Stop the Confusion for Investor Clients

Hard money loans feature fewer requirements than fix-and-flip products

By Michael Mikhail

Hard money loans and fix-and-flip loans are among the most popular financing programs for investors in single-family homes. Although they are two different products, many people both inside and outside the mortgage and real estate industries believe they are the same, but this is the furthest thing from the truth.

Mortgage originators who work with these types of borrowers should know about the array of loan programs that are designed to meet your clients' financing needs. There is something for everyone, regardless of the type of investor and their loan scenario.

Hard money basics

A true hard money loan is asset-based financing, which means it is based on a loan-to-value (LTV) ratio set by the home's appraised value. Compared to a fix-and-flip loan, it has fewer guidelines and criteria. It doesn't go through full underwriting, so there is little to no minimum FICO score requirement for the borrower.

This type of loan doesn't have as many restrictions as one might think. Borrowers do not have to worry about previous bankruptcies, foreclosures or accounts in collections, etc. Due to the lack of guidelines and underwriting, a true hard money loan is often capped at 65% LTV or less.

For example, let's say you have an investor client looking to purchase a home valued at $1 million. If they want a $500,000 loan against it (or 50% LTV), they should be able to receive the funds within one to two weeks from the day of application. This type of financing is normally in the form of a bridge loan, which is short-term financing of 12 to 24 months.

High-cost and predatory-lending regulations are one reason why hard money loans are only for investment properties. Federal law limits or prohibits many high-cost loan features, such as balloon payments or prepayment penalties, for owner-occupied properties. Also, borrowers who run into financial trouble are less likely to repay their investment-property loan than the mortgage for their primary residence.

Many states have nonjudicial foreclosure laws that allow a hard money lender to get their money back quickly if a borrower defaults on a mortgage. These foreclosure laws make the lender more comfortable doing a high-risk loan, especially if they are holding it and not selling it on the secondary market.

The biggest misconception borrowers have is that many believe a hard money loan will have a high interest rate even if they are qualified and have a high credit score. The fact is, you can receive interest rates and terms that are similar to conventional financing while still retaining the benefits of a loan with no income-verification requirements. Hard money is not a blanket statement that covers all private money loans.

Fix-and-flip contrast

Although fix-and-flip loans are another form of asset-based financing, they utilize more underwriting guidelines and criteria than hard money loans. The latter product is almost exclusively focused on the asset, while the former examines both the asset and the borrower.

Furthermore, a fix-and-flip loan is specifically for rehabilitation purposes — it is short-term financing of 12 to 18 months that is used to acquire property and renovate it. The main reason why people confuse hard money loans with fix-and-flip loans is because the purposes and parameters for both products are similar. They are both private money loans for investment-property purchases. Many of these investment loans are backed by hedge funds, but even though the money comes from the same place, the underwriting is different.

Contrary to hard money loans, fix-and-flip loans are commonly sold on the secondary market and undergo a full underwriting process with tighter guidelines. Depending on the lender, fix-and-flip loans may have a minimum FICO score requirement. Additionally, the borrower is less likely to be approved if he or she has any late payments, judgments, foreclosures or bankruptcies on their credit report during the previous 24 to 36 months.

Depending on the lender you are working with, it can be important for mortgage originators to bring something dynamic to the table that can help you close these loans quickly, efficiently and professionally. When you move forward with a specific lender, make sure that you and your borrower know all the details of the loan program, why it's being utilized and whether the program is being properly presented to suit your client's needs.

Originators and real estate investors across the U.S. should look to lenders that offer both hard money and fix-and-flip financing programs. These lenders typically have their own experienced loan officers who will match each loan scenario to a wide range of mortgage programs that will best serve the borrower. ■

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