

PRIVATE Money Equity Loans  
By Alan Mandelberg Ph.D.

Private money lenders hope to make a profit by collecting interest (“return on capital”) along with receiving the money back that was originally lent (“return of capital”) over the course of the loan. These lenders who are not “institutional lenders” such as, banks or credit unions, choose to make these as an alternative to, say, leaving the money in an insured savings account, buying stock, investing in a business or even buying real estate.

Private lenders may be individuals, retirement funds, trusts or even businesses who seek the profit that well placed private lending can offer. A typical private lender may be an individual who invests his or her retirement money in private loans to sustain a good cash flow to support his or her lifestyle.

Properly invested, a private money loan can offer a high rate of return while being a passive investment. That is, lending money privately requires little effort after the loan is made. The periodic payments and any final payment can be expected to come in the mail.

Like all other investments, private money loans always require a balancing by the investor of the “risk” involved, that is, the possible loss even hypothetically of some or even all of the money lent, against the gain to be made, the “reward” which is the return on capital by way of interest on the money, the profit from the loan.

Private money lending has gone on for a very long time. However, since the bursting of the financial bubble in 2008, many more borrowers than before have felt the need to seek private money. Banks have been much more reluctant to lend money since the bubble burst in terms of to whom they will lend, the amount that they will lend and, moreover, on what they will lend. Consequently even borrowers with good credit, good income and significant net worth have been forced to seek out private money.

Sometimes it is just a matter of timing that leads strong borrowers to look for private money. The money may be needed more quickly than a bank may provide. Bank loans can take several weeks. Sometimes upwards of two months or longer to accomplish. A private loan can be arranged in just a few weeks. Sometimes in just days. Thus there should be no embarrassment in borrowing private money. It just involves the business decision by the borrower as to as to whether the cost of the money is justified by the opportunity afforded by receiving it.

Private money lenders know, of course, that they are being approached for a loan by someone who is not in a position to borrow from a bank. Consequently the terms under which the money is lent may be a lot less favorable than at what a bank might lend – if banks were lending at all in the situation. The interest rate charged is likely to be higher. The cost to obtain the loan - represented by “points” charged, that is, the amount subtracted from the gross loan amount in one percent increments to determine the actual net amount paid to the borrower. The time period for which the money is lent may also be much shorter.

What at first may seem paradoxical is that a private money loan may also carry a “prepayment penalty”, that is, an extra charge for it being paid off early. The reason that private money loans often may carry a prepayment penalty is that the private lender may want to be guaranteed a certain profit in return for the effort required to decide whether to make the loan.

The terms of a private loan, including any possible prepayment penalty, may be negotiated one on

one with a potential lender. My job in arranging a private money loan is to create a “win-win” scenario so that the lender will want to make a loan that the borrower will be willing to accept. It is a running joke in the lending business that the “Golden Rule of Lending” is that “The lender makes all the rules.” However, unlike borrowing through a bank, there are fewer hard and fast rules to private lending. In the case of a private loan, the lender will need to be convinced that the reward clearly outweighs the potential risk.

Under present market conditions, private lenders may not lend more than 65% of the value of the subject property even if it is an income property that nets more than the loan payment. Because there is likely to be more risk in, say, a requested 65% loan to value loan than in, say, a 50% loan, private lenders may demand a higher interest rate on a loan at a higher loan to value ratio loan. Land loans are quite difficult to obtain these days. As your broker arranging a loan for you, I still may be able to find a lender on land – but you should be forewarned, Lenders may not want to lend even 50% of the value – if they will lend at all on even a good piece of land.

If one private lender has “rules” that do not lead to an acceptable loan for the borrower, there are always other private lenders to approach – who may not invoke the same rules. Private lending is common sense lending. If a loan makes sense to a private lender, he, she or it will make the loan. “It only takes one.”

There are a surprisingly large number of investors who lend privately. A broker like me who has been arranging private loans for a few decades may know many potential private lenders and/or call on a fellow private loan broker to supply a private lender if one is not directly available to him or her.

One rule that private lenders pretty much always follow is that they expect to be happy if the borrower pays as agreed but they would also be happy if the borrower does not pay. In the latter case they want to be sufficiently rewarded if they have to foreclose on the property and resell it. Following this rule, private lenders will lend a lesser percentage of what the property may be worth (a lower “loan to value ratio”) than what a bank might lend – again, if a bank were lending at all in the situation. For this reason private money loans are often also called “equity loans.” The lender wants to be sure that there is enough equity above and beyond the funds being lent so that the loan is “safe” even if the borrower were to default.

If the amount to be borrowed appears to be low enough compared to the value of the property, “loan to value ratio” again, as shown by sales of comparable properties in the area, the lender may be satisfied with information about these “comps” and, therefore, not require a formal, independent appraisal of the subject property.

Because private money loans are primarily based on the equity in the subject property, private loans may require less paperwork than a bank loan. Before the real estate bubble burst, sufficient equity might have been enough to convince a private lender to make the loan in question. These days, private lenders want to know more about the borrower than they did before. Verification of good enough credit, for example, may now be required along with a basic loan application. Many private lenders have had to acquire properties through foreclosure in what has been an atmosphere the last few years of declining real estate values. If private lenders wanted to own real estate, they would be buying property instead of lending on it. So it is not enough for them just to know that they could foreclose safely. They would just as soon want to know that the borrower has his or her “exit strategy,” that is, the ability to successfully pay the loan back.

Successfully negotiating a private money loan is an art. It involves most of all, listening to the

concerns of both the borrower and the potential lender – besides understanding the ingredients that go into a private money loan. I've been doing lending of all sorts for many years, but private lending is the first sort of loan that I did, before I got involved with bank lending. Working with a borrower and lender to accomplish a private money loan is still a very satisfying exercise for me.

I much prefer discussing a possible loan with a borrower and then preparing the loan application together with him or her. I do not want to just send a borrower a blank application. However, it will help the process for you to follow the simple loan request format that I have prepared so that we can have a fruitful discussion. You can email this to me at [alan@approvedfinance.biz](mailto:alan@approvedfinance.biz). Or call me any time at 619-249-4713.

One further note: If you are someone with capital and would like to explore becoming a private lender yourself, I'd certainly would like to speak with you about that.

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