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Understanding Hard Money Loans: What You Need to Know Before You Borrow

When it comes to financing real estate, most people are familiar with conventional mortgage loans offered by banks and credit unions. But in certain situations—especially when time is of the essence or traditional financing isn't available—hard money loans can serve as an alternative.

In this newsletter, we explain what a hard money loan is, how it differs from a conventional loan, and what you need to know before using one.

□ **What Is a Hard Money Loan?**

A hard money loan is a short-term loan secured by real estate, funded by private investors or companies instead of traditional lenders. These loans are typically used for investment or commercial purposes—not for buying a primary residence.

□ **Hard Money vs. Conventional Loans**

A hard money loan differs from a conventional loan in several key ways. First, the lender in a hard money loan is typically a private investor or lending company, while conventional loans are offered by traditional financial institutions such as banks or credit unions.

The approval process for hard money loans focuses primarily on the value of the property being financed—this is known as asset-based lending. In contrast, conventional lenders base approval on the borrower's creditworthiness, including income, credit score, and debt-to-income ratio.

One of the most appealing aspects of hard money loans is speed. These loans can often be approved and funded in just a few days to a week, making them ideal for time-sensitive real estate deals. Conventional loans, by comparison, typically take several weeks or even months to close due to stricter underwriting and documentation requirements.

When it comes to interest rates, hard money loans tend to be much higher, often ranging from 8% to 15% or more, whereas conventional loans usually carry lower interest rates, typically in the 5% to 7% range, depending on the borrower's credit and market conditions.

The term length is another major difference. Hard money loans are short-term, generally lasting between 6 to 24 months, while conventional mortgages are long-term, with repayment periods of 15 to 30 years.

Finally, down payments for hard money loans are generally higher, often requiring between 25% to 40% of the property's value, whereas conventional loans can be obtained with as little as 3% to 20% down, depending on the

loan program and borrower qualifications.

□ **Pros of Hard Money Loans**

- **Fast Access to Capital:** Ideal when timing is critical (e.g., property auctions, fix-and-flips).
- **Flexible Underwriting:** Approval is based more on property value than personal credit.
- **Useful for Non-Traditional Borrowers:** Good for investors or self-employed individuals who may not qualify for bank loans.

⚠ **Cons and Risks**

- **High Interest Rates and Fees:** Substantially more expensive than traditional financing.
- **Short Repayment Periods:** Typically must be repaid or refinanced within 6–24 months.
- **Risk of Foreclosure:** Because of the short terms and high payments, default risk is higher.
- **Less Consumer Protection:** These are often unregulated or loosely regulated compared to residential mortgages.

□ **When Might You Use a Hard Money Loan?**

- **Fix-and-Flip Projects:** Investors buying distressed properties to renovate and resell.
- **Bridge Financing:** Short-term funding while waiting for longer-term financing or a property sale.
- **Unique or Distressed Properties:** Properties that wouldn't qualify for traditional lending.
- **Time-Sensitive Deals:** When closing quickly is essential to secure the deal.

□ **Key Takeaways**

- Hard money loans are powerful tools for real estate investors and developers but carry higher costs and risks.
- They should only be used when you have a clear exit strategy—whether it's a sale, refinance, or payoff.
- Always consult a real estate attorney before entering into a hard money agreement to ensure terms are fair and your interests are protected.

Thinking about using a hard money loan for a project? Have questions about structuring deals, legal protections, or title issues? We're here to help.

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