



# GETTING BOTH RIGHT: THE "HORSE" AND THE "JOCKEY"

Use these tools for valuing a property and vetting your borrower.

► by Michael Fordham

**W**hen private lenders get together, they may find themselves engaging in a discussion about which is more important for winning a race—the “horse” or the “jockey.” It goes something like this: When you underwrite a loan, do you rely more on the merits of the property (the “horse”) or the borrower (the “jockey”)?

Both are important, of course!

Following are tools a private lender can use to both value a property and vet a borrower.

## PROPERTY VALUATION TOOLS

Several good residential property valuation tools are available to private lenders.

**Local MLS.** The local Multiple Listing Service (MLS) is a straightforward and inexpensive service that allows you to complete your own property valuation by reviewing similar, recently sold and on-market properties (comparables). Yes, completing your own value analysis can be time consuming, and you must be a real estate agent (or partner with one) to have

MLS access. That said, for “the buck stops here” underwriting, completing your own review of comparables using this primary source can be unbeatable, even if only as a check after using other resources.

**Local Real Estate Professionals.** Local real estate professionals, including real estate agents and real estate brokers, can be a wealth of property value information. In addition to the conversations you may have with these pros, they can also prepare a formal value estimate for you, either a Comparative Market Analysis (CMA) or a Broker Price Opinion (BPO). Both can be prepared inexpensively and relatively quickly.

Although it varies by state, a CMA is usually a qualitative comparison of recently sold properties, often based on price per square foot. A CMA also typically references active and pending listings.

A BPO usually incorporates additional property information that allows them to use their own judgment to make price adjustments, etc. Sometimes a BPO also involves a property inspection.

**Sample questions you may ask a real estate professional preparing a CMA or BPO include:**

- ▶ Which of these two reports can you provide?
- ▶ What are the inputs you will use to estimate property value?
- ▶ What is your experience producing this report?
- ▶ Are you willing to discuss the completed report if I have a question?
- ▶ What is your turn-around time for completing the report?

**Appraisers.** Appraisers are professionals who can determine the market value of a property. They must comply with rigorous standards under state and federal law when they complete an appraisal. Partly as a result, appraisals are considered the “gold standard” in property valuation.

An appraiser uses several inputs, including an in-person inspection, prices of comparable properties recently sold, property price trends, and details specific to the property.

Often a private lender is not just interested in a property’s current market value. You may need to know a property’s after-repair value (ARV). For an appraisal of ARV, appraisers use their experience (and imagination) to determine this future value. The appraiser does this using a Scope of Work (SOW), outlining expected repairs and related expenses your borrower will provide. To help the appraiser and to get the best ARV appraisal result, require the borrower to provide detailed information about planned repairs and expenses (more than just a quick list of “\$800 for carpet, \$500 for tile,” etc.).

Not surprisingly, getting an appraisal is more expensive than other valuation tools. Also, an appraisal takes more time, so it makes sense to order an appraisal early in your process.

**Sample interview questions you may ask an appraiser include:**

- ▶ What is your experience in the specific area in which the property is located?
- ▶ For ARV appraisals:
  - What is your experience with ARV appraisals specifically?
  - How do you analyze planned repairs to determine ARV?

## **CURRENT VALUE SHIFTS**

Given recent downward shifts in property values, when valuing a property, most private lenders are now giving particular weight to recent comparables and discounting less recent comparables. Additionally, some lenders are now discounting values to reflect further possible downward price movement. Along these lines, today lenders may want to make their own adjustments to a property value provided by the valuation tools discussed.

- ▶ What is your turn-around time for completing the appraisal?
- ▶ What will you need from me (and the borrower)—and when will you need it?

**AVMs.** Automated Valuation Models (AVMs) are computer-driven models that review property data, providing a value or value range for a property within seconds. The freely available AVMs online are not known for their reliable valuations, though they can offer useful comparables.

Fee-based AVMs can be a worthy tool for a private lender. While instantly producing a property value report for you, an AVM also allows you to choose which comparables you think are most appropriate and filter possible comparables by specific parameters (e.g., date range of when built,

### **"YOUR RESULTS MAY VARY"**

Although the valuation resources discussed here can be useful for a private lender, lenders sometimes need to adjust a valuation to reflect the lender's property due diligence.

Due diligence that can warrant adjusting a property's value includes, for example:

1. Your personal inspection of the property (alternatively, a complete set of property photos).
2. A Google Earth review.
3. A contractor inspection (particularly where significant renovation is planned).
4. The ability to get permits to complete planned work.

single- vs. double-car garage, etc.). Of course, AVMs are only as good as the data they use, so they may not include some external factors (e.g., a property that abuts a landing strip). It is also important to review the photos of comparables, because AVMs cannot discern property condition.

Although they are not perfect, AVMs have become extraordinarily popular due to the speed, ease, and flexibility with which you can get a property valuation.

AVMs are often best for private lenders with some volume, and a contract may be required. To learn more about an AVM, an AVM representative may offer you a "tour" of their website's capabilities.

Sample questions you may consider asking an AVM representative include:

- ▶ What data sources do you use, and how often are they updated?
- ▶ What adjustments do your algorithms make to this data?
- ▶ What parameters for valuing a property can I select and change?
- ▶ What is your pricing, and do I need to sign a contract?

### **TOOLS TO VET THE BORROWER**

Most aspects of borrower vetting are best performed in-house. That said, several

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external services can greatly assist with determining the strength of a borrower. Here are some tools that can be helpful:

**Credit Reports.** Some private lenders do not pull a credit report for their borrowers. This may be based on an existing relationship with the borrower or a stellar referral. But if the saying “the best predictor of *future* behavior is *past* behavior” is true, then pulling a borrower’s credit provide invaluable insights.

**Loan Origination Systems.** In addition to providing software that processes and manages your loans, loan origination systems (LOS) provide the private lenders with the option to pull credit reports as an add-on service.

Besides asking about an LOS’ primary functions, consider asking questions about credit reports too:

- ▶ Will reports be produced via a “soft” pull? (a “hard” pull can negatively affect a borrower’s credit)
- ▶ What is the pricing for this service?

**Landlord Websites.** Lenders can use the same websites landlords use for background checks on prospective tenants to check a borrower’s credit. Usually, the borrower receives a link to request their own credit report, assuring a “soft pull.” A copy of the report is then immediately emailed to you. Because the content and format of these reports vary, you may want to try several of these services to see which is best for you.

Often these services have a chat function that will answer questions such as:

- ▶ Can I pull credit reports without any other obligation or cost?
- ▶ What is the cost of each report, and can I have the borrower pay for it?

**Borrower Entity Documents.** Whether the entity you’ll be funding is a limited liability company, corporation, or other type of company formation, it is important to confirm, among other things, that it is properly organized and in good standing. A private lender will often complete this review themselves, but there is also help out there.

For example, private lenders may turn to legal counsel to review entity documents when there is a particular question or an unusual circumstance that needs consideration. Other lenders have an attorney complete this review along with preparing loan documents and reviewing the title.

Before engaging an attorney for help, specifically with entity review questions, consider asking them:

- ▶ What corporate law experience do you have, including reviewing these types of documents and confirming good standing?
- ▶ Are you willing to explain what you look for when reviewing these documents?
- ▶ How do you price your services?

As it relates to entity documentation, title companies will gather many of the same documents as you. Although your diligence around these documents may be stricter, it can be helpful to talk to the title company if you see a shared issue that must be resolved.

## THE GREAT RACE!

There is always more you can learn and improve as your private lending

practice grows. In this ongoing “race” for improvement, the resources discussed here can help you both value a property and vet a borrower, improving the quality and efficiency of your lending. ●

*Disclaimer: This article is not legal advice.*

## ABOUT THE AUTHOR



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Michael Fordham is founder and CEO of Silverstream Funding, a private lender funding loans for real estate investors, primarily in Texas and Utah.

Before launching Silverstream, Fordham accumulated more than 20 years of banking and real estate experience. He practiced corporate and securities law for 18 years with investment banks JPMorgan Chase & Co. (New York City) and Credit Suisse, A.G. (Zurich, Switzerland). His real estate experience includes multiple projects in the multifamily investment space. For more information, visit [www.SilverstreamFunding.com](http://www.SilverstreamFunding.com).