7 GUARANTEED Ways To Lose *All* Your Money Through Private Lending

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Thank you for downloading this FREE report. I have prepared this report for use by only those persons downloading it from my website, www.viprealestate.com. It may not be distributed, copied or resold without my express written consent. I hope you find this report helpful. Although I cannot hope to answer every question or cover every possible topic related to private lending in this brief report, I hope to at least give you some helpful introductory information on the following topics:

- **Why private lending has become so big**
- **The biggest questions that you, as a private lender, must be able to answer before risking any of your hard-earned money**
- **7 key ways you could lose your money through private lending**

It is important to note that, although this report touches upon both both the financial and legal underwriting aspects of private lending, I have focused this report primarily on the legal aspects of private lending. If you need separate underwriting assistance not covered herein, please feel free to contact me and I would be more than happy to discuss how I can help you with that process.

It is also important to note that, although I discuss legal aspects of private lending, no information herein should be construed by you as legal, tax or financial advice. Your particular situation is peculiar to you and requires specific advice or counsel. If you need specific legal, tax or financial advice, contact your attorney or financial or tax advisor.

Introduction

"When a person with money meets a person with experience, it's usually the person with the money that gets the experience."

Due to the financial collapse which began in 2006, many banks and mortgage lenders are either out of business or have severely constricted their lending practices. Of course, banks have never been interested in lending against properties that need extensive renovation. But now the exotic mortgage products that existed through 2006 are no longer offered and banks and mortgage companies now require much higher credit scores and bigger down payments from their borrowers. For these, among other reasons, most real estate investor loans are now nearly impossible to qualify for in the conventional marketplace.

Private lending has always been an important resource for real estate professionals but, for the above reasons, private lending over the past several years has exploded and is now, more than ever, an essential part of the real estate investment business. There are many great real estate deals out there, but no bank loans available, so investors have turned to private capital to fill the void left by the banks. Simply put, without private capital, real estate deals in today's marketplace don't get done.

Along with the explosion of private loans, there has been a tremendous uptick in the number of websites, classes and training

programs designed to help real estate investors attract private capital for their own individual real estate deals. Most of these courses teach investors how to scour the public records for the names and addresses of private lenders and send them advertisements enticing them with the promise of big returns. In return for the lender's capital, the investor will give the lender an 8-11% return. The lender will be "safe" because the borrower will give the lender a mortgage, deed of trust or other security instrument on the real estate he or she is borrowing against.

Perhaps you are one of these lenders. Perhaps you have received these advertisements and have started to loan money to an investor or a group of investors. Whether you have never written a private loan, have made a few loans, or are a seasoned lender, it is important to always evaluate whether you have maximized your level of safety in your particular deals. I will try to help you do that in the pages that follow.

Do You Know The Answers To These Questions?

Private lending is serious business. You are risking large amounts of your own hard-earned capital at a time when you probably cannot afford to lose it. Unfortunately, in the world of private lending, if you make one mistake, that's *exactly* what could happen. Experience tells us that financial disaster will ultimately strike a private lender if he or she does any of the following: 1) lends on the wrong type or piece of collateral; 2) lends without the proper legal protections in place; 3)

lends to the wrong borrower; 4) lends outside the bounds of the law, knowingly or unknowingly.

For these reasons, before you make any private loan investments, you should always be able to objectively answer these questions, among others:

- ✓ Do I fully understand all the risks associated with private lending and have I analyzed whether the benefit (higher interest rate) is worth that risk?
- ✓ Has the person asking for my money or the person creating my loan documents fully explained those risks?
- ✓ Has the person writing my loan documents been chosen by me or the borrower? Are they fully representing my interests? Does that person have a lot of experience with private loans?
- ✓ Do I really understand how to underwrite these deals or am I relying too much on the word of the borrower?
- ✓ Does each and every loan meet my underwriting guidelines, or do I find myself doing "favors" for my borrower and stretching my comfort level because nothing bad has happened in the past?
- ✓ How do I know if I'm lending too much?
- ✓ Does the borrower have enough "skin" in the game or am I making it too easy for him or her to walk away from the deal?
- ✓ If the borrower walks away from the deal, will I be able to properly manage the property and complete construction without having to

infuse more money into the deal over and above my current loan amount?

- ✓ Will I be able to go after the borrower's personal and marital assets if the borrower defaults, or will the borrower be able to hide behind a corporate shell, thereby making him or her judgment proof?
- ✓ Will I get made "whole" if the deal goes sideways?
- ✓ Am I holding enough money back in escrow to protect the construction process or am I taking excessive risk by letting the borrower dictate the draw schedule or have construction funds in advance?
- ✓ Do I have 3rd party, independent verification of the property values before and after repair and that the construction is being done properly?
- ✓ Does the property meet local zoning and licensing requirements?
- ✓ Have I properly underwritten the 4 "C's" of each and every deal (credit, collateral, capacity, character)?
- ✓ Is the borrower's exit strategy realistic given his or her financial situation? What if that situation materially changes before maturity date of the loan?
- ✓ Are there any aspects of the deal that make me worry because I don't understand them?
- ✓ Am I making lending decisions based upon emotion rather than logic, i.e., I've fallen in love with the high rate of return and,

because I don't have other deals to choose from and need to keep my money working, I've lowered my underwriting standards for this borrower?

- ✓ What do I do if there is a default and the borrower disappears?
- ✓ What constitutes "default"?
- ✓ Have I properly protected myself against fraud? Do I even know how fraud can be perpetrated against me in these deals?
- ✓ Should I include an arbitration clause in the legal documents?
- ✓ Should I lend from my name or should I form a company to do it?
- ✓ Do I need to worry about any lender licensing requirements?
- ✓ When is a deal considered "commercial?" Is it based upon the type of property or based upon what the loan proceeds are being used for, or both?
- ✓ Does the title insurance policy have all necessary endorsements to maximize my protection in the event of a title claim or fraud?
- ✓ Should I make the borrower get a survey of the property before closing?
- ✓ Have I carefully examined the borrower's corporate documents and do I understand them?
- ✓ Can I trust where my money is going?
- ✓ Am I sending my money to a trusted escrow account, or am I giving it to the borrower directly?
- ✓ Should I require a Deed In Escrow? Is that legal?

- ✓ Do I have too much of my capital tied up with one borrower? What if that borrower goes under?
- ✓ Should I diversify my funds across a broader range of borrowers and loans to protect against the potential collapse of one borrower?
- ✓ Am I getting a customized set of loan documents, or am I using standardized, boilerplate "shelf" documents?
- ✓ Has the borrower obtained the proper type and amount of hazard insurance coverage and am I protected by it?
- ✓ Are my loan terms legal?
- ✓ What is the foreclosure process and how long will it take? What do I need to do with the property in the meantime?
- ✓ Do I know how to service these loans properly? What about 1098's?
- ✓ Can I afford to lose all my money in this deal if I make a mistake?

These are just some of the questions that my private lender clients must answer on a regular basis to assure themselves they are writing successful loans.

As I mentioned in the beginning of this report, some of the issues I address in this report are financial, some of them are legal, and some both. The financial underwriting of a private loan is beyond the scope of this report, so you may not find answers to several of the questions I have posed above. I have focused this report on identifying the key legal underwriting issues related to private loans. Make certain that

before you risk your capital you also get proper direction on all the key *financial* underwriting issues associated with private lending.

You should also be able to tell from the above list, that unless you are completely comfortable with the borrower, the collateral, the loan documents, and the team of experts you have helping you, you should not write the loan!

7 Key Issues You Must Address

Someone brings you a private note opportunity. You have underwritten the borrower and the collateral and you like the deal - now it's time to document and close the transaction. Do you know how to protect your money? Could your entire investment be at risk without you even knowing it? Here are some key questions to ask before risking your capital:

1. Do You Have Sufficient Title Insurance Coverage?

Title insurance is a little understood item. Lenders and owners almost always obtain title insurance, but few understand exactly what the insurance actually protects against or the variations between the different types of title insurance. Let's briefly review.

Owner's Title Insurance

Because you are the lender, your understanding of the owner's policy is not that relevant, so I will not spend much time on it. It is only

important for you to understand that your lender's policy will be different from the owner's policy. The owner will be looking to get protection for the full value of the property in the event of a catastrophic failure of title. For that reason, the owner's policy is more expensive than the lender's policy and has different types of coverages. Some coverages in the owner's policy will overlap with the lender's policy while others will be completely different.

Lender's Title Insurance

Your interest as the lender is fourfold: 1) understanding the status of title and making sure the legal documentation and title insurance coverage properly map to the status of title; 2) getting the title insurer to guarantee your lien position (usually a first lien position); 3) providing you a legal defense in the event of a title claim or challenge to your rights in the property; and 4) being reimbursed or indemnified by the title insurer in the event of a loss of your investment.

In theory, the lender's policy does all this - but it is oftentimes not automatic. The devil, as they say, is in the details. There are often title "problems" or "defects" inherent in the title that *may* not be covered unless it is addressed and dealt with prior to closing. As counsel for private lenders, it is my job to review the title commitment (or "binder" as it is commonly called), identify any potential problems in the title, and resolve them in a way most advantageous to the lender. If you do not have counsel, you will have to do this yourself. There are several

types of insurance endorsements available with title policies and, depending on the status of the title, the type of deal, and the current market conditions, the title insurer may or may not be willing to offer those additional endorsements or coverages.

An entire book could be filled with the types of potential problems you could see as a lender and the types of coverages offered by the insurer and, unfortunately, I could not hope to cover all of that in this report. However, it is important for you to recognize that the title insurance business is like any other insurance business. The policies issued by the title insurer will attempt to cover as little as possible - that's just part of the insurance business. So it is your or your counsel's job to review the title commitment and request appropriate edits, endorsements and coverages.

I strongly recommend that before you invest in any further deals, you spend some time understanding the different types of claims that could arise and how best to protect yourself, or find an attorney that understands these issues. This is not an exhaustive checklist, but if you are going it alone without the assistance of counsel, make certain you at least understand the following:

- The title policy should be issued by a large, institutional, AAA rated title insurer;
- If the title policy is going to "except" to mechanic's liens, you must make sure to understand how mechanic's liens can get onto the

property and whether they can take priority over your mortgage. You may need affirmative mechanic's lien coverage;

- Make sure the title company removes any "standard" exceptions to the title policy. They usually have no problem doing that for a lender;
- Ask if there is any creditor rights coverage available. In today's title insurance environment, it is difficult to get it, but it's at least worth asking for;
- Make sure the title company covers the "gap" period for you. In other words, you want title coverage from the time the commitment is issued and the time of recording the mortgage (this is called the gap period);
- Make sure you obtain copies of any "exception" items for review;
- Make sure there are no items in the policy that can take priority over your lien;

There are many other endorsements and title related issues, and the above is the bare minimum you should address to help protect yourself. By simply asking the title attorney about these items, you may spur an important conversation about potential pitfalls in the title policy.

Unfortunately, there is no way to give you blanket advice for every title policy, as each is a little different. These basic items are no

replacement for experience or legal counsel, and I strongly encourage you to retain an attorney to help with these title issues.

2. Is The Hazard Policy Sufficient?

It's no surprise, but borrowers will usually buy the least amount of insurance possible to save on premiums - so make sure that *prior* to settlement the borrower names you as a "loss payee" and provides to his insurance agent your exact and correct address (you don't want to miss any cancellation or claim notices), and that the policy provides coverage in an amount sufficient to *completely* pay you off in the event of a catastrophic event.

If you are lending on a rehab project, many borrowers attempt to get away with under-insuring the property, or by obtaining a cheaper but inappropriate policy such as a **homeowner's policy** or a **landlord policy**. The policies are most definitely cheaper than a **builder's risk policy** or a **vacant property policy** but, if there is a catastrophic event, these cheaper and inappropriate policies may not cover the loss. For instance, what if the borrower or the borrower's contractor starts a fire while working on the electric panel in the house? What if the borrower has kitchen cabinets and appliances delivered and they are stolen before they can be installed? With a simple landlord policy, these losses may not be covered, exposing you and the borrower to an unpleasant situation. After all, guess who the borrower is going to come to when his cabinets are stolen and can't complete the project

without more money? You guessed it – YOU. Are you prepared at that point to lend him or her more money?

If you are not familiar with the types of insurance product that is appropriate for any given lending situation, I would recommend sitting down with a trusted insurance agent (who is also experienced with investment properties) and discussing all the possible scenarios and how you can best protect yourself. Here are some questions to ask:

- What coverages do I need?
- Does the policy cover my entire loan amount?
- Does the policy cover theft?
- How much would it cost to rebuild?
- When does the coverage expire?
- Does the policy cover me all the way to maturity date of the loan?
- What if the borrower doesn't pay the insurance bill or the coverage expires? What happens then?
- Do I need to be a loss payee or additional insured?

Here's the bottom line: If you don't carefully choose and monitor the insurance on the property, you are exposing yourself to a total loss of your investment.

Important Tip: Make sure the borrower/borrower's contractor has an maintains workmen's comp insurance. It may not directly affect you but, for your borrower to remain in business and pay his debt, you don't necessarily want him embroiled in legal battles. If a worker

gets hurt in his house (the one you have a loan on), you want to be certain the contractor has the liability and not the borrower/borrower's insurance company.

3. Do Your Documents Properly Set Forth The Terms of The Deal and Are They Legally Compliant?

All too often, I see private lenders using "shelf" or boilerplate documents rather than having an attorney prepare them. Many times these documents are form documents from the internet or prepared by the title company closing the deal (which may have a conflicting relationship with the borrower). After closing hundreds of hard money loans, I can tell you that each deal is slightly different, and often require adjustments to the standard documents or special disclosures in order to properly "lock down" the borrower and stay compliant with State or Federal law. Although in no way exhaustive, here are some examples of the ways in which documents need to be tweaked in particular circumstances:

- Oftentimes lenders have difficulty identifying the difference between a borrower and a guarantor, or why each person needs to be classified differently. How do you decide who's who and whether you can have more than one borrower or guarantor?
- If a party agrees to be a guarantor, do you need to add the spouse? Although some of this is a financial underwriting

decision, there are also significant legal ramifications to only having one spouse as a guarantor.

- If you are lending construction money, what are the borrower's rights to that money? How do you control construction in the lending documents and keep the borrower from having unfettered access to the money?
- What if this is a high risk default loan? Do you need to build additional specific safeguards?
- Do you need UCC Financing Statements for the deal? Does this deal have significant equipment that may need to be secured over and above the real estate?
- Should the lender on the docs be you, individually, or an entity? If you don't lend through an entity and you don't have indemnification and other safeguard language in your documents, you could be exposed to a lawsuit which could, in turn, expose your assets.
- Should you or, better yet, can you legally require the borrower to sign a deed-in-lieu?
- How do you insure the title company is having the documents executed and recorded in the specific manner and with the specific requirements you have laid out to them? Or did you even give them written instructions? You don't want the title company

operating in a vacuum without your specific conditional instructions, or you could be risking your money.

- When do you need to use arbitration? What are the pros and cons, and how do you properly implement arbitration into the documents?
- What if you are lending in another State? Which State's law will control the terms of the deal? Can *you* control that so you get the most advantageous venue and substantive law? Or will you let the borrower and the Courts dictate when, where and how you will show up in Court?
- Although it *sounds* easy to define "default" (no payment = default), it may not be so easy to do so. Is there a grace period for payments? How late can the payment be before default? What is a "non-monetary default" and how is it defined in your documents? Will the borrower be in default if he files bankruptcy or fails to make insurance or property tax payments? How do defaults get cured? Can you or should you charge extra in the event of default?
- What type of notice do you and the borrower have to give each other? Hand delivery? Overnite? Email? What if you need to serve the borrower and all you have is a P.O. Box from him (I've seen this happen - it then costs a lot of money to skip-trace the borrower)?

There are many, many ways in which document can change depending on the needs of the lender, borrower, collateral and terms of the deal. The devil is always in the details and, as someone risking a lot of capital, it is incumbent upon you to pay attention to all the little details because – trust me – the borrower isn't.

Needless to say, I think it's important to have an attorney draft your lending documents.

4. Are You Violating Any State Usury Laws?

Although not as much an issue with commercial deals as with residential deals, it is important to remain under the legally imposed caps on interest rates. If not, a Court could find your whole deal invalid. What then? You could lose the mortgage on the property and your security for the deal, or you could even face State imposed sanctions for your actions.

One super-important, critical, don't ignore it, tip: If you take nothing else away from this Report, don't forget this one. One of my clients learned the hard way, i.e., $50,000.00+ in legal fees:

Always, always, always understand whether you are lending against a borrower's primary residence. There are very strict mortgage lending laws surrounding loans to primary residences. I highly recommend against lending against a borrower's primary residence unless you have first obtained an opinion from a local attorney about how and whether you can do it, which you likely can't do without State and/or

Federal licensing, and without being severely limited as to what interest rates and loan terms you can apply. BE CAREFUL. I have seen situations where the borrower claims the property is an investment property simply to get a loan (because he can't get a loan elsewhere), but in reality it's his primary residence. It will be your job, and yours alone, to verify the status of the property. A Court could hang you up for years, or you could lose your mortgage completely, if you lend on a primary residence the wrong way, even if the borrower originally claimed otherwise. I HAVE PERSONALLY SEEN BORROWER'S DO THIS, so don't take this advice lightly.

You will also want your borrower to sign an affidavit in *every* deal you do certifying under oath that he/she is not borrowing against a primary residence and that the loan proceeds will be used solely for commercial, business and/or investment purposes and not for personal, family or household purposes!

5. Do You Know How To Identify Fraud?

There's an old saying among poker players that if you look around the room and can't find the mark, you're it. The truth is, even the most experienced and savvy investors can fall victim to fraud without ever seeing it coming. Just ask the Bernie Madoff investors. Better yet, watch *American Greed* on television, and you'll get your fill of real estate fraudsters. The show even profiled a few hard money lenders in the southeast that got taken by a borrower who stole identities form

homeless people, got title to a property through seller-held financing, recorded fake mortgage releases from the seller in the land records, and then took out multiple loans on one property from several experienced hard money lenders. I personally know several wealthy individuals in my area that fell victim to fraud and lost a substantial amount of money. Fortunately, they both have deep pockets and survived but, if you fall victim, you may not be so lucky.

In the world of private lending, there are no government bailouts or "safety nets" available for lenders so, if you are a victim of fraud, your chances of seeing your money again are very slim. For this reason, you must always remain diligent in your search for fraud as long as you stay in the private lending business. There are many con artists in the real estate game that would love to take your money from you. You must always have your radar up. You must also understand how and when fraud can be perpetrated against you and how it can impact your deal. You should never get so comfortable with a borrower that you "let your guard down," as that will be when you get hit. Always remember that the best con artists *are* the best because they're very good at gaining your trust. Always follow the golden rule: "trust but verify." Each and every deal you do should undergo strict underwriting. No exceptions should be made just because you've done 10 other successful deals with the same borrower. The borrower may not like this, but remember - it's not their money at risk, it's yours.

As to how you can be hit by fraud, I have identified two different methods by which fraud can be perpetrated in a real estate deal, each equally as devastating to your wallet.

The first method is what I call **direct fraud** - Generally, a con artist convinces you to put your money into a deal that doesn't exist, or gets you to invest in a ponzie scheme, such as a real estate investment pool or an "escrow" arrangement, and then runs away with your money, never to be seen again. And if he *is* caught, guess where your money is? Correct - gone - probably in a boat, or expensive Mercedez, or something akin to that.

The second method is **indirect fraud** – the borrower commits some act of fraud to acquire the property and you, as lender, get caught up in the inevitable litigation. This is similar to the *American Greed* example above. Here's another example:

The con artist advertises for short term loans. An elderly, vulnerable property owner on a fixed income is in desperate need of cash to pay property taxes or a small debt, and contacts the con artist. The con artist comes to the property owner's house with a notary and, through deception, gets the property owner to sign a deed – usually by intermingling it with other loan documents. The con artist then has a scumbag title officer record the deed for him. Now the con artist gets a loan from you. Later, after your money is already in Tahiti, the elderly woman's daughters find out and start suing everyone, including you! I

won't play this scenario out any further. I think you get the idea where this is headed.

Fraud in real estate lending/investing is more rampant than you may realize, so protect yourself by: 1) working only with trusted and reputable parties; 2) if possible, always sending your money directly to the title company rather than the investor directly; and 3) if possible, always being the direct noteholder (vs. investing in a "pool," where fraud is easier to perpetrate).

If you're not experienced in identifying all the potential areas of fraud, it may be a good idea to have an attorney help you with your due diligence, even if it costs extra money. A few pennies now could save you thousands, tens of thousands, or even hundreds of thousands later.

6. Does Your Borrower Have Authority To Borrower?

Sounds like a silly question, but it's not. Here is an example of how this may come into play for the lender:

The borrower is a limited liability company (LLC). The person who contacted you for the loan is *supposedly* the sole owner of the company. He agrees to your loan terms and you go to closing. The property, as well as your loan, is in the name of the LLC. You don't review the LLC documents prior to closing. Later, after closing, you learn there are two additional owners of the LLC and the individual who contacted you did not have proper authority from other owners to

obligate the LLC to your loan or the purchase of the property. Or, even worse, the individual who took the loan is an imposter and has nothing to do with the LLC.

This is the type of problem that an inexperienced private lender is susceptible to, so you must be careful when lending to a non-person. If you are lending to a company, a trust, an estate, or any other "non-person," it is crucial that you have proof from the "non-signing" parties that the "signing" parties are authorized to act on behalf of the entity. You must also make sure the signing party is not violating any applicable restrictions, either in the documents or under the law, by entering into your deal. If you don't do this, your security against the property (mortgage), as well as your note, could come under direct attack by Trustees, Beneficiaries, Heirs, etc., thus risking your capital investment.

7. Are Property Taxes Current And Are You Monitoring Them?

Municipal liens (water, taxes, etc.) usually take priority over your mortgage, so *always* make sure property taxes are current and up-to-date at the time of closing. Usually, in any tax or municipal action against the property, all interested parties are notified, so you *should* get notice of any pending tax sales or the like. However, I have seen circumstances where the County/City makes mistakes with addresses. Or perhaps, for some unknown reason, your mortgage was never

properly recorded, meaning nobody knows you are an interested party, so you don't get a notice.

I usually recommend obtaining tax and water information from the title company at the time of closing, and then setting a reminder on the file and the calendar to follow up with the title company or taxing authorities as necessary. At the very least, you will want to check around tax payment due dates to make sure taxes remain current. If you don't, and the property gets sold at tax sale, your lien could get wiped off the title and you could lose your entire investment.

Conclusion

I hope the information in this Report has triggered you to ask some important questions of yourself and the people involved in your transactions, and that you use the information contained herein to help you structure and close successful private loans. As you can see, there's more than meets the eye in making sure you keep your money safe. As I stated in this Report, the devil is in the details, so make sure you pay close attention to them on your next loan and, if you need assistance underwriting or documenting your deals, please feel free to contact me. I'd be happy to help. Good luck and happy investing!

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