THE 5 BIGGEST MISTAKES DSCR INVESTORS MAKE WHEN BUYING OR REFINANCING RENTAL PROPERTY...

AND HOW YOU CAN AVOID THEM :)

BEACON LENDING
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1

Not understanding what DSCR is

DSCR is a ratio that is used to determine whether a property can generate enough income to cover its debt payments. It is calculated by dividing the property's net operating income (N.O.I) by its total debt service (DS). A property with a DSCR of 1.0 or higher is considered to be a safe investment with most lenders, as the rate of default greatly reduces when your rental income is matching your mortgage liabilities with any HOA on top of that.

For example, through your research, if you are gathering data that the market rents are $1500 a month, and your proposed mortgage payment is $2000, do you know what your DSCR Ratio is?

$$\frac{\text{Net Operating Income}}{\text{Debt Service}} = \text{Debt Service Coverage Ratio}$$

$$\frac{\text{\$1500 Market Rents (through research)}}{\text{\$2000 Proposed Mortgage Payment with HOA}} = \text{.75\% DSCR RATIO}$$

Because the lender will equate this to a potential default your interest rate likely will be much higher at this .75% ratio, as now this has fallen into a low DSCR loan ratio.

Focusing on the DSCR number and not on the mortgage payment is the key to a higher likelihood that your DSCR loan will get funded.

For example, if through your home shopping you come across a beautiful condo and the listing agent is providing you with the Airbnb rental income from the seller property management ledger and you realize that the seller earned $30,000 last year in short-term rental over 12 months, that will give you a net operating income (N.O.I) of $2500.

PRO-TIP - If using short-term rental in your DSCR equation, be sure your lender will allow the rents from the seller for the last 12 months, to be used as your DSCR. This is so crucial as if not, you are going to fall mercy to whatever the Appraiser will write in their 1007 Rent Comparable report.

If they say in the report, $1500 for Long Term Rents, you will be stuck with that number, even if you know you will intend to use the property as an (STR), short-term rental, and you will be getting much higher rents.

Know your numbers.

This leads us to mistakes...

2 Not obtaining a 12 month rental ledger to support (STR) Short term rental income.

Why is this a mistake?

Great Question Brian

Let's use a beachfront Condo in St. Petersburg, FL as an example that is being listed for $900,000. You would like to put down 25% under the DSCR program, which brings your loan amount to $675,000.

Assuming an HOA of $1000
Interest Rate at 8.5% = $5190.17
Principal and Interest
Taxes and Insurance $500
Total Monthly Mortgage Payment
= $6690.17

The appraisal happens, and in the report, the appraiser lists the (LTR), Long Term Rents, in the 1007 section of his report, which is the rental comparable number. He lists it for $3500.

What is your DSCR? $3500 Market Rents (through appraisal report)

$$\frac{\text{Net Operating Income}}{\text{RATIO}} = .52\%\ \text{DSCR}$$

$6690.17 Proposed Mortgage Payment with HOA Debt Service.

You were hoping for a DSCR of at least 1. What happens now? Well, if your lender is flexible, you can obtain the 12-month rental ledger from the seller, who kept very good books and records.

The listing agent can give it to you, and you find out the seller made $100,000 in income last year for the previous 12 months off the rental.

Yes, we can use that. Now, what is your DSCR?

$8333.33 Market Rents (through seller monthly ledger from property management company)

Net Operating Income / RATIO = 1.25% DSCR

$6690.17 Proposed Mortgage Payment with HOA Debt Service

Now you are at a 1.25% DSCR Ratio, and might even get a lower interest rate because of the amazing cash flow this property has been receiving.

Ask Questions! Lots of them.

3 Not knowing anything about the (H.O.A), Home Owners Association.

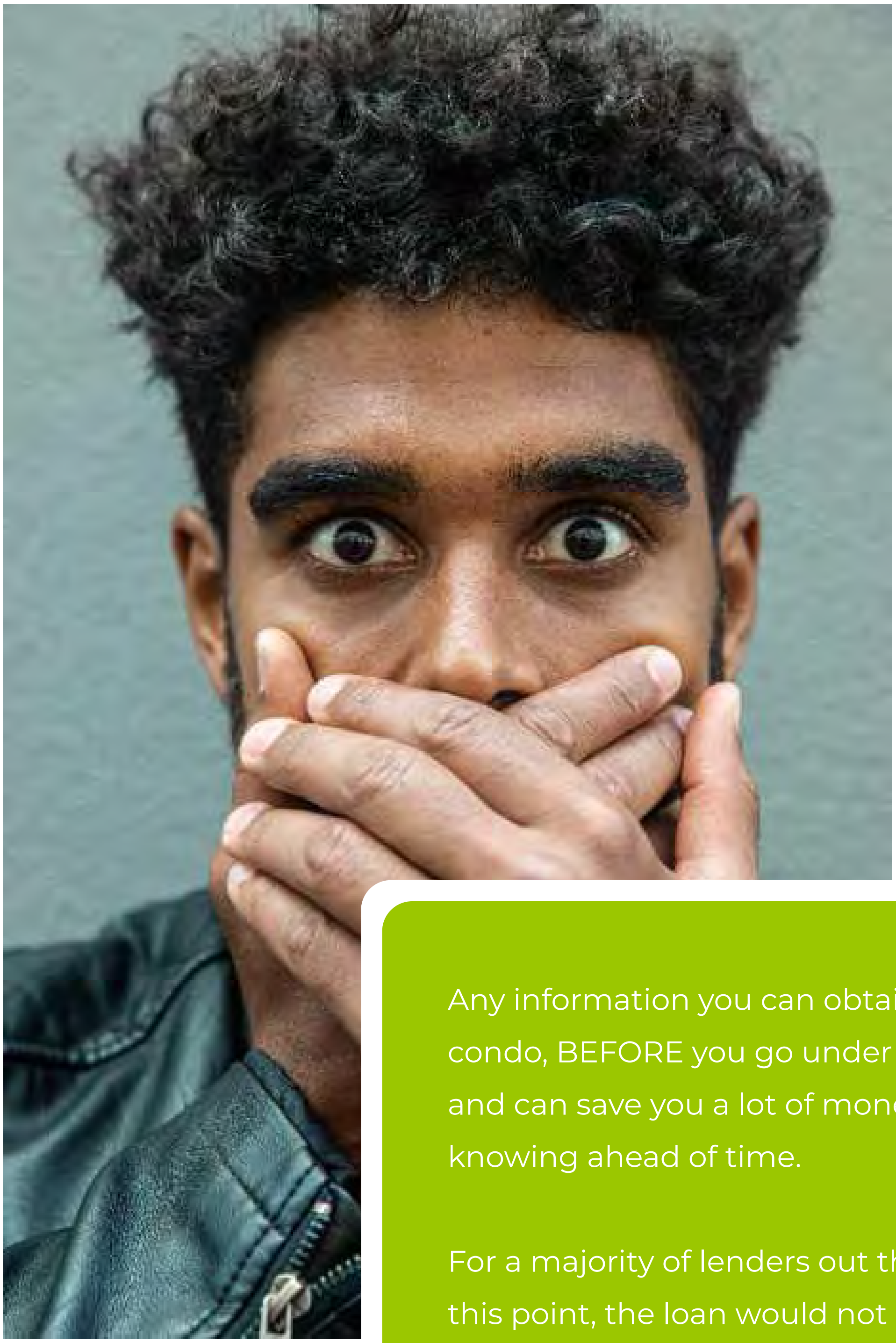
This only applies to condos, however, a sobering fact when dealing with DSCR loans and all of the nuances involved in them.

Let's use the above example of the amazing 1.25% DSCR Loan you just got. You are more than midway through your underwriting process, and the underwriter informs the loan officer of 3 major issues that popped up, through the completion of the HOA Questionnaire being filled out.

Reading the questionnaire, it is found out that the 100 units in the development of this high-rise condo, are part of a Condotel, with a 24-hour concierge. The HOA is in a lawsuit that is ongoing for misallocation of funds, depleting it of its reserves for being fiscally responsible for the development for improvements, and one entity owns over 30% of the entire building.

At the very beginning of the loan process, you were under the impression this was just a normal Condo that was warrantable, and now it is being classified as a Condotel, nonwarrantable.

To be clear, getting the HOA Questionnaire filled out before going under contract is completely acceptable, and the listing agent might even have one on hand if this transaction does not close.



Any information you can obtain, specifically on a condo, BEFORE you go under contract is crucial and can save you a lot of money and headache, knowing ahead of time.

For a majority of lenders out there, however, at this point, the loan would not be doable, as the risk would be too high for them. That is why it is so important to know all the facts as early on in the loan process as possible.

4 Not keeping good records.

This applies to buyers, sellers, and owners, investors who want to build a successful real estate portfolio over the years, which most likely span decades. How are you going to build something on a poor foundation? You might get lucky on the purchase, however what about if you want to purchase another real estate property in a year?

Considering you are an investor, with no active income, or tax returns to provide, DSCR only has the property to go off of to grant you the cash out you need. If they are requiring a 12-month rental ledger, and you can document the rents from a management company for that time, you are good to go. Add to that, the fact you are wise to the Airbnb game, and you have been consistent in commanding and getting high, positive cash flow rents, month after month.

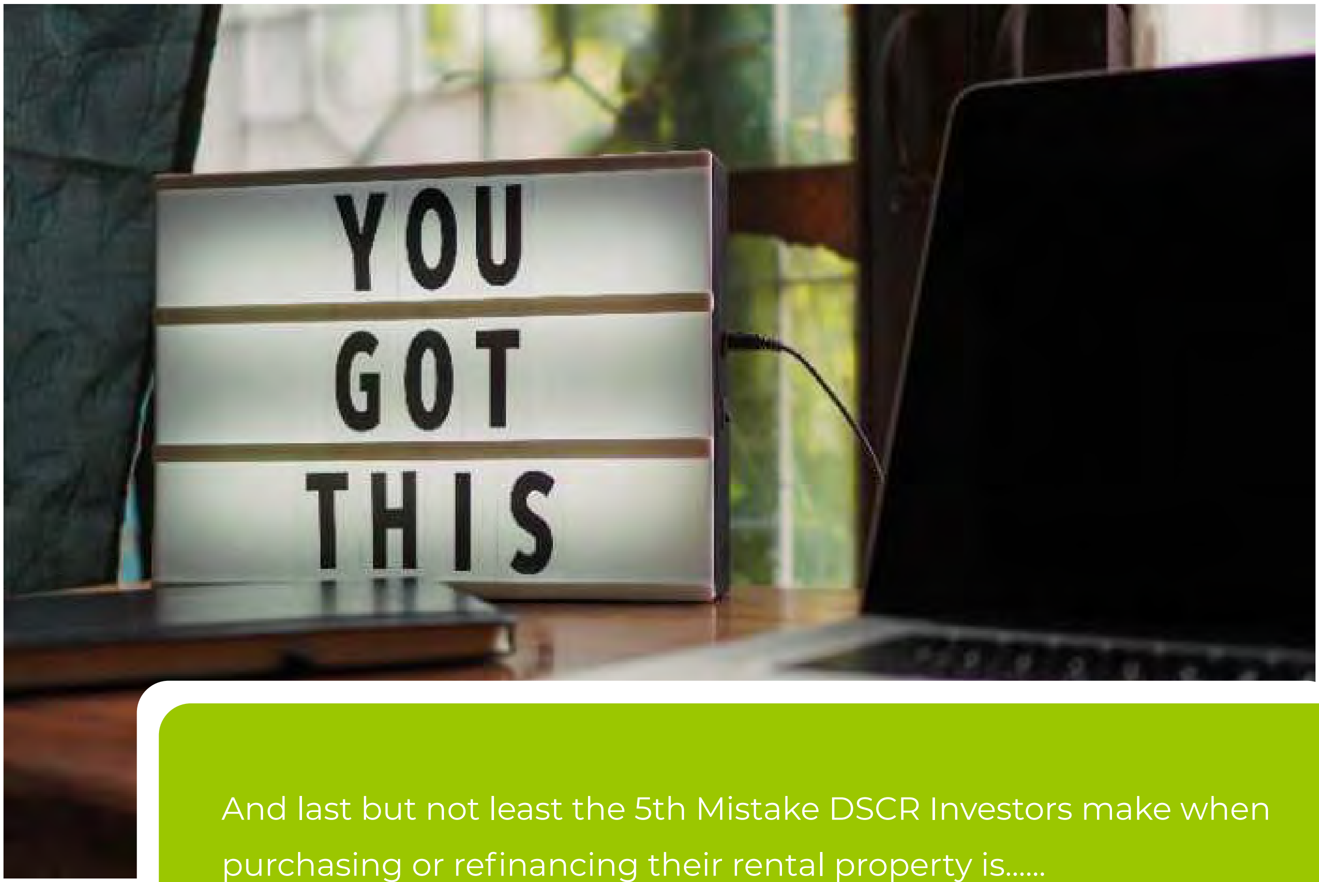
In that case, you should have no problems, doing a cash-out refinance, to pull that equity out, so you can buy another, cash flow, income-producing rental, using DSCR because you kept solid records.

Well, what is the mistake then?

The mistake is if you go into this purchase, and don't treat it like a business. You might rent it out for a few months here and there, make some good money, and then stop renting it out. Why?

Family Vacation, friends want to celebrate a birthday or bachelor weekend, mom's in town, you want a getaway from Colorado, fill in the blank. If you are not treating your rental like a business, especially with Air Bnb Income, really exposing you, then when the numbers are added up over 12 months, and annualized, you will have a poor rental ledger, which will equate to a Low DSCR, which will affect the interest rate, and might even cost you the refinance.

Be mindful.



And last but not least the 5th Mistake DSCR Investors make when purchasing or refinancing their rental property is......

5 Not working with experienced lending professionals.

You need to be crystal clear way ahead of you even starting to look for a property in what loans are out there that are DSCR, who lends under DSCR guidelines, and how comfortable are you with your lending professional, whether it is a mortgage broker, mortgage banker, or private money investor. And come with lots of questions to vet them out. The more the better.

DSCR is a very straightforward, easy loan from a distance when speaking of it, however, there are many pitfalls, nuances, and constant moving variables, that your lender needs to be flexible with.

Some questions are just off the top.

- Can you finance condotels?
- Nonwarrantable condos?
- Is it okay if HOA is under litigation?
- Will you do a low ratio or no ratio DSCR?
- Will you allow rental ledgers from the seller, if we can show 12 months of rent?
- Will you allow a lease agreement on a cash-out refinance, vs going off market rents?

Anyway, you get it. Not trying to overwhelm you, but when you do choose your lender, you need to feel 100% comfortable and confident in who you are working with. This is for your protection.

Happy hunting!