

# Will They Take A Post-dated Check? (Or, how will I pay for my new property?)

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Most of us don't have enough money stashed under the mattress to pay cash for a rental property or other real estate investment; and even those who have enough funds at their disposal may prefer not to use them to pay for property. Fortunately, in today's financial world, there are many options to choose from when it comes to finding funds to buy real estate. This discussion will focus on options and procedures with traditional sources of purchase money, but there are also other resources and methods that may be useful or necessary depending on the situation. (These will be addressed in another article.)

Although not a requirement, it's usually a good idea for buyers to obtain pre-qualification or pre-approval for a purchase money mortgage before submitting an offer. Having some of the financing work done in advance (especially a pre-approval) provides a measure of assurance to both buyer and seller that a deal is less likely to fall through because of financing difficulties; and in cases where more than one buyer is competing for a property, a seller will often accept an offer from a pre-approved buyer over an offer from a buyer who has not investigated financing. Furthermore, if it is important to either the buyer or seller to close a deal quickly, pre-approval can make a significant difference in the realistic time frame for closing.

There is a major difference between the two "pre's." Pre-qualification can often be done over the phone in a single conversation and typically involves only number-crunching: calculations of the borrower's income, debt and proposed mortgage payment to see if he or she would "qualify" to assume liability for the required monthly loan payment (in accordance with the lender's guidelines). In contrast, pre-approval is far more involved – it may take a couple of weeks or more, and requires a formal loan application (and often an application fee) along with evaluation of the borrower's credit, verification of income and assets, basic information about the property to be purchased and submittal to an underwriting specialist for review and preliminary loan approval.

There are many general lending guidelines that are followed with relative consistency within the traditional lending community (which would include mortgage brokers, banks, credit unions, savings and loan associations, etc). Some of the guidelines relate to the borrower, and others relate to the property that is being purchased. Of course, all lenders do not use the same guidelines, and there is variation on specific details between lenders, but here are some general rules of thumb to consider:

## Relating to the borrower:

- When evaluating the ability of a borrower to make payments (debt to income ratio), lenders will not give credit for the full amount of rent that will be collected from a rental property. Having a proven track record as a landlord is helpful, but lenders will still credit the borrower with a maximum of 75% of the contract rent in residential properties to account for vacancy and operations expenses.
- Owning other assets and having a positive net worth is an advantage to investors seeking to buy real estate. Although the lender will not typically have legal claim to assets other than the property being

purchased, it makes a lender more comfortable to see that the borrower has resources that can be tapped into if cash flow becomes insufficient for any reason or for a significant length of time.

- Money for the down payment may not be borrowed and must be documented in a borrower's account for at least 60 days, except in the case where investors use home equity to access funds.
- Good credit history of the investor is perhaps more important to lenders than for an applicant who is buying a primary residence, because they figure if things get tough, the likelihood that borrowers will make payments is less on property that they do not live in vs. making sure the payments are made to keep the roof over their heads!

## Relating to the property:

- Raw land that has not been improved will usually require a substantially larger down payment than developed properties. 50% down is generally required to purchase undeveloped land or land that has not been developed to certain standards, usually requiring a site-built structure on a foundation with completed installation and hook-up of utilities.
- Multi-family properties where the owner will be living in one of the units require less money down (and will likely get a lower loan interest rate) than properties that will be non-owner-occupied. In some cases, small (1-4 unit) owner-occupied rental properties will fall under the same lending guidelines as single-family primary residences; so required down payments may be as low as 5%.
- Non-owner-occupied properties will usually require a minimum of 10% down, but significant savings on loan rates, closing costs and mortgage insurance (PMI) are realized with down payments of 20%. Further savings in interest rate will occur when the down payment is 25% or more on 3- and 4-unit properties.

## In general about loans:

- The lower the down payment, the higher the interest rate
- The lower the closing costs, the higher the interest rate
- The longer the term of the loan, the higher the interest rate
- Fixed rate loans have higher interest rates than adjustable loan starting rates

Wow, quite an array of variables! With so many choices to make, a buyer must carefully consider the alternatives and trade-offs to determine the most advantageous type of property, property price, loan program and down payment. Although some buyers prefer to shop around themselves to see the various loans available to them, there are times and circumstances where utilizing the services of a mortgage broker (who has access to many lenders' programs) can be helpful. However, whether comparing different loans independently or through a broker, it is always important for buyers to take the time and make the effort to become informed about their options before making a decision.