term interest income of the loan.

Adjustable prepayment penalty:
Keep in mind that some lenders allow borrowers the flexibility of choosing a prepayment penalty option. Depending on the scenario and an investor's loan needs, an adjustable prepayment penalty can help reduce interest rate or allow a borrower to pay off the loan early if their exit strategy changes before the term length ends.

PRINCIPAL

In the context of borrowing, principal refers to the initial size of a loan; it can also mean the amount still owed on a loan. Does not include loan interest or fees that might be due for the loan to be paid off.

RECOURSE LOAN

This type of loan is secured by collateral, usually physical property, but **the borrower is personally liable** as well. The lender may seize the borrower's personal assets along with the property if the borrower defaults on the loan.

REFINANCE

A loan scenario where a borrower is **taking out a loan on a property they already own**. This may include paying off existing debt on the property, cash out to the borrower, or paying off other debts. A rate and term refinance does not include any cash out to the borrower.

SECOND MORTGAGES

Also known as a 2nd lien, a second mortgage is **subordinate to a senior mortgage on a property**. Considered riskier than a first mortgage because in the event of a foreclosure, the first mortgage will get paid off first and whatever is left over goes to the second mortgage lender. Ask your lender if they allow a second mortgage on their loans.

SHORT SALE

A sale of real estate in which the **net proceeds from selling the property will fall short of the debts** secured by liens against the property. In this case, if all lien holders agree to accept less than the amount owed on the debt, a sale of the property can be accomplished.

TABLE FUNDING

Table funding is an option which allows **brokers approved for Wholesale Traditional Lending** to originate, process and close loans in their name. However, the loan is transferred to the lender who provides the funding at the time of settlement and the lender simultaneously advances funds for the loan.

WHOLESALE

Wholesaling is when a buyer gets a property under contract and then **markets it to new buyers at a marked-up price**. Typically, they do not actually purchase the property but instead assign the contract to a new buyer. A less popular method is to have a double closing on the same day but that involves more paperwork and fees.

About RCN Capital

RCN Capital is a direct private lender that provides funding for non-owner occupied residential properties. Our loan programs are used for purchase, purchase & rehab, refinance, or cash-out of investment properties.

Visit RCNCapital.com \ **Email** Info@RCNCapital.com \ **Call** 860.432.5858

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