5 Common & Costly Refinancing Mistakes

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When it comes time to refinance your property, you want an easy process that gets you the best pricing. If you're not prepared, it could hurt you with a higher interest rate, lower loan proceeds and an agonizing experience. Below are the top five issues I see investors encounter when refinancing their properties.

1. **Deferred Maintenance.** Is the paint peeling on your property or is there a couch in the alley? What does the street view on Google Maps look like? Have tenants posted negative reviews on Yelp or Google? If a lender sees your property in a negative light, they may delay closing or withhold funds until you address their concerns. Some lenders may decline the loan entirely or increase the interest rate to offset the perceived risk associated with your property. In addition to eliminating any health and safety risks, lenders want their collateral to look attractive and be well-maintained. While increasing your maintenance costs may be undesirable in the short run, it will benefit you in the long run with lower financing rates and potentially higher rents. A poorly maintained property could drive your interest rate up by 25 basis points (0.25%) or more. So, if you have a $2 million outstanding loan, that additional 25 bps translates to $5,000 of additional interest expense *every year*.
   Take Action: Review your property condition and address maintenance issues early, especially before applying to refinance your property. Not only does this help avoid potentially compounding maintenance problems, but you'll create a better impression with potential lenders. An ounce of prevention is worth a pound of cure.

2. **Limited Liquidity.** How much cash and marketable securities do you keep on hand? If you're an astute investor, you probably maintain only what you need since you like to keep your money working for you. Unfortunately, lenders want to see more liquidity. They see extra cash as cushion that reduces risk in case sudden repairs are necessary or your property experiences prolonged vacancy. Many lenders like liquid balances that are at least 10% of your total liabilities and sufficient to cover at least 9-months of amortizing debt service. As always, exceptions can be made, but they may come at a cost such as a greater interest rate or requiring a personal repayment guarantee.
   Take Action: Increase your liquidity before seeking financing. Keep in mind that most lenders give partial (50-75%) credit for retirement accounts and marketable securities.

3. **Existing Prepayment Premium.** How much will it cost to prepay your current loan? Unfortunately, I have seen some investors find out at the last minute that there is a 1-3%

prepayment premium. If this happens, they can either pay the premium or cancel the refinance in process. The choice boils down to the math. Compare the cost of prepayment versus the interest differential on the new loan and the cost of unwinding the loan in process (i.e., the rate lock deposit and any third party costs incurred to date). In addition to monetary costs, don't forget time. Imagine spending the last 60-days gathering financial information, negotiating loan terms, and answering questions only to find out that it was all for nothing and may end up costing you thousands of dollars for lender and third party charges.
Take Action: Avoid this issue by reviewing your existing loan documents to understand the cost of prepaying your current loan before starting the refinancing process.

4. **Poor Application Preparation.** The first thing lenders need to quote a loan is the operating statement and rent roll for the proposed collateral. Lenders use this information to estimate the maximum loan amount your property can support and determine the appropriate loan program. If your operating statement blends nonrecurring expenses or otherwise understates the expected Net Operating Income of your property, the lender will size the loan accordingly and you may not get the loan amount you need. After this, it will be tough to explain or recharacterize your nonrecurring expenses to get the loan amount you want. The horse is out of the barn.
   Take Action: Review your operating statements for the last 3-years before submitting them to the lender. You want these statements to provide the most realistic perspective on your property's cash flow and debt service ability so that you get the loan you deserve. In addition, ensure you can explain any material differences between the operating statements and your tax returns.

5. **Sub-700 Credit Score.** While a credit score is primarily a consumer credit-driven metric, most lenders will pull your credit score. Lenders believe your personal credit score indicates your ability and willingness to perform on your credit obligations. Freddie Mac's Small Balance Program will trigger an exception around a 650 score. Many other lenders require a score of 675 or more. Consider that a low score may not kill your loan but it could still cost you. When I managed a loan program at a large regional bank, we added at least 12.5 basis points (0.125%) to the rate if the credit score was under 700. Doesn't seem like much? On a $2 million loan this is $2,500 per year and adds up to $12,500 over the average 5-year fixed period of most loans.
   Take Action: Pull your credit report. If your credit is under 700, take steps to boost it so you can avoid any potential issues or rate increases. There are free tools like annualcreditreport.com and creditkarma.com that help you track your credit history and scores. In addition, it is good practice to monitor for identity theft and credit reporting errors.

"The best time to plant a tree was 20 years ago. The second best time is now." Similarly, you don't want to wait to prepare for refinancing your property. If you do, it could cost you with higher rates and punitive structure with less proceeds. Talk with your community of experts to ensure you are well-positioned for your next refinance.

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