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Explaining the Methods of Hard-Money Lenders

As banks continue tightening their purse strings, hard-money lenders are pouncing on the opportunity to lend to shunned borrowers.

Kathleen Rosen
Leonard Rosen, an unofficial spokesman for hard-money lenders, at an industry seminar in March.

It's not the major financial firms you'd expect. As we write today, more of these lenders are everyday investors tapping their savings accounts to make a profit doling out mortgages.

So how does it work?

Through brokers, hard-money lenders offer high-interest, short-term loans to borrowers who can't get traditional bank financing, including investors and people with spotty credit. The interest rate can be in the high teens — compared with less than 5% for bank mortgages — while the length can be as short as a few months.

Hard-money lenders don't focus much on a borrower's credit scores. They care more about asset valuations and loan-to-value ratios. Many lenders won't lend more than 50% to 70% of the home's value, while banks will lend as much as 80% and government-backed loans can go as high as 96.5%.

Because there is little bureaucracy when compared with big banks, deals can be approved and closed in just a few days. "There's no red tape," says Merrill L. Kaliser, co-founder of Longhorn III Investments, a Texas lender and broker.

Typically, individual hard-money lenders are matched with borrowers through loan brokers who make a commission on each deal. As with traditional mortgage brokers, they charge points and fees, which can be several thousand dollars per transaction. Some loans are set up with low monthly payments and a balloon payment due at the end of the loan term — a feature they share with some of the mortgages that contributed to the financial bust.

When the loan comes due, borrowers either refinance into a conventional mortgage, flip the property to pay off the loan or, if those measures fail, extend the hard-money loan. "The hard money loan is an interim loan," says Sophie Lapointe, a co-owner of Five Star Mortgage in Las Vegas, Nev., which doesn't do hard-money loans. "Borrowers can position themselves to refinance or pay off their loan within that time period."

Lenders say that defaults are low, in part because borrowers have plenty of equity tied up in the properties themselves. When a borrower encounters trouble making payments, some lenders will extend the due date or charge late fees to avoid initiating foreclosure proceedings. "We're really just concerned with the interest on the money," says Phillip Cujilan, a mortgage broker based in Freeport, N.Y., who connects borrowers with lenders and charges the borrowers 3% to 5% of the loan amount for his work. "We'll give the borrower enough time to get out of the loan. Foreclosure is the last resort."

Robert and Yvonne Fassett praise the hard-money business. They secured a loan last year to restructure their finances after a kitchen-cabinet distribution business they owned for 30 years suffered in the downturn, ruining their credit. The couple received a one-year, $120,000 loan with a 12% interest rate.

“The fees and interest rate were no doubt higher than a bank, but it was well worth it since no bank was willing to listen,” says Mr. Fassett, 59