Top refinancing tips for real estate investors

Refinancing enables you to access equity in your property or switch to a better mortgage deal. *Dalia Barsoum* and *Enza Venuto* explain what you need to consider before you switch

Investors often think of refinancing when they are looking at better deals or at pulling out their accumulated equity.

Mortgage rates have been at a historical low, and from time to time we see a lender launch a marketing campaign announcing new rate promotion for their one-, three- and five-year fixed terms.

Every time this happens, we get a flow of calls from our investors who currently have mortgages at higher rates, asking whether or not it would make sense to break their mortgage and lock into these very attractive rates.

Investors pull equity from their properties for one or more reason, including using equity to buy another property, paying out a joint-venture partner, or for a secondary loan or funding a renovation.

DO THE BENEFITS OUTWEIGH THE COSTS?

It all boils down to crunching the numbers and seeing if it makes sense to touch your current mortgage. As part of this analysis, you need to factor in both the costs and the benefits before making a decision.

THE COSTS

In most cases refinancing comes at a cost, including legal fees, discharge fees associated with leaving the current lender, appraisal fees, mortgage penalties (which depend on the remaining term on your mortgage, whether the mortgage is fixed or variable, and on the gap between the current rate on the remaining term and market rates), and the soft costs associated with the time you put in for providing support documents to the lender.

THE BENEFITS

✔ What your plan is for the extra money you are receiving from the refinance
✔ How much you will save over the term under the new rate, compared to if you stayed with your current lender at the current rate
✔ How the refinancing will impact on your cash flow and ability to obtain approvals on future investment purchases. Can you tap into that money through other avenues?

PROPERTY VALUE

Value is a primary determinant of how much money the lender will give you, and will have an impact on how much money you can pull out. Two factors generally impact on the value of your property – one that you can control and the other that you have little control over:

1. The condition of your property and how many value-add improvements you have made since you purchased it.
2. Market forces that drive property values, including:
   - demand and supply of real estate for your property type and location
   - macroeconomic forces that have an impact on real estate valuation
   - supply and demand, such as the state of the economy
   - interest rates

HOW IT WORKS IN REAL LIFE

You purchased a property in 2009 for $250,000 with 20% downpayment. This means your first mortgage at the time of purchase was $200,000. Assuming you purchased at 30 years amortization at a rate of 2.99% for five years, your mortgage balance by the end of the five years would be roughly $177,000.

SCENARIO 1: VALUE IS UP

Now let's assume this property has gone up in value at an inflation rate of 3% annually over the past five years and is now worth roughly $290,000, and that the sold comparables in the local market as well as the appraisal support this value. In this case, the difference between value and your mortgage balance (i.e. equity) would be $113,000.

If you were to go to a conventional lender, they would be willing to give you up to 80% of the value ($232,000) in the form of a mortgage or 65% of the value as a line of credit ($188,000). This means that in a mortgage situation you would be able to tap into about $55,000 of the equity, and in a line of credit scenario you could tap into only $11,000.

There are some products that allow you to tap into the equity through a combination of a mortgage and a line of credit. If you take a private path, a private lender may be willing to give you 95% of the value in the form of a loan. So, let's run the math.

This means that at a value of $290,000 the private lender may be willing to lend you up to $275,500, which translates into you being able to pull out about $98,500 in equity.

SCENARIO 2: VALUE IS DOWN

Now let's assume the property has gone down in value. There are two scenarios here:

1. Value is still above the total debt. This scenario is similar to the value going up, because you can still go to a conventional or private lender for equity pull-out (depending on how much you are looking to refinance and on your personal financial situation).
2. Value is below the total debt. If the value of your property has declined to really low levels where it is below what you owe on the property, then your only avenue for tapping into funds is to go private. In that scenario, the lender will very likely ask for cross-collateral, meaning they may be willing to give you some money but will need another property as security, and they will base how much money they give you on the combined values of the properties.

> Value determines how much money the lender will give you, and how much you can pull out

> Lenders factor in your personal situation, the guidelines, and the property at the time of a refinance, and at the end of the day those drive what they can and cannot offer you

If your property is located in an area where the local economic fundamentals driving real estate values are strong, the likelihood of it maintaining or increasing in value is greater.

Before you start applying for a refinance or equity pull-out, we recommend you get an opinion from your local realtor who knows the area and is well versed in the property type and its value.

For residential properties with one to four units, your realtor can share with you a list of comparable properties sold in the area over the past six months. For properties that are five-plus units, your realtor can give you an idea of the value based on the cap rate for the area and the net operating income your property generates.

ACCESSING EQUITY: HOW ITWORKS

Once you have a "feel" for what your property is worth, you can get in touch with your lending advisor to crunch some numbers and help you determine how much money you can pull out and at what rates.

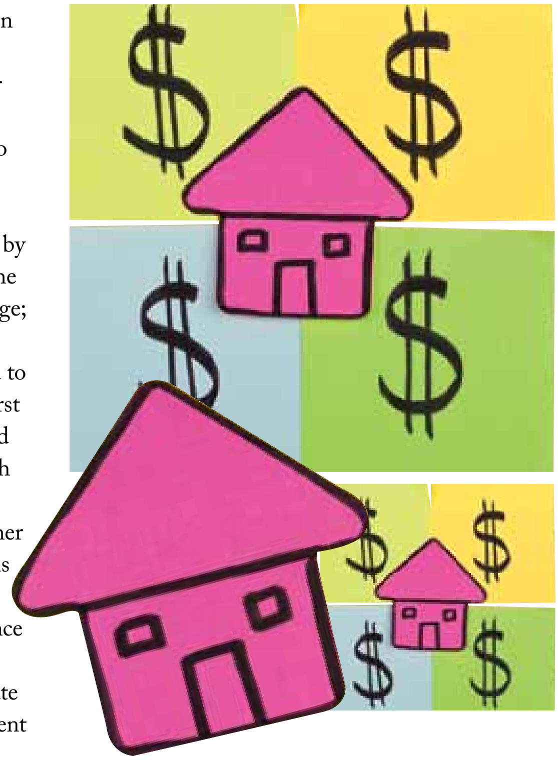
Generally, conventional lenders refinance 80% of the appraised value, but other factors affect what they can offer, including the condition of the property, its location, and your financial situation (income, credit, employment status).

If you have equity (the difference between value and all debt owing on the property) due to an increase in your property value or a reduction in the debt, then your lending advisor can help you explore the best way to tap into that equity.

Equity pull-out may be done by refinancing the mortgage; or in some cases by setting up a secured line of credit against the property without touching the first mortgage; or by what we call a "blend and extend" exercise, which is a method that allows you to tap into any equity without touching the first mortgage – i.e. avoiding any penalties – and blending the rate on the new mortgage with your existing first mortgage.

Another way to pull out more equity, other than what a conventional lender can offer, is to go private.

If your property has declined in value since you purchased it, and you need to tap into funds, then you may want to consider private lenders as their criteria are much more lenient than those of conventional lenders. Private lenders can go up to 95% loan-to-value on a refinance, compared to a conventional lenders who go up to 80%.



PERSONAL SITUATION

Industry and lender guidelines are always shifting. Not too long ago, the banks and

HOW IT WORKS IN REAL LIFE

Jennifer

Jennifer is a real estate investor with a small portfolio of residential properties. She purchased the properties when 40-year amortizations were still in effect. Many of her properties had increased in value, and she was looking to refinance at today's competitive rates in order to pull out money to buy larger apartment buildings.

We sat down with Jennifer and crunched the numbers, and informed her of the implications of refinancing today. The maximum amortization offered is 30 years, and some of her properties had 32 years' amortization left. By refinancing, Jennifer would cut 2 years off amortization, which on one side of the coin would translate into paying her mortgage off sooner, but on the flip side it would impact on her cash flow. Jennifer made the informed decision to move forward despite the impact on amortization, because the benefits still outweighed the costs.

Anthony

Anthony is a successful investor and owns 50 doors. Anthony had leveraged joint-venture funds to help expand his portfolio and it was time for him to pay off some of his joint-venture partners. Over time, Anthony had become a full-time real estate investor and quit his day job. His portfolio had also expanded significantly.

Being self-employed, and with the scale of his portfolio, we were able to help Anthony refinance some of his properties through a combination of private and B lenders to help pay off his joint-venture partners.

B lenders are more flexible than conventional lenders in their lending criteria. They offer higher rates than conventional lenders but are still competitive.

A-schedule lenders reduced what they would lend on secured lines of credit from 85% loan-to-value to 65% loan-to-value.

We have also seen amortization periods cut from 30 to 25 years for buyers putting a downpayment below the 20% mark.

Similarly, client situations change over time: credit may change, employment status may change from employed to self-employed or vice-versa, and debt levels may also change.

Lenders factor in your personal situation, the guidelines, and the property at the time of a refinance, and at the end of the day those drive what they can and cannot offer you.

Step-by-step guide to refinancing

The steps involved in refinancing a mortgage are similar to those for applying for a new mortgage. They involve:

1. The submission of a completed mortgage application.
2. Appraisal.
3. Providing support documents to show income, property holdings and any other information the lender requires.
4. Engaging a lawyer when closing the deal. The process may involve loan fees (depending on where the deal is placed) – for example, private and B lenders always charge a fee. If you are planning on refinancing or exploring ways to pull out equity, here are some tips that will help streamline the process and get you the best deal.

➜ Know the value:
- Get an opinion from your realtor on how much your property is worth.

➜ Know the costs:
- Gather information from your lending provider regarding any fees associated with breaking the mortgage, including discharge fees and penalties.
- Call your lawyer and ask them how much they would charge for a arranging a refinance.

➜ Give your advisor a shout:
- Provide them with up-to-date information on your property holdings, income situation and credit (you can obtain your credit report from www.equifax.ca).
- Explain what you intend to use the funds for.
- Share with them any future plans for buying more properties.
- Have your lending advisor help you with the number crunching.
- Discuss the options available to you and have your advisor do the shopping around for you.

DALIA BARSOUM MBA, FICB and **ENZA VENUTO** AMP, CMP are lending advisors with CENTUM Streetwise Mortgages #11789 and real estate investors with over 48 years of combined lending , financial and investment experience. The team provides advisory services and lending solutions tailored to Real Estate investors and different investment strategies (www.streetwisemortgages.com)