02

Financing

This step intimidates most new real estate investors - but armed with a plan and plenty of knowledge, you can secure financing for your property purchase without breaking a sweat.

You're Not Alone

If you didn't inherit property and need to venture into the market in search of a suitable rental, you're in good company.

Let's look at the stats - in 2022:

- **78%** of recent buyers financed their home purchase.
- The average down payment for first-time buyers was **6%** .
- For first-time home buyers **26%** said saving for a down payment was the most difficult step in the process.
- **22%** of first-time buyers used a gift or loan from friends or family for the down payment.
- Been around the block? The typical down payment for repeat buyers was **17%** .
- **38%** of repeat buyers used the proceeds from the sale of a primary residence to purchase their new property.

Source: NAR

How to Get People to Give You Money

Before we dive into the various types of loans available, you need to be in tip-top lending shape. How do you accomplish that?

Maintain a steady income. Lenders want to see that you have money flowing in regularly and in expected amounts. **Explore the impact that stability of income can have on your lending experience >>**

Step up your credit score game. The higher your score, the better - especially when it comes to shopping for loans. At minimum, you'll need a credit score of 580. **Learn how to boost your score >>**

Improve your debt-to-income (DTI) ratio. The less debt you have, the more attractive you are to lenders. Aim for a DTI of 43% or less.
Whittle away your debt >>

“Everybody thinks that they’re going to time the market, they’re going to sharpshoot the market, and buy right at the bottom. The truth of the matter is that nobody is good at it.”

- *Barbara Corcoran,*
Creator of the world-famous Corcoran Group brokerage

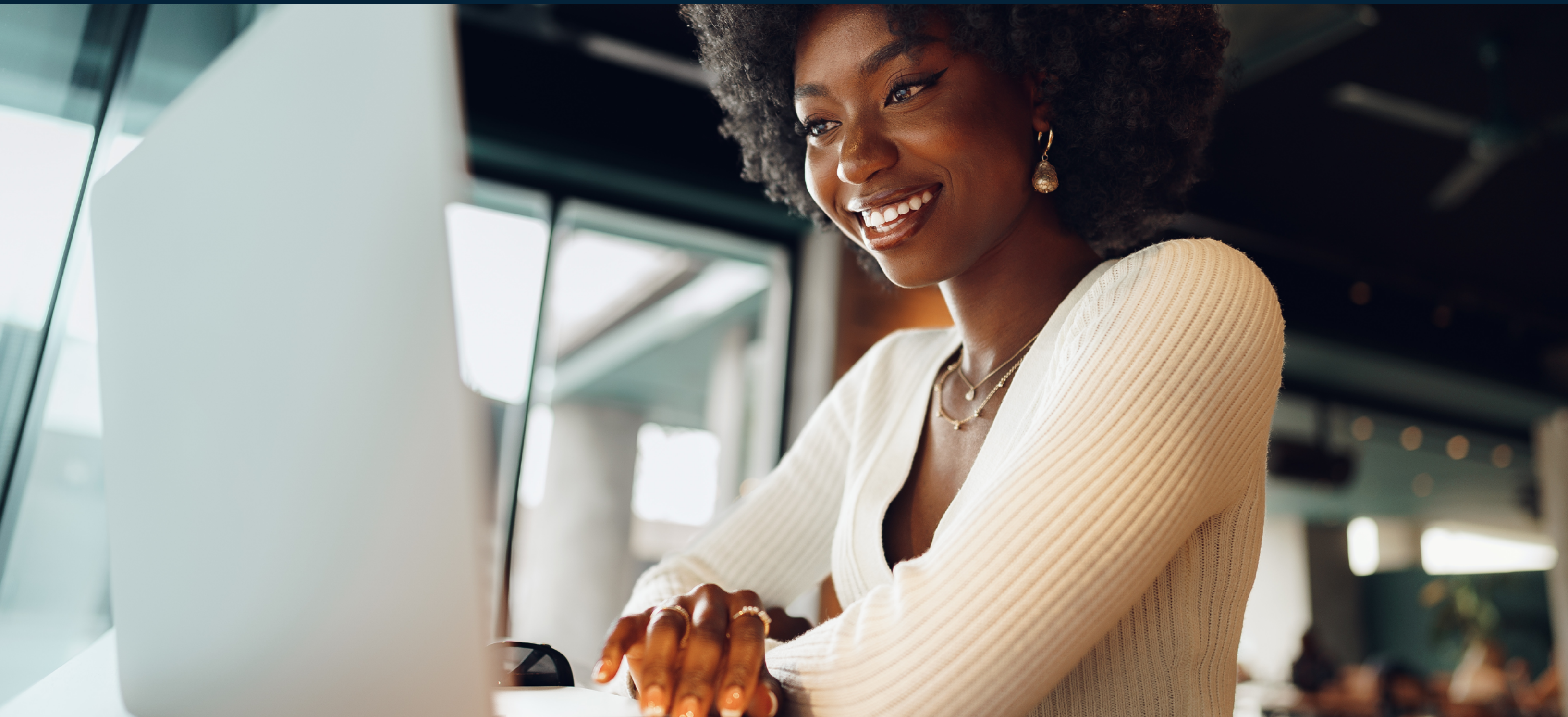
Don’t Be Afraid of Financing

Would-be investors hesitate at the financing step because they see the gap between where they are and where they want to be.

Don’t give up. While you work to get your financials in order, learn all you can about different loan types. Knowing your options is half the battle.

Quick Term Breakdown

- When considering how to finance a property purchase, pay close attention to the loan term and interest rate type of each option.
- The **loan term** is the amount of time you’ll have to repay the loan. 15 or 30 years is common for a mortgage. The longer the term, the lower your monthly payment, but the more you’ll pay in the long run in interest.
- The **interest rate type** can be fixed (unchanging throughout the life of the loan) or adjustable (starts low but increases over time).



Common Loan Categories

Let's look at popular financing options.

Conventional: Backed by a private lender

Pros:

- Lower interest rates
- No mortgage insurance requirement with >20% down payment
- Greater loan term options

Cons:

- Higher down payment requirement
- Requires a higher credit score

Government-backed loans: Insured by the government

Pros:

- Lower credit score requirements
- Lower down payment requirement
- More flexible underwriting, meaning you may still qualify even with a less-than-perfect financial record

Cons:

- Rigid qualifications
- Higher mortgage insurance costs
- Minimum property standards

Rule of Thumb: If your credit score is low and/or you have a small down payment saved, a government-backed loan might be best for you. If your credit is strong and you have a 20% down payment saved, a conventional loan may be the better fit.

Government -Backed Loans

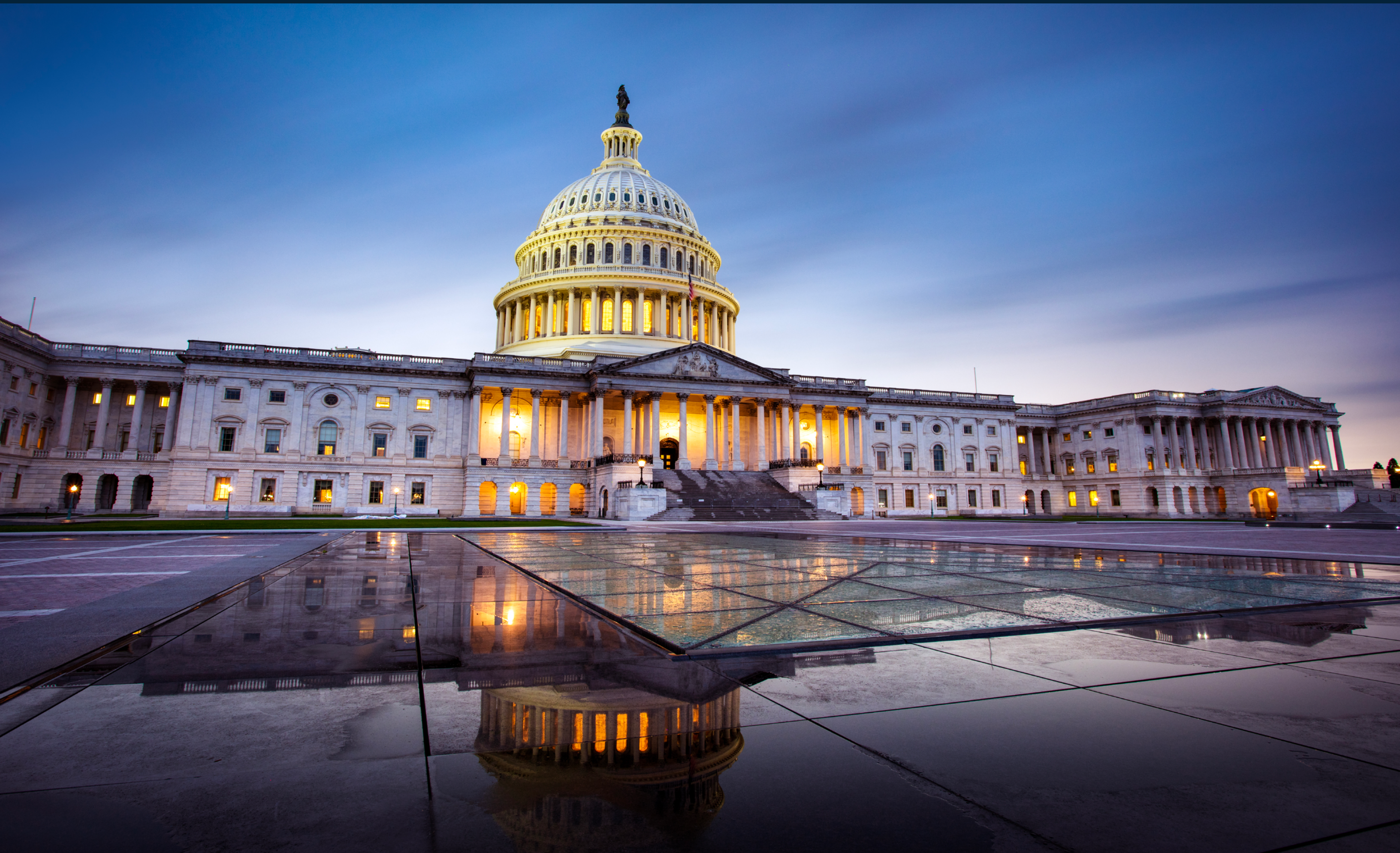
Though they often have strict eligibility requirements, including limitations on the kinds of properties they can be used to purchase, government-backed loans are attractive to many buyers.

The most popular loans backed by the government include:

FHA (Federal Housing Administration)

VA (Veterans Affairs)

USDA (U.S. Department of Agriculture)



Eligibility Requirements for Popular Government-Backed Loans

FHA Loans: Offer lower down payments and credit requirements than a traditional mortgage.

- Qualifications: Credit score of **580** and a **3.5%** down payment
- Downside: You must pay an upfront mortgage insurance premium (typically **1.75%** of your total loan value), followed by monthly mortgage insurance payments. Can only be used on properties with one to

VA Loans: Allow eligible veterans, active-duty military, National Guard personnel, reservists, and qualifying spouses to avoid paying a down payment.

- Qualifications: Determined by individual lenders, though you'll be required to have a certificate of eligibility to secure the loan.
- Downside: You'll still be required to pay closing costs.

USDA Loans: Support low- to middle-income buyers in certain rural areas and don't require a down payment.

- Qualifications: Must meet income eligibility (can't exceed 115% of median household income), agree to occupy the dwelling as their primary residence, and be a U.S. Citizen, non-citizen national, or Qualified Alien.
- Downside: This loan can't be used to purchase rental property - but you could live in the house with your tenant.

Check the terms of your loan to ensure it can be used to purchase rental property. Otherwise, house hacking may be a better fit!

With this information in mind, let's shift to conventional loans.

Source: USA.gov

Conventional Loans

Private lenders generate most of the loans used to purchase property in the United States. Here's what you should know:

- Conventional mortgage loans typically have 15- or 30-year repayment periods
- There are conforming loans and nonconforming loans (more on that later)
- If you put down less than 20% of the total loan amount, you'll have to pay private mortgage insurance (PMI). On average, PMI costs between 0.5%-1% of the loan amount annually and does not go toward paying off the loan

Average Lendee Requirements

- Credit score of **620+**
- At least **3%** down payment
- Reliable income with at least a two-year track record
- Clean credit history (no recent bankruptcy or foreclosure)
- Looking to borrow within local loan limits set by the Federal Housing Finance Agency

Check your loan limit >>

But these requirements differ by lender, so it's important to shop around!

Typical Property Requirements

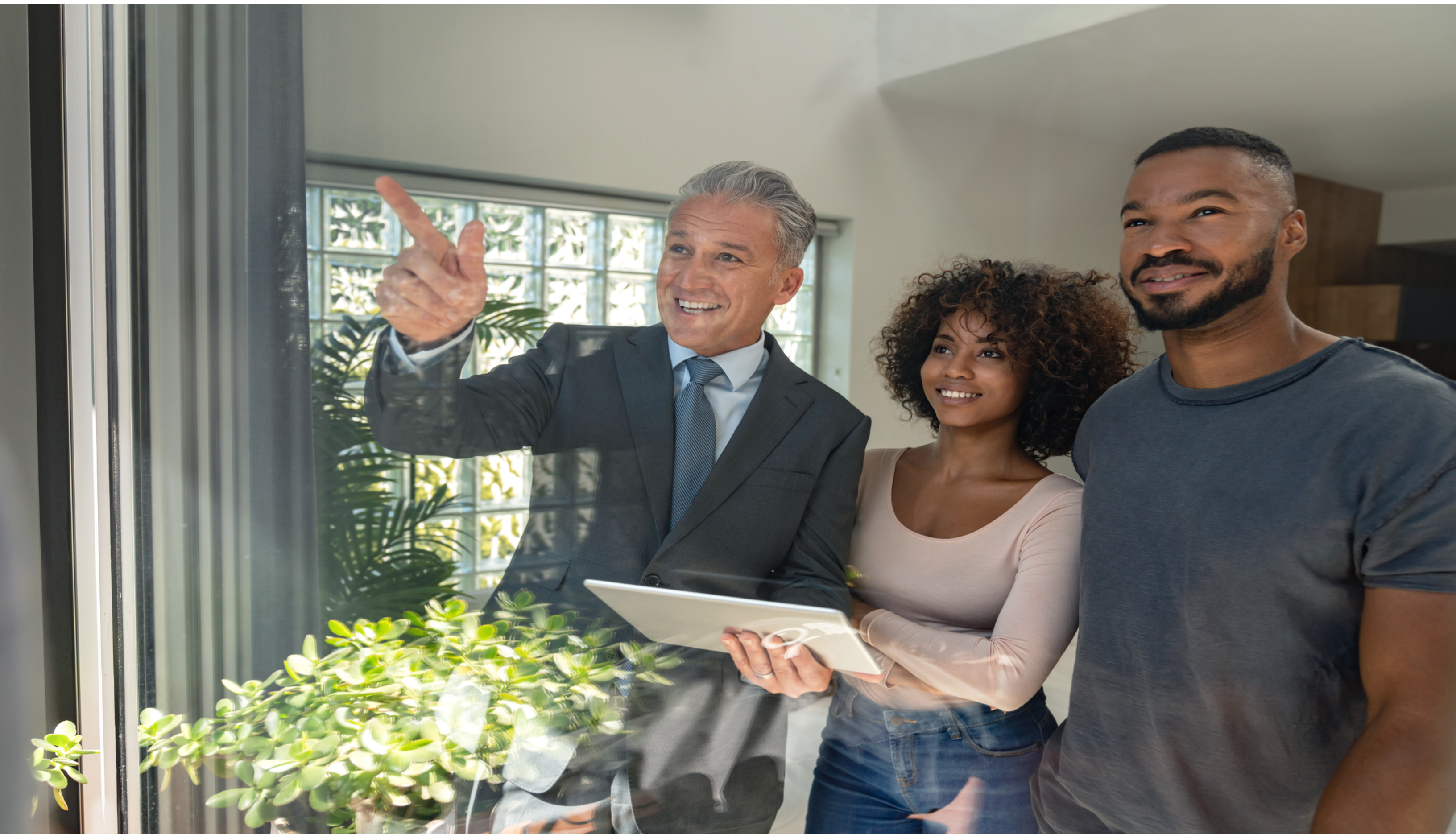
When pursuing a conventional loan, your lender is likely going to require a home appraisal to verify the property's value.

The home appraiser will:

- Look at the property's condition generally
- Compare it to similar properties that have recently sold in the area
- Calculate its current market value

The **Mortgage Reports** highlight special property features that could impact your ability to secure funding, including:

- Wells and septic tanks
- Environmental hazards
- Solar panels that are financed as a debt secured on the home
- Properties that comprise multiple parcels of land



Conforming vs. Nonconforming Loans

Conforming loans align with guidelines from Fannie Mae or Freddie Mac, two of the largest mortgage buyers in the United States. These government-sponsored enterprises buy conforming loans and bundle them to be sold to investors, which creates a secondary market that enables competitive interest rates.

Nonconforming loans don't play by those rules. They could offer a higher loan amount, cater to those with lower credit scores, or be used on otherwise banned property types. Jumbo loans, Alt-A loans, and subprime loans are all nonconforming. **Learn more >>**

To Conform or Not to Conform: What's right for you?

Your unique financial situation and goals dictate the type of loan you should take.

That said, let's look at conforming vs. nonconforming loans side by side:

Characteristic	Conforming Loan	Nonconforming Loan
Loan amount limits	Yes	No
Credit score requirements	Generally good (600+)	Varies
Down payment requirements	Typically 20% or less	May be higher
Interest rates	Generally lower	Generally higher
Availability	Widely available	Less widely available
Eligibility	More borrowers qualify	Fewer borrowers qualify

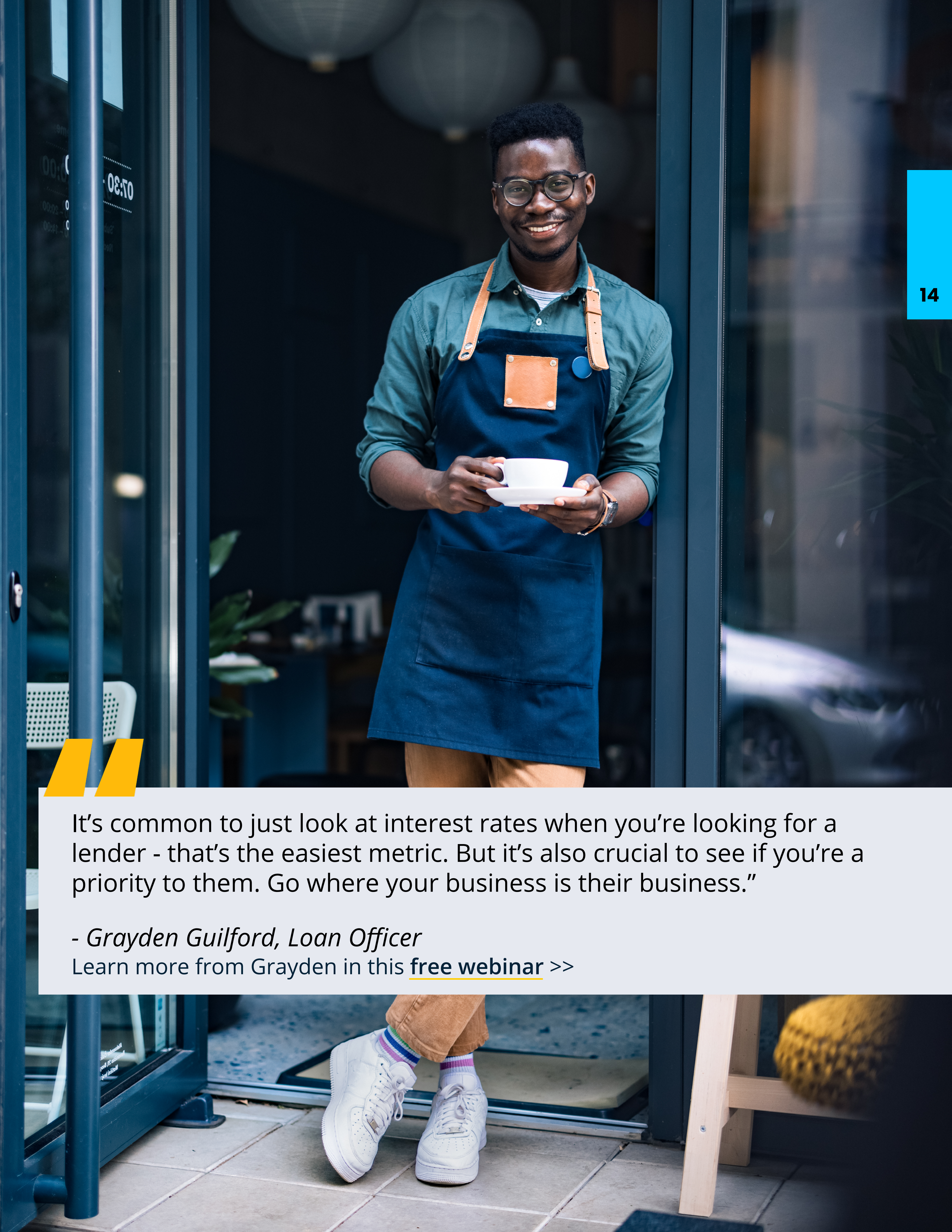
Remember: You don't have to make this decision yourself. Use this information as a starting point to find mortgage lenders who offer the loan types that most interest you, then schedule a meeting with them.

How to Find Your Lender

Now that you understand the various mortgages at your disposal, it's time to put your knowledge into action. Align with the perfect lender for you in four steps:

1. Google "[loan type] in [where you want to buy property]"
2. Compare online reviews and rates from at least three mortgage lenders offering your ideal loan
3. Request a loan estimate from at least three lenders
4. Pay attention to how responsive they are to your questions and requests

Pro Tip: If you know a real estate investor, ask if they'd refer you to their lender! Real estate agents also typically have a long list of preferred lenders.



It's common to just look at interest rates when you're looking for a lender - that's the easiest metric. But it's also crucial to see if you're a priority to them. Go where your business is their business."

- Grayden Guilford, Loan Officer

Learn more from Grayden in this **free webinar** >>

Critical Formulas for Rental Investors

Not sure how much you'll need to borrow? Start by finding the average property value in your area. Then consider:

The 1% Rule - Maintenance typically costs about 1% of the property value per year.

- **Formula: 0.01 * property value**

Property Tax Calculation - Properties are evaluated every one to five years on average.

- **Formula: Take the property's local mill levy (or tax rate) * the value of the property**

Landlord Insurance - Landlord insurance protects your rental(s) like homeowner's insurance protects your main residence.

- **Formula: Average homeowner policy premium * 1.25**

Net Operating Income - This phrase refers to the money remaining after paying operational expenses.

- **Formula: Annual net operating income/property's current market value**

Cap Rate - This figure is the expected rate of return on an investment property. For example, a property with a cap rate of 20% would take about five years to recover the investment.

- **Formula: The revenue of an average rental in the target area - estimated operating expenses**

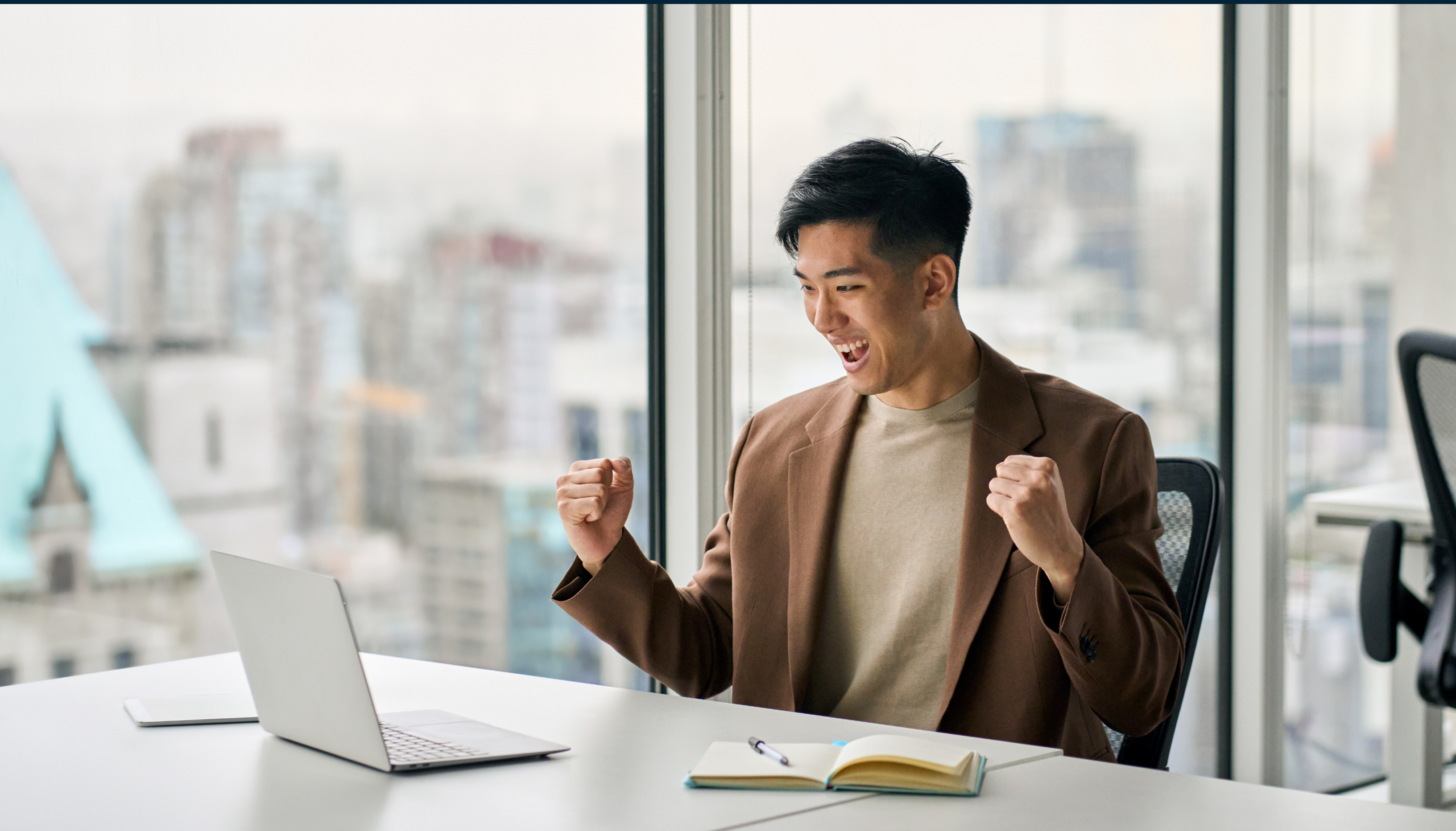
Pro Tip: Does your head hurt from the thought of crunching all these numbers? Use a free rental property calculator to determine your potential profitability in mere clicks.

Putting the Numbers to Work
Part 2

Let's get back to Larry from our example in Chapter 1. After five years, he was able to save **$71,100.** He's seeking preapproval for a **$600,000** FHA loan.

His down payment is $36,000, and his closing costs are 3.5% of the property value.

- With a **30-year** fixed-rate mortgage worth **$585,000** and a **3.5%** interest rate, Larry's monthly payment would be **$3,994.70**.
- He's going to live in the property with his tenant to save money.
- The average monthly rent for similar properties is **$2,200.**
- *Larry gets to pay less in rent while building equity, saving him nearly* **$500** *per month. That's a total of* **$10,992** *per year!*



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