



# Extra Points For Creativity

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**As traditional lending  
takes its blows,  
creative-financing tools  
become more important  
than ever**

If there is one term that could capture what sets mortgage brokers apart, it might be creative financing.

Creative financing has been used for decades in many ventures, including the film and television industries, churches, governments and even the building of Donald Trump's empire. It applies to almost every industry in which there is an exchange of money or its equivalence for goods and services.

When applied to real estate transactions, this type of financing is an innovative way to fund any real property, be it a single-family home or a large complex of commercial buildings. Further, it can be used for buying or selling real property when a traditional mortgage or loan from a third-party lending institution or bank will not suffice.

Now that traditional options have decreased significantly for brokers and their clients, it is time to think more about alternative strategies to home financing.

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To begin to understand the role creative financing plays, it helps to understand its impact in the real estate environment.

This type of financing first gained notoriety in California in the 1970s. Housing prices were soaring to new heights, and the demand for mortgage money exceeded traditional, conventional suppliers' desire to meet that demand by extending credit at affordable terms.

By the 1980s, creative financing became the competitive edge, in part because of the Tax Reform Act of 1986. This act of Congress eliminated many tax incentives in an attempt to stimulate equity in real estate. Coupled with the savings-and-loan failure, it made creative financing a near-universal approach to real estate financing in the United States.

Thus, a number of commercial and residential loans that closed in the '80s used some form of a seller carry-back, in which the seller holds a note in financing the property, or another creative-financing strategy. This became the usual course of business when the savings-and-loan debacle created a shortage of mortgage funds. A 1984 RAND Foundation study called "Creative Financing In California: The Morning After Santa Monica" found that as many as one-sixth of all California homes were subject to liens held by their former owners, who had provided at least \$36 billion in mortgage credit.

### Why creative financing today?

Today, there are residential mortgage professionals who will not permit the term "creative financing" to pass from their lips without expressing major disdain. Often, their first thought regarding this form of funding is that it means "no money down," followed by, "I'm not going to get paid," followed by, "It's not a doable deal." Some also avoid using these strategies with the same intensity that brokers did in the past.

But the time likely is right for such strategies to return. Borrowers are increasingly unable to keep up with their high debt commitments. They're falling behind on their mortgage payments and defaulting in incredible numbers across the country. This puts a strain on brokers and lenders.

Creative financing works in many different ways for many different situations. This is particularly true when loan situations are outside the traditional lending parameters of the usual conventional lenders.

Suppose you have borrowers with good credit who were prime candidates for a nonprime loan with nothing down just last month. Now, the only lenders you have a working relationship with require a substantial downpayment, which your borrowers don't have.

They do, however, have old cars that they can part out or sell outright to bring \$5,000 toward the downpayment.

### Other ideas

Creative financing also can help when avoiding foreclosures. Say you have a couple trying to get a loan on a home with an appraised value of \$575,000. The wife has no credit history, and her husband has marginal credit. The prevailing issue is the house is in foreclosure, leaving you limited time to act. The borrower is the husband's father, who wants off of the loan.

You could be able to stop the foreclosure process with the borrower's lender. For example, a hard-money lender could help take the original lender out of the deal by making an acceptable offer to purchase the underlying mortgage at a discount.

The couple could work out a lease with an option to purchase so that they can stay in the home.

Another creative-financing tool is a partnership. It does not necessarily have to be a 50/50-split situation; many partnerships can be adjusted to fit your borrowers' specific situations.

Seller carry-backs and refinances are alternatives to conventional home-financing, as well. A seller could carry back a second and refinance the first, thereby giving the seller some money.

### For commercial deals

Creative financing can be the competitive edge for brokers tackling commercial deals, as well.

On the commercial side, many commercial lenders are well-versed in providing creative real estate financing and alternative financing for commercial loans secured by income-producing real estate. Moreover, it is an ideal option when the scenario includes properties that would not qualify under normal lending guidelines or borrowers with subpar credit.

Try this scenario: Your investor wants to purchase a small hotel in a rural community. The property has an appraised value of \$2 million, though the seller is asking for \$2.1 million. The existing first mortgage is approximately \$300,000 with a private lender.


A family trust could lend to as much as

85-percent loan to value (LTV) on the commercial project, with a first mortgage as security. Its interest rate is higher, but its terms likely would be more flexible than with a traditional lending source.

The downside is that these types of funding sources are slow. But they allow borrowers flexibility in structuring the deal with the right downpayment. If investors are short on the cash side, they could apply for a federal downpayment grant for a new rural business. Additionally, you get paid immediately out of escrow.

In the aforementioned scenario, the seller also could be convinced to work in a carry-back for \$120,000. At closing, the seller would create an all-inclusive trust deed at 8 percent, with a "bonus clause" stating that the buyer would receive a credit for early payback. This deed is an old creative-financing tool often known as a wraparound mortgage.



When job one is getting the transaction done professionally and ethically, creative financing can be the way to ring up additional profits. For smart brokers, this can apply to residential clients who normally wouldn't qualify for traditional funding or to small-balance commercial borrowers. 

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