Private Money Update

CLEAR SKY FINANCIAL NEWSLETTER

OCTOBER 2018

Letter from the Editor

This year is chugging along really quickly – it's hard to believe the fourth quarter of 2018 is upon us! We wish you the greatest of success in your endeavors as we enter this final quarter.

September was a relatively slow month for loan originations for us. We originated four loans, two of which were First Trusts and two of which were Second trusts. Of the four loans, three were in Maryland, and one was in Virginia. October has been a very fast-paced month so far. We have already closed seven loans, and we expect an additional three or four to close soon.

CHUCKLE'S CORNER

"If plan A fails, remember there are 25 more letters.

– Chris Guillebeau

Deal of the Month

This month's Deal of the Month was a Second Trust, located at 1620 Fort Fisher Court, Dumfries, VA 22026. This deal was small but mighty! The property was undesirable to banks because it was both for sale in the MLS and under contract. The deal wouldn't make sense for a bank, because the money would come right back to them very quickly after they made the loan.

What might not make sense for them, however, definitely made for good business for us! The return on an investment like this would be very high with consideration to the interest received, the origination fees, and some payoff fees. As a result, these kinds of loans are exactly in our wheelhouse.

The seller needed funds quickly – before the sale of his house closed. We closed/purchased this loan in less than 24 hours with the assistance of a local attorney who originated it. The loan was a $55,000 Second Trust, and was behind a First Trust of $70,000. The total encumbrance on the house was $125,000. The house was already under contract for $212,000, giving us a Loan to Value Ratio (LTV) of the After Repair Value (ARV) of 58%. This represents a very safe loan… and the loan has since been paid back.

In This Issue:

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www.cskyfinancial.com

Charlie Einsmann
(703) 887-1039
charlie@cskyfinancial.com

Sam Jacknin
(703) 587-2475
sam@cskyfinancial.com

Six Tips for Purchasing Properties at Real Estate Auctions

There are many ways to purchase real estate. The most popular is through the Multiple Listing Service (MLS). However, there are many additional ways to purchase properties, as well. These methods include buying the property directly from the owner and at real estate auctions. Here are a few tips to keep in mind when purchasing properties at real estate auctions:

1. Get to Know Your Local Bank or Hard Money Lender

Homes sold at auction are often foreclosures or they have already been foreclosed (REO's). The lender wants to make a quick sale and get a portion or most of their investment back. Depending upon the equity in the home, this means you can sometimes find good deals through these auctions. Take the time to reach out to your local banks and let them know you're interested in investment properties. They may even let you know when they have foreclosures available and are getting ready to hold an auction.

2. Study Local Real Estate

If you are not familiar with the local real estate market, it will be impossible to know whether that auction price is a good deal or a bad one. One of the elements both buyers and sellers like about auctions is that you do not have to negotiate terms and go back and forth. However, this is also a drawback if you aren't familiar with what that home is worth in the exact condition it's in.

3. Talk to Contractors

Auctioned homes are almost always sold as-is. That means you need to become familiar with potential problem areas and how much it costs to fix and upgrade the house. For example, if the roof looks as though it's ready to fall in, how much will it cost to replace the roof? Take the time to talk to local contractors and get general estimates. While you may be able to complete smaller jobs on your own, you'll need a list of professionals to come alongside you and fix serious issues. Knowing the potential cost also allows you to determine if you can afford that "great deal" at the auction or not.

4. Learn How Auctions Work

Buying a property at auction is entirely different than going through a realtor. There are two models for auctions — they're either instant, in real-time, or they happen over a few weeks with a minimum bid set or online bids taken. When the bidding gets down to a single bidder willing to pay the top price, the auction closes. You'll either need to pay immediately, which means you will need financing ahead of time, or you'll place a five- to 10-percent deposit and pay the remainder within 30 to 45 days. Talk to the auctioneer ahead of time to learn the terms of a specific auction. It is also very important to know if there is a buyer's premium and, if so, how much it is, so you are prepared to bid.

5. Figure Out the After Repair Value (ARV)

If you need to secure funding from a lender, understand that they typically only lend 65 to 75 percent of the purchase price. Hard money lenders will lend 65 to 75 percent of a home's after repair value (ARV). You will likely have to make up the rest in the form of cash down. This is where knowing the market and what a home is worth after rehabilitation comes in handy — you'll be better able to determine if that great deal is one you're ready to bid on or not.

6. Drive by the Property

Much of the time, the home is foreclosed, and you'll be unable to get inside to determine the condition of the house. If the person has not paid their mortgage, it can be a good idea to assume they have not had the funds to keep up with maintenance, and to plan for multiple repairs and cosmetic upgrades. Take the time to drive by the property and get a general idea of the condition from the outside. Take the time to look at the roof carefully. Does it look like it needs to be replaced? You can also determine a lot from the age of a home. A newer home may not need a new furnace, while an older home likely will. These types of big-ticket item costs add up quickly.

www.cskyfinancial.com

Charlie Einsmann	Sam Jacknin
(703) 887-1039	(703) 587-2475
charlie@cskyfinanical.com	sam@cskyfinancial.com

Back Office Management Through Tracking Systems

How does a hard money company track all of its transactions and accounting? How do we know what borrowers owe us and when we owe noteholder's money? Here at Clear Sky Financial, we rely on a lot of systems and processes to keep us informed. We have a loan tracking system and an accounting system. Beyond ordinary software backups, we keep a manual accounting of data with which to cross-reference our automated systems.

Our adoption of a loan tracking system evolved over the life of our company. When we first started tracking loans, spreadsheets were adequate. Once our company outgrew spreadsheets, our first foray into a fully-automated loan tracking system resulted in the use of a cumbersome system that couldn't deliver logically compiled reports and management information. From there, we migrated to a fully outsourced loan tracking system. The outsourced system inhibited communication between our borrowers and our company. Finally, in late 2017, we adopted a loan tracking system that is web-based and enables us to quickly review any loan account. This web-based system also allows borrowers to check their account status and make payments online.

After capturing all of the loan transaction data, we need to get that data into our accounting system. The accounting system is Quickbooks and it is hosted by an authorized provider that backs up our data. Our most recent system integration effort is designed to automatically get the data from our loan tracking system transferred directly to Quickbooks without any manual data entry. Once this is completed, it will speed up our back-office process and reduce the possibility of data errors. Integrating two programs like these requires consultation with technical professionals from each software provider. We have targeted Q4 to complete this full system integration.

What actionable outputs are there from a loan tracking and/or accounting system? The loan tracking system lets us know when a payment is late. We can immediately contact the borrower to get their payments on track. If a loan is maturing in 30 or 60 days, we can start working on an extension for it or plan for the payoff. Late payments and extensions are a source of additional revenue, but they need to be closely managed so that a loan doesn't get in trouble. The late report and maturity report are good tools to reference when planning physical site visits to properties. If a loan is late or maturing, it is likely a good candidate for a field visit to check on the physical status of the property. Our accounting system produces a plethora of actionable reports.

Our back-office process is designed to "close" our books monthly so we can track our P&L and Balance sheet at any given point in time. This enables us to be prepared for our annual audit, banking requirements, and tax preparation. Staying on top of our numbers enables us to have the most accurate information about our business to make effective and profitable lending decisions.

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Charlie Einsmann	Sam Jacknin
(703) 887-1039	(703) 587-2475
charlie@cskyfinancial.com	sam@cskyfinancial.com

Food for Thought

Are Higher Interest Rates Hurting the DC Metro Housing Market?

Recent market data for the Washington, D.C. metro area suggests that this could be the case.

According to Bright MLS and data collected through October 3, 2018, the D.C. Metro area median sales price rose 3.7% to $420,000 compared to this same time last year. This brings the median sales price in our area to the highest September level of the decade. Average 30-year fixed rate mortgages currently sit at 5.00%, according to Mortgage News Daily, which is the highest level in the past seven years. The average 30-year fixed rate this time a year ago was around 3.92%. A full percentage point move like that means on a $400,000 loan amount borrowing costs have increased approximately $237 per month on average.

Bright MLS data shows that closed sales for the month of September were down 10% from last year and 28.2% from August. This was the largest single month drop in year over year sales since May of 2014. Interest rates made their most aggressive move towards the high side at the end of August and into the beginning of September. The yield on the 10-year treasury note, which doesn't set mortgage rates but is the general benchmark of U.S. rate movement, sat at 2.86% on August 31, 2018. It had moved to 3.07% as of October 1, and currently sits around 3.19%, a significant 33 basis point movement higher. The 3,636 closed sales in September fell below the 5-year average of 3,909 and the 10-year average of 3,694. September's new pending sales also fell and were down 7.6% from last year and 6.4% from last month. With that being said, new listings in September were also down 3.3% from the same time last year, but were up 11.1% from August. Active inventories were down 3.3% compared to September of last year; however, they were up 8.9% from August.

Time will tell for sure, especially when we get into the busier spring buying months. It will be interesting to see how active the market will be at that time, the year-over-year changes, and if interest rates continue their upward pace.

Ben Biscoe
Senior Loan Officer | NMLS ID #317573
Atlantic Coast Mortgage, LLC · Branch NMLS ID# 643114
4097 Monument Corner Drive, 6th Floor, Fairfax VA, 22030
Direct: 703-851-4730 | Office/VM: 571-421-2410 | E: bbiscoe@acmllc.com
www.atlanticoastmortgage.com

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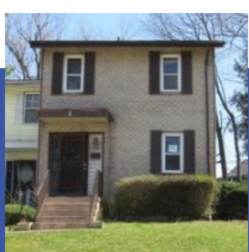
September Deals



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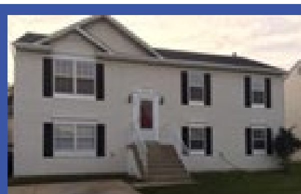

1707 Bradmoore Drive

4108 Havard Street

1620 Fort Fisher Court

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charlie@cskyfinancial.com	sam@cskyfinancial.com