



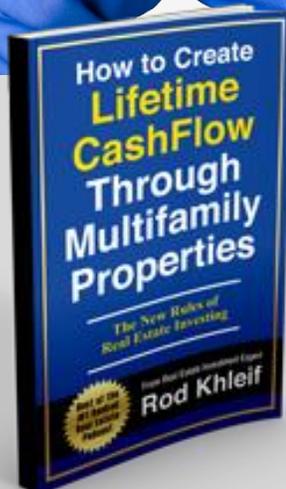
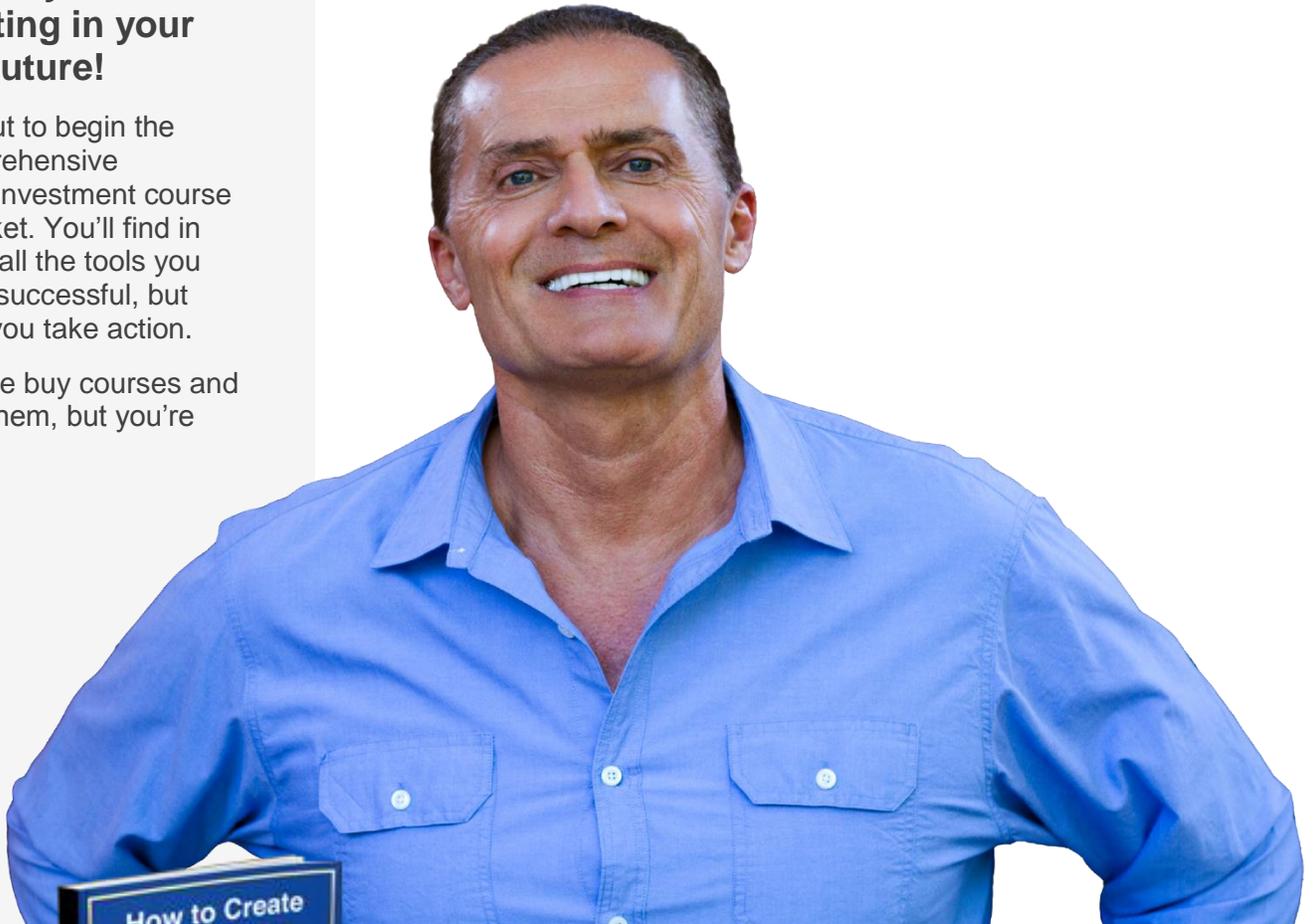
The
Lifetime CashFlow
Academy

Lifetime CashFlow Through Multifamily Properties

**Thank you for
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future!**

You're about to begin the most comprehensive multifamily investment course on the market. You'll find in this course all the tools you need to be successful, but only when you take action.

Many people buy courses and never use them, but you're different!



Rod Khleif

*Author of **How to Create Lifetime CashFlow Through Multifamily Properties***

*Host of the #1 ranked Real Estate Podcast on iTunes:
Lifetime CashFlow Through Real Estate Investing*

MODULE

8

**Mortgages, Loans &
Creative Funding Options**



Rod Khleif

*Lifetime CashFlow
Through Multifamily Properties*



The
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Mortgages, Loans & Creative Funding Options

Key Points

- The Power of Persistence
- Financing Your Deal
- Working With Banks
- Seller Financing Strategies
- Creative Ways to Buy and Finance Deals
- Constant and Never-ending Improvement

Key Terms

Recourse debt: loans where the borrower is personally liable for the debt, applies to most commercial loans.

Nonrecourse debt: loans where the borrower's personal assets are safe, though the bank can take the property. Commercial Mortgage Backed Security (CMBS) Loans, also known as Conduit Loans, are nonrecourse.

Defeasance: a bank term for very stiff prepayment penalties.

Points: prepaid interest, paid at the time of closing.

The Power of Persistence

Find the video on Module 8, Video 1 at :40

“Persist: to go on resolutely or stubbornly in spite of opposition, importunity, or warning”

~Webster's Dictionary

When you hit a wall and go around it, over it, or sometimes through it, that's persistence.

Everyone has at one time or another taken the path of least resistance, the easy road. Many people have done that all their lives, and unfortunately it's become a habit.

Persistence takes effort and energy, but if you want more and know you're destined for more, you can develop and maintain persistence and drive.

Actions You Can Take to Develop and Maintain Persistence

Know Your Mission and Why

You must know your purpose and mission in life. Clearly and regularly defining and writing your goals are an absolute prerequisite to succeeding in anything.

Your 'whys' have to be super strong. They keep you going.

Make a Plan

Make a plan that will get you to your goals. You've heard the phrase, "Fail to plan, plan to fail." Your plans will almost definitely change, but that's OK. Like a train on a track, a plan will help you stay on task.

"If I had to select one quality, one personal characteristic that I regard as being most highly correlated with success, whatever the field, I would pick the trait of persistence. Determination. The will to endure to the end, to get knocked down seventy times and get up off the floor saying, 'Here comes number seventy-one!'"

~Rich DeVos

Choose Good Friends

Make sure your closest friends elevate you, drive and encourage you to be the best you can be and pick you up when you fall.

Find others that have accomplished what you aspire to do. Model them. Let them inspire and motivate you. Look at how they get past the obstacles on the way to success.

Celebrate Your Wins

Celebrate your wins. Reward your mind whenever you accomplish something toward your goals. When you make your plan for next week, look back at the past week and celebrate anything that got you closer to your goals. Small wins keep you going when you hit speed bumps on the way to larger goals.

Try a Different Approach

If you get knocked down, get up and change your approach, again and again. It's never a straight line to your goal. Even airplanes are off course 99% of the time, but they know their destination. As long as you know your ultimate outcome, you'll always get up dust yourself off and try it a new way.

Keep Your Environment Positive

Stand guard at the door to your mind and keep the naysayers away from your dreams.

Learn From Mistakes

Be prepared to fail. I call failures 'seminars', and every successful person has lots of them. Don't be surprised when you do too. Pick yourself up and learn from them. It's always worth it.

Stay Healthy

Take care of your body and mind. Pay attention to what you're reading, exercise, eat healthy foods, drink plenty of water. Fuel your body like it's a racehorse.

Keep Taking Action

Take action on your goals every day and keep your forward momentum going. Repeated actions lead you down the road to massive success.

Track your progress in a journal so you can look back and see you're getting closer to your dreams and goals. It's common to overestimate what you can accomplish in a year, but underestimate what you can accomplish in a decade. It might take longer than you planned, but remember that God's delays are not God's denials.

Stay focused on what you want!

Financing Your Deal

Residential Mortgages

- Applies to 2-4 units.
- Typically have fully amortized terms of 15, 20 or 30 years with no balloon payments. (This is a real advantage.)
- Fixed interest rate, not floating or accelerating. (This is a real plus.)
- Entirely based on a borrower's credit rating and ability to repay, as opposed to a commercial loan which depends more on the property's ability to meet the payments.
- Lower down payment – a huge plus. I've interviewed people on my podcast who started by buying a duplex and living in one side, who now have hundreds of units and millions of dollars of net worth and cash flow.
- More financing options such as FHA (often in the 97% range for loan-to-value).

If there is a mix of residential and commercial (like a storefront on the first floor) you still need a commercial loan.

Commercial Mortgages

- Payments are based on an amortized term of over 20-30 years, but they have a balloon payment typically due in 5-10 years.

Caution!

As of 2016, we're going into a market contraction possibly within the next two years. That means cap rates will rise and prices will fall, and you don't want to get caught with a 5-year balloon payment due when you can't refinance or sell for a price that will pay it. (See my full explanation in Module 8, video 2 at 2:40.)

So go ahead and buy properties now, but position yourself to weather the storm. Real estate goes in cycles. Multifamily weathers the storm just fine, but not when your debt comes due before you're ready. Your focus is cash flow and PLENTY of it!

- Have a slightly higher interest rates compared to residential.
- Rely heavily on the property's ability to cover debt and still cashflow.

Remember from the last module that banks will evaluate your deals based upon:

- Net Cash Flow
- The Debt Service Coverage Ratio (DSCR) Banks look for 1.25-1.45, but I recommend a minimum of 1.6.
- The Loan to Value (LTV)

Balloon Payment

- Occurs within 5-10 years.
- The loan is amortized over 20-30 years.
- Typically, owners at the time the balloon payment is due refinance or sell the property because they don't have the cash to pay the full amount.
- You can calculate what the balloon payment would be at www.bankrate.com. Make sure you see the screen share video where we show you exactly how to do this.

Costs of Commercial Mortgages

- Down payment of 20%-30%. You can bring in partners, syndicate, or be creative with seller financing.
- Legal fees
- Recording costs
- Appraisal fee, more expensive than residential
- Loan origination fee at time of closing

The fees involve more money which is why you can get an acquisition fee to cover these expenses plus your time, energy and travel.

This is why, if you don't have this money, you bring in other people.

- Purchased under an LLC
- If the LLC has no history, the lender will require principals to guarantee the loan.

Recourse vs. Nonrecourse

Recourse

Most commercial loans are recourse, which means you are personally liable for the debt.)

Recourse allows the lender to come after the borrower/guarantor if he defaults on the loan and the value of the property is insufficient to cover the remaining balance.

Nonrecourse (CMBS Loans)

A Commercial Mortgage Backed Security (CMBS) Loan, also known as a Conduit Loan, is a type of commercial real estate loan that is secured by a first-position mortgage on a commercial property. These loans are packaged and sold on Wall Street by Conduit Lenders, commercial banks, investment banks, or syndicates of banks.

CMBS loans come from big insurance companies and larger lenders.

They are used for stabilized and performing assets: A or B class usually, maybe C class, but never D class.

The huge advantage of nonrecourse debt: If the market and/or property turns south, your personal assets are safe, though the bank can take the property.

The main disadvantage of a CMBS loan is "defeasance". This is a bank term for very stiff prepayment penalties. So don't plan to sell a property with this kind of loan in a couple of years.

Bad Boy Clauses on CMBS loans

The lender can come after your assets if:

- Commit fraud
- Misrepresentation of loan information
- Don't have property insurance
- Don't pay property taxes
- File for bankruptcy

That's why new investors may bring in an experienced investor on their first deals as a sponsor in exchange for a piece of the deal. This person can sign on the Bad Boy clauses. With a few of these deals on your resume, you will have the credibility to sign for yourself. Don't be afraid to give up big chunks of your first few deals to build your resume.

Bridge Loans

- Also called gap financing or swing loans.
- Primarily for quick closing before the bank has had enough time to underwrite a commercial loan, as happens with auctions.
- Also for temporary short term loans for properties with less than 80% occupancy that you want to stabilize.
- Funded by bank or mortgage broker (institutional lenders)
- Obtained to "bridge" you until you can get better long term financing.

Other cases where bridge loans can be used:

- Preconstruction funding or finishing construction
- Foreclosures, need to move quickly
- Carry distressed property until stabilized and selling
- Property doesn't qualify for traditional mortgage because:
 - Under construction or renovation
 - Lack occupancy permits
 - Short term high vacancy rates
- Borrower can't qualify for traditional mortgage
- Portfolio reorganization, need to pay off some debt
- Funding needed to cover purchase before sale of other property
- Partner payout
- Need to close quickly, most common
- Interim financing while refinancing other properties into a jumbo loan

Characteristics of Bridge Loans

- Higher interest, often 2 percentage points higher
- More points (Points are prepaid interest, paid at the time of closing.)
- Larger closing costs
- They are easier to obtain
- Less documentation
- Lower LTV, lower than 70%

- Cross collateralization, sometimes request a mortgage on your other assets
- Can vary in length 6 months to 5 years

Mezzanine Loans

A mix of debt and equity, mezzanine loans give the lender the right to convert to ownership or equity interest if the loan isn't paid on time or in full.

The lender requires some form of collateral, often a second deed of trust to allow them to foreclose.

The most common form is assignment of membership interest in your LLC so if you default, the mezzanine lender can take your ownership interest. In turn, they'd assume the first mortgage. This requires an intercreditor agreement.

Questions to Ask the Bank and Yourself

When Evaluating a Loan

- What are the loan terms?
- How much equity will you have to come up with? What's the LTV?
- Is the DSCR 1.6 or higher? Can you get to that number quickly?
- How long is the amortization or length of time they will carry the debt? This impacts the amount of your monthly payment. (On A class properties, interest only for a number of years may be an option.)
- How long until the balloon payment is due?
- How much are all the loan costs and fees? This affects the amount of equity you need to raise.
- Is there an early prepayment penalty? (Usually not on recourse loans, but definitely on nonrecourse.)
- What are all the additional fees you will need to pay?
- Are there any time periods/blackout periods in which you can't repay?
- Do you require an expense reserve?

Loan Package Checklist

- Completed application form
- Copy of purchase agreement
- Copy of any other agreements between you and the seller, such as a letter of intent (LOI). Commercial deals begin with an LOI. Before spending money to write a contract, you want to make sure you and the seller agree on the core basic general terms. Then you hire an attorney to write the contract. We'll cover this more in depth later.
- Subject property information
- Profit and loss statements for the past 2-5 years
- Current rent roll
- Pro forma numbers for the property, you can use what the broker provides, but check to make sure it's accurate.
- Lease examples including new lease agreements and current signed leases
- Information on the management company you will be using, their credibility and whether they manage other like properties. If you or a member of your team will manage the property, they will need to see your experience.
- Property insurance binder and the name of your insurance broker
- Property tax statement from assessor's office if available, possibly from owner
- Copy of past appraisals, if it helps you.
- Copy of surveys
- Copy of environmental reports
- Borrower information on you and your team and your sponsor
- Prior management experience, even in single family real estate
- Prior and present properties owned
- Financial strength and stability of the borrower
- Financial strength and stability of any sponsors
- Experience with single family homes or smaller rentals
- Portfolio
- Purchase dates
- Increases in income
- Current vs. past vacancy
- If you don't have much experience they will probably require you to hire a licensed property manager for the first year or you'll need a sponsor with experience. I highly recommend this anyway, because it's how you learn the systems, forms, software and all the details of property management.
- They may require you to set aside 6 months of expenses.

Sponsors

A sponsor is:

- experienced in investing in the same type of property in your criteria, size, and class.
- financially strong.
- borrowed money in the past.

A sponsor can be someone you know or someone you find through networking as you spend time with peers in the industry.

Typically you should give them a piece of the deal and don't be afraid to give them a lot. Your goal for working with a sponsor is to complete some deals to build your "resume" and to learn from a mentor.

Seller Financing Strategies

This is review, but it's important. Seller financing is a powerful way to ramp quickly.

Advantages of Seller Financing

- Can often get much lower down payments.
- Can structure the deal very creatively.
- Seller financing allows you to purchase properties that wouldn't be approved for traditional mortgages.
 - Non-stabilized properties
 - Properties requiring heavy repairs
- Won't show up on credit reports
- Makes getting future loans/mortgages easier

Great Candidates for Seller Financing

Older individuals or couples who have owned a piece of real estate for over 20 years and now want to earn retirement income from their investment are great candidates for seller financing. You can find them by researching the county assessor's real estate records and sending out direct mail letters to the addresses you find.

Why Seller Financing is Great for Mom & Pops

- They have high equity and low debt.
- They've owned the property long enough that their tax benefits have gone dry.
- They still want cash flow. You can show them examples.

- They don't want to take a huge capital gains tax hit upon sale. They can keep the government from taking a large part of their retirement investment through seller financing.
- They will often only be able to keep 60% of their net proceeds after taxes if they sell. If they reinvest that 60% elsewhere, they'd have substantially lower monthly cash flow.
- They can save thousands on broker commissions if they buy from you directly.
- It's a win-win for you and the sellers, so you can feel good about helping them.

If you negotiate a seller financing agreement, always have an attorney write the contract! This is important!

In seller financed deals you can negotiate:

- Down payment
- Rates
- Amortization
- Cash flow
- Security

You can structure this kind of deal any way you want. You can even negotiate things like no payments until the property is stabilized or terms of 40 or 10 years. There are many creative options.

Master Lease Option

This is an exciting way to tie up a property that needs repairs or sprucing up and is not a good candidate for a bank loan.

Short for "master lease with option to purchase", this is when you create a master lease on the entire property. You effectively sublease the rest of the units. You control the whole property and can make decisions about improvements and rents to increase occupancy.

Similar to seller financing, this is a win-win for you and the seller.

Benefits to you

- No money or little money down
- Typically just a small amount of earnest money
- Often leads to seller financing
- If you can't turn it around or get the property to your liking, you just don't close on it.
- Far less risk for you
- Gives you a chance to gain experience, confidence, and the ability to influence by working to improve a property.

Benefits to the seller

- They do no work, no management.
- They don't pay for repairs.
- They still get monthly cash flow payments.
- They still claim all of the properties tax benefits.
- They get depreciation.
- They get all of this because they are still the ones on title.

Reducing the Down Payment

Here are some tips for reducing the amount of cash you need up front:

Get cash for repairs at closing by asking for a repair credit. You can use that cash for the down payment and use rents and monthly income to make needed repairs over time.

Close on the 2nd or 3rd of the month and you will get credit for all rents. This way you basically get 27-28 days of free rent to bring to closing.

Apply service company prepayments. Some companies want to earn your business so badly they will pay you up front. Laundry companies in particular will also give you a percentage of profits every month. So ask to be prepaid and get this money upfront at closing.

Constant and Never-ending Improvement

Find the video Module 8, video 6 at 5:18

The philosophy of *kaizen*, originated by American engineer Dr. W. Edwards Deming, means in Japanese: change (*kai*) good (*zen*) or "change for the better". When Dr. Deming went to Japan after World War II to help improve business there, he enrolled every member of the organization to commit to constant never-ending improvement. It was an incredible success.

It's not hard to make micro improvements to every area of your life. They're not painful.

When you continually make small improvements, they can add up to massive improvement over time in all areas of your life.

Intimate relationship

- Finances
- Business
- Real estate career

- Family
- Children
- Friends
- Health

Weekly planning for small improvements in each area add up to huge positive changes over time.

What minor improvements can you make in each of these areas this week?

Example: I decided to write a full journal page every morning on what I loved about my wife. She didn't know I was doing this, but she could feel it because, as you know, what you focus on becomes your reality. It came through in how I treated her. It only took me a few minutes every morning and sometimes I was mad at her and it was hard, but after three months I had filled up the journal. I gave it to her on her birthday and you can imagine how well that was received.

What little thing can you do for your spouse, your children, your employees or coworkers? What little improvement can you make at work?

Example: At one of my companies, I get all my employees together and buy them lunch once a quarter. Then I ask one of them to take notes on large paper sheets as everybody shares their ideas for improvements. Anybody who questions an idea has to pay a \$20 penalty! The ideas keep free-flowing. Everybody there contributes. I give out prizes like cruises for the best ideas. Everybody looks forward to these sessions and we actually implement 60% of the ideas that come from them.

It's easy to get overwhelmed by the size of the big goals you're planning. But there's nothing overwhelming about making micro-improvements to your life every day.

These small actions make your major goals more manageable. They give you momentum, a sense of satisfaction and fulfillment and a greater chance of success.

Success is the journey, not a destination. These small frequent improvements accelerate your personal growth and satisfaction because they make each small step on the journey something to celebrate.

So ask yourself:

- How can I make things better?
- How can I show those I care about more love?
- What can I learn?
- What skills can I improve?
- How can I be a better communicator?

- How can I be a better cook, play a larger role at church (or any other specific area like this that's important to you)?
- How can I manage my money better?
- What valuable book can I read a little every night?

***Commit to becoming better and better
in every area of your life
and I promise you
the results will be astounding!***

Module 8 Most Common Mistakes

- Not having personal financials in order before trying to obtain residential/commercial multifamily loans
- Not “shopping around” at banks
- Thinking bank/banker relationships aren't important
- Fear of asking for seller financing