The Paper Game

The Beginning Note Buyer's

Guide To Winning The Game

by

Jayme Kahla & Bob Leonetti

PLEASE NOTE

This manual is designed for educational purposes only. It has been prepared as an expression of the publisher's opinion concerning the subject matter covered. The information is from resources deemed reliable, but not guaranteed. The manual is given with the understanding that the publisher is not engaged in rendering investments, legal, accounting, or other professional services.

This course does not deal with lending money. Should the readers wish to engage in the practice of lending money, they should check and comply with the laws of their individual state. If legal advice or other expert professional service is required, the readers are urged to consult competent professionals, accountants, attorneys, etc.

The publisher specifically disclaims any liability, loss, or risk, personal or otherwise, which is incurred as a consequence, directly or indirectly, of the use and application of any of the methods, techniques, contents, advice, or information in this manual.

TABLE OF CONTENTS

PART ONE

WELCOME TO THE GAME!

"Doubt your doubts, not your beliefs."

This is the age of achievement. Never have more people accomplished more things in more different fields than they are accomplishing today. More people are becoming successful at a faster rate than at any other time in history. In fact, there have never been more opportunities for you to turn your dreams into realities than there are right now.

Leading futurists and prominent businesspeople are predicting that mankind is entering a Golden Age. Personally, with the advent of the Internet and a rapidly approaching Global Economy, I think we already have. The Western ideals of democracy, individual liberty and free enterprise are sweeping the globe and bringing prosperity, growth, and human freedom wherever they are seriously tried. There has probably never been a better time for you to achieve greater success, freedom, happiness, and financial independence than at this very moment.

I know this to be a fact: I started my national note buying company in the spare bedroom of my house in 1994, specializing in the purchase and sale of privately held mortgages. In 2001, I took my company public. I say this only because I know that the system you are about to learn can change your life. It certainly changed mine…

No matter who you are or what your situation; you have within you, right now, the ability to accomplish more than you ever have before. You have the potential to exceed all of your previous levels of accomplishment. You can be, have, and do more than perhaps you have ever imagined. All you need to do is to learn how, and then put what you learn into action.

The Paper Game…

The Paper Game, or "Note" industry, as those of us in the business like to call it, has been a little known, but lucrative, business for many years. It offers an incredible opportunity for anyone willing to put forth the time, effort, energy and capital necessary to achieve success. In recent years, a number of companies have popped up to provide training to those who want to enter this field, and have provided an excellent way to gain a solid foundation of knowledge quickly and inexpensively.

There are quite a few, however, who teach this business without ever practicing what they preach. Their format generally provides a technical overview with some marketing ideas thrown in to get you started, but they don't have real world experiences upon which to draw. This course will be different.

Purpose of the Course…

This course is all about the purchase and sale of privately held mortgages. In it, I hope to provide you with a solid, proven, systematic plan to generate a quantity of "do-able" deals on a consistent basis. That's what this system is all about: gaining the confidence and enthusiasm to deal directly with the note holder, and enjoying the rewards of doing this successfully! Everything in this program has been tested and proven in the training ground of real life. You, however, must ***use*** this program in order for it to be effective. Pretend it is a map...

Imagine you are going to drive from Spokane, Washington to Orlando, Florida. You have already mapped out your course, and are ready to go. Would you want to take a map with you? Of course, you would! Why? One reason might be to check your progress so that you would know where you were on your journey. What if you wanted to get off the beaten path and go sightseeing? More important, what if the road you wanted to take was closed and you had to take a detour? A map would show you exactly where to get back on! When we learn to clearly define the desired outcome of our activities, it becomes much easier to pinpoint which activities will produce results. Even more important, it becomes possible to look at the "map" and find out if the road you are on is going where YOU want to go.

Use it or lose it…

Now, the only way a map is useful is if you ***use*** it. The greatest tragedy would be for you to read one or two chapters, or perhaps all of them, and then do nothing! I find it amazing that so many people have multitudes of courses sitting on their shelves, all gathering dust. They complain about not getting any results, yet they don't even bother to crack the book open, let alone apply its principles.

We (my partner and I) have a joke that goes like this: You are sitting in your living room one day going through The Paper Game, (that's this wonderful course you just purchased)! All of a sudden, your doorbell rings. Wondering who it could be, you go to the door and encounter your neighbor, who says, "*Hey! Didn't you just receive Jayme Kahla's course on how to buy mortgages? This is great news! I live down the street and just happen to have a note that I am carrying that I want to sell – will you buy it?*"

Now I know that this sounds a little ludicrous, but I want you to get the point that, as with any program, this program requires effort on your part! It doesn't work automatically; you actually have to tell people what you do! People often ask me if other people's courses are "any good." I just smile and say they are all good, but only as good as the willingness of the student to use and apply the information.

The process of learning…

Before we advance any further into the materials, this is a good time to discuss the process of learning. We have produced the materials with several goals in mind; in order to get the most from them, we want to suggest a study plan to help you.

First, you must be in the ***proper state of mind*** in order to learn. I suggest you do several things in order to achieve this.

1. Create a vessel as a place to store all of your newfound information. To achieve this, tell your brain what you plan on telling it. No, I didn't stutter. Giving your brain an outline will help it categorize any relative information you put into it.

    a. **ACTION STEP:** Review all of the chapter titles before going any further, so that you can start building a mental framework.

    b. **ACTION STEP:** Read the introductions to all of the chapters. Again, you're building a framework so that you have an idea of what you'll be learning.

    c. **ACTION STEP:** You may want to read the Terms first, so that you'll have a good idea of what we'll be discussing.

2. Make sure that you participate and make this process ***interactive.*** There will be times that we ask you to *do* the problems as we present them in this book: by physically doing the assigned tasks and following along (preferably with your calculator), you will get a lot more from these materials.

3. ***Repetition*** is one of the keys to success. One of the advantages of reading an e-book is that you can print it out or store it on your hard drive, and access it any time you want. One of the most creative real estate investors I have ever met attributed his success to the fact that he had read a basic book on "nothing down" real estate at least seven times. He knew the basics so well; he was able to creatively apply them!

   There are times when this manual may seem redundant. This is intentional (brought to you by the Department of Redundancy Department). While you may not always "get it" the first time through, I've found that if you are presented similar information in different ways, repetition usually facilitates the information "soaking in" to your already overloaded brain!!

   On the one hand, there is repetition. On the other hand…you have different fingers!
   Just kidding! The jokes don't get any better, but I hope they will, at the very least, keep you awake!

   Don't be like the student who called my office, wanting to know if there was a way he could "shortcut" the materials, and start doing everything without ***"reading all that material."*** Poor guy! I told him if he wanted to perform brain surgery, he really should go to medical school first! Though this isn't brain surgery, it does require specific knowledge. Here's how to attain it:

a. **ACTION STEP:** Read the materials through at least once. Granted, you'll have to set some time aside to concentrate however…you'll benefit a lot more.

b. **ACTION STEP:** To really benefit, do the suggested exercises!

4. ***Preview, Review, and…DO!*** If I had to pick one technique that would get you the results you wanted, it would be this one. Tell your mind what you intend to tell it (build a mental framework), review the materials at least twice, and…go out and apply your knowledge to the real world.

Take Action! You have a choice. In fact, life is filled with choices. What will yours be? Will you ***choose*** to read and listen to these materials in their entirety, or will you ***choose*** to put them on the shelf to gather dust? Will you ***choose*** to implement your newfound knowledge, or will you ***choose*** to go back to your same old habits, only ***wishing*** that you were successful?

You're free to make your own choices and proceed in whatever direction you feel most comfortable. You see: there's no right or wrong choice, only *your* choice. So…the choice is yours, but if you choose to move forward, then do so, and let's talk about those wonderful investment and money making tools: ***Privately Held Mortgages…***

PART TWO

GETTING READY TO PLAY

"The Secrets of Paper…"

Own or loan…

I have learned that there are two ways to make money in real estate -- either ***own*** or ***loan***. When people loan money on real estate, they carry paper. The purpose of this course is to provide you with the necessary skills to start making money immediately in this exciting industry. I have been active in the mortgage and real estate market for over ten years. I have taught mortgage investing to literally thousands of people across the country and have been involved in over 30 million dollars of real estate transactions. In all of my experience, I can unequivocally say that the lucrative field of discounted mortgages has to be one of the most exciting opportunities in real estate and personal investment available today.

There are so many real estate books on the market today that it would take years to read them all. These books cover literally dozens of topics ranging from investing in real estate with little or no money down to buying foreclosure properties. The one topic you will not find in the library or bookstore is how to make money with discounted mortgages. Herein lies an untapped opportunity for you!

Discounted mortgages are a great way for the beginning investor to get started in real estate without a lot of experience, without a lot of time and without a lot of money. Better yet, you can do this without being a landlord and putting up with tenants and toilets. You can make immediate profits or, if you prefer, make yields on your personal investments of 15%, 20%, 25% and even more!

Why is Paper Important?

Paper is an extremely important investment tool. Sure, you can buy it low and sell it high, but then again, you can do that with shoes! It is when you use paper as an investment tool to yield large returns, which makes the **Paper Game** different. Not only can you use it to generate quick cash; you can also use these techniques to generate long-term wealth. You can do the paper business full time, or use it to merely supplement your real estate strategies. Use it on its own to generate quick cash, or as a base for creating your own notes. You can also use it as a key tool in your real estate toolbox of creative techniques, as I've covered in **Paper Magic**.

GAME HINT: Regardless of how you use paper, it should still be a basic, integral part of your overall investment strategy.

This is the point where I have people call me and say something like, "*All of my life I have been told that if it seems too good to be true, it probably is. Therefore, I am not interested in your course.*" AAAGGGGHHHH! I don't care whether or not you are interested in my course. The only thing I care about is that you don't pass up opportunities! Sure, you need to learn about them, analyze them, and do your homework! But can you imagine turning something down because it seems to be too ***good***?

Sorry, I digress…

There are three ways of making money in the note business:

1. Using other people's money, you can **flip** notes to a Note Investor for a quick-cash profit.

2. You can **invest** in notes for a long-term, high yielding investment.

3. You can buy and sell **real estate** using these techniques, and create real estate short and long-term profit. ***(Subject of Financial Mastery!)***

Yes, you *can* make money while using none of your own. We call this concept "flipping" notes; investors do this all over the country on a daily basis. This system will show you how you can flip notes and make a profit while using someone else's money.

Yes, you *can* get tremendous yields on your personal investment, as high as 20% or greater, and yes, you can do this without taking advantage of the other guy, and you will still be able to sleep well at night. This system will show you this concept as well.

Yes, we *will* debunk the myth that the "greater the return on your money, the higher the risk." In fact, I will show you that the greater the return on your money, the *lower* the risk.

In fact, this information will show you how to smoothly go from targeting your market to closing your first note transaction. If you find variations that work better for you or find that you don't need to include certain steps, by all means use what works best for ***you***! If you find yourself getting lost or not achieving the desired results with your own techniques, you can always go to your "map" and get back on course. However, if you do so, remember this:

You get what you *commit* to accomplish. This information will show you how to make clear distinctions and identify exactly what you want to accomplish. Many inexperienced brokers make the mistake of prospecting for a nice conversation with a seller, or a pleasant meeting with an attorney. Keep in mind; your desired outcome is to ***purchase a note.*** A nice conversation or a pleasant meeting in itself can be a wonderful thing, but bear in mind: if your goal is to buy notes, these activities are not the final result, but merely a means to an end.

Mortgages are real…

It amazes me when I teach a class, and so many people are awed by the fact that mortgages are bought and sold daily throughout the country. They are often under the illusion that note buying is a cottage industry, one that has no validity outside its own sphere of influence. They couldn't be more wrong.

For centuries, the mortgage industry has been the most reliable source of creating wealth the world has ever known. Most major financial institutions are grounded in real estate finance, and invest in mortgages daily. Almost every major Fortune 500 Company, from insurance companies to automakers, is heavily vested in real estate mortgages. Even the federal government buys billions of dollars of real estate secured notes annually. These purchases are made through various government entities, all of whom have cutsie names to go along with the Flag, Motherhood, and Apple Pie. Mortgages are purchased by the Government National Mortgage Association (Ginnie Mae), the Federal National Mortgage Association, (Fannie Mae – a company in which you may now own stock!), and the Federal Home Loan Mortgage Association (also known as Freddy Mac).

All of these trades are done through something called the "secondary market." In other words: when a seller or a lending institution extends financing to a borrower, it is considered a **retail** transaction, because the borrower is the end user. However, those mortgages often don't stay with the same investor after they are created; in many cases, they are sold to another institution in a *secondary market* transaction. You will understand the secondary market better after we discuss the basics of notes, and a sample deal complete with the seller's motivation and the Time Value of Money. But first, so that we can all play the game, we need to learn the rules. And in order to that, we need to all speak the same language. So, let's review some basic *terms*…

GAME HINT: A recent study completed by a major institutional note investor says this: if we placed an immediate moratorium on all private notes where no more were created, at the current rate of buying, there is *seven years* of inventory remaining in the marketplace. It doesn't stop there – statistics show more notes are created every day; note buyers buy approximately $1 billion in privately held notes annually.

PART THREE

LEARNING THE TERMS

"Define your Business…"

In order for you to best understand the note business, my Texas-born Daddy would say that you and I need to both be *"singin' off the same page of the hymnal."* Let's take a few minutes and review some basic terms.

GAME HINT: When you have finished this chapter, you may want to review it because we will be using all of these terms regularly throughout the remainder of this manual. To understand the entire program, it is imperative that you understand these terms.

PAPER: You've heard about, read about it, and are ready to experience it. No, the term isn't just for the material that these words are printed on! In this case, the term *paper* refers to a couple of specific documents that represent an individual debt and the collateral that secures it. When we discuss paper, we are referring to a mortgage on a house. Banks buy and sell *paper* all the time, as do private investors.

Perhaps, as a homeowner, you are now paying someone other than your original lending institution. Notice that, even though you are paying someone different, your payment amount hasn't changed. That is because you contractually locked yourself into that payment when you signed the original note, or I.O.U.

NOTE: A note is nothing more than an I.O.U. (of course, in Texas, we refer to them as *I.O.Y'alls…).* The note is the evidence of the debt. In lending, a buyer (also called the *payor*, *mortgagor*, or *Trustor*) acknowledges his debt to the lender by signing an I.O.U., which is called the ***Note*** or, in some states, the ***Mortgage Note.*** The simplest form of a Note is a dollar bill; it is the U.S. Government's *promise to pay* upon demand. A personal check is another very common form of a promise to pay, or a note.

Every note includes several components: the amount borrowed (**PV**), the interest rate (**I**), the number of payments allowed for repayment (**N**), and the actual payment amount (**PMT**).

MORTGAGE / DEED OF TRUST: The mortgage is the **security instrument** for the debt. In other words, this document gives the lender the right to take back their collateral (the house) if the payor decides to stop paying. I heard a closing agent succinctly describe a mortgage as the document that says, "*You don't pay, you don't stay.*" Funny, she was from Texas, too… Seriously, I can think of no better way to describe a mortgage.

The mortgage is filed at the County Recorder's office, and becomes part of public record. It you ever want to find notes for sale, the County Recorder's office is a great place to start, because all real estate notes have mortgages attached to them (or should, if the lender wants any leverage against the borrower). The mortgage is the document that gives the lender, or the seller, if he is the one carrying *paper,* the right to ***foreclose*** (more about that in a minute).

Who are the players?

In all real estate financing, there are two major sets of players: those who are *paying* the payments, and those who are *receiving* the payments. Depending on the state and local custom, the *payor* is also known as the *Grantor*, *Mortgagor*, or *Trustor*. Just remember, all of them end in "or."

Members of the other set, those who receive the payments, are known as the *Payee*, *Grantee*, *Mortgagee*, or *Beneficiary*. In this case, all of those receiving the payments end in "ee."

Now I know that you are pretty sharp, and have, by now, figured out that the word beneficiary doesn't end in "ee." You're right. In a state where the Deed of Trust is the main security instrument (v. a mortgage), the players are the person making the payment (the *Trustor*), the one receiving the payment (the *Beneficiary*), and the guardian of the trust, the person with the power to foreclose, the *Trustee*. But hey, beneficiary *sounds* like it ends in "ee…"

FORECLOSURE: Many of my real estate students say they would like to get involved with foreclosures. *(I advise them to stop paying their mortgage…)*

OK, so the jokes haven't gotten any better, but there are certainly a *lot* of things that are better than foreclosure. A foreclosure is the Lender's act of taking back the property in lieu of payment. Each state has its own foreclosure laws. In some states, if the payor stops making payments, the lender can have the house back in as little as 21 days. In other states, this procedure may take up to two (2) years.

I bring up foreclosures because they are the Note Investor's only remedy should the payor stop paying. If you, too, plan on investing in notes, you should also be aware of the foreclosure laws in your state, and how your state's homestead and bankruptcy laws affect them. Fortunately, my company has had to foreclose on very few notes in the last eight years; we credit this to the effectiveness of our up front homework, or due diligence.

LIEN POSITION: This is a very important concept, because the position of the lien affects the ability of the lien holder to foreclose. Let me repeat that in simple English: When a lender (or seller) accepts an I.O.U, he immediately securitizes it by filing the security instrument (mortgage or deed of trust) as a matter of public record. When this happens, that action puts a *lien* against the title of the property. In other words, the borrower cannot give clear title to someone else before paying off the note, or, *satisfying the lien*.

When a lien is in first position, it means only that the lien holder (person receiving the payments) got to the Recorder's office *first*. A first lien has priority over all liens that come after it, or that are *subordinate* to it.

EXAMPLE: If you were to sell your house today, you might find buyers who qualify with a traditional lender for a mortgage, but who may ask you to carry a small balance as a second mortgage. The lender' first lien mortgage takes precedence over your second lien mortgage. If the payor falls behind on their payments to you, you would, in order to foreclose, need to keep the first lien's payments current. On the other hand, if the first lien holder wanted to foreclose, they could totally wipe out your position, unless you had the cash to pay them off.

LOAN TO VALUE (LTV): Also known as LTV, this concept has to do with the amount borrowed by the payor divided by the value of the property. LTV is a great indicator of risk, too. Let's say that you want to buy a $100K house, and have only $5000 in cash for a down payment, hoping to borrow the rest from a lender. In this instance, you would be borrowing

$95,000, which would represent 95% of the value of the property, or a **95% LTV** (95,000 ÷100,000=95%)

The Note Investor's risk is directly proportionate to the LTV on the property. The higher the LTV, the less the borrower has invested and the greater the risk of default. Hey, if, and when, things go bad, the buyer has a lot less to lose than if he had put down a larger sum of money.

COMBINED LOAN TO VALUE (CLTV): Sam Seller sold his free & clear $100K home to Barbara Buyer and carried an $80,000 mortgage; we would say that the **LTV** is 80%. If she put $20,000 down on the house, she would have 20% ***equity*** in the home. If the seller carried a 1st lien for $80K (which he then sold), a 2nd lien for $15K, and got $5K in cash from Barbara for the down payment, we would say that Barbara's Combined Loan to Value (**CLTV**) is 95%, and her equity is 5%. **[80%** first lien + **15%** second lien + **5%** down payment = **80/15/5 = 100%]**

ASSIGNMENT: Now let's say that the lender is running out of money. Seems inconceivable, doesn't it? When you think about it, though, you realize that even though lenders have very deep pockets, those pockets aren't infinitely deep. In other words, at one point, the money is going to start running out. Here's how the lenders generate more cash:

When a lender loans money, he, in effect, is assigning the right to receive *cash flow* in exchange for *cash*. Running low on cash means that he has accumulated a lot of receivables in the form of mortgage notes. Now he is 'mortgage rich' and 'cash poor'. In order to reverse that situation, he sells those notes to someone else, this time assigning the right to receive payments (the cash flow) for cash. In other words, he exchanges ***cash*** for the right to receive ***cash flow***.

Even the big boys play the game…

This happens all of the time on the secondary market. Countrywide Lending (SPECIAL NOTE: Countrywide Lending was purely a random choice; we could have chose *any* major lender) makes loans for $100 million, then turns around and sells those loans to Wall Street for $100 million plus some profit. Now they have the $100 million back in their pocket to loan out all over again. Private sellers who have carried financing may also exchange *their* cash flow (right to receive payments) for cash.

When Countrywide (or even our example seller) sells their notes, they assign the right to receive payments to the entity buying the note. It is kind of like endorsing a check to someone else: when someone writes you a check, you have the right to receive that payment. When you endorse that check to someone else, you are *assigning* to him the right to receive that payment. The same holds true for notes.

GAME HINT: We are looking for privately held notes *only*, <u>not</u> for notes that are being sold by a bank or lending institution. Though they also sell notes, most lending institutions are not accustomed to selling their notes at a discount.

INVESTMENT TO VALUE (ITV): Contrary to **LTV** (what the borrower pays), the **ITV** reflects what the investor *invests* in relation to the value of the property. For instance: let's say that the $100 million that Countrywide is carrying is backed by $120 million of real estate. Their ITV on their loan portfolio is 80% (100/120 = 80%). If Wall Street pays more for those notes than their face value, their ITV will be higher than 80%. On the other hand, if Wall Street buys those notes at a discount, their ITV will be less than 80%.

DISCOUNT: Why in the world would a private seller offer to sell his/her note at a discount? In other words, if a seller were owed a principal balance on the note of $96,000, why would he take less than that in cash?

The answer is quite simple. When a seller carries back financing, he is agreeing through the terms of the Note to receive periodic (usually monthly) payments over a long period of time. In many cases, he would much rather have the cash now; he would rather have less cash in hand now than wait for more cash spread out over 30 years.

Think about it… If I offered you a dollar a year for the next ten years, or eight dollars today, what would you choose? My guess is you would choose the latter, because of the Time Value of Money – money is worth more today than it is in the future. Speaking of future, I see more about the time value of money in yours…

TIME VALUE OF MONEY: This concept merely states that money is worth more today than it will be in the future. You could also think about the reverse of this concept: money is worth less today than it was 10 years ago. To prove this, just think about the price of homes (or gas, or eggs, or…) 10 years ago and compare that with today's price.

In the Paper Game, we use the Time Value of Money to talk about why a person would take a discounted lump sum now rather than receive payments over time. It's kind of like the lottery in most states: if you win $30 million, you can choose to take $1 million a year for the next thirty years, or, you can have $18 million now. Some people prefer the cash now…as do sellers who are selling their notes.

YIELD: This is another term that applies only to the Note Investor. When a person borrows money, his cost of renting that money is known as *interest*.

GAME HINT: *Interest* is what a person *pays*, *yield* is what an Investor *receives*.

The best way to illustrate this is with an example:

Example: You decide to loan Fred, your neighbor, $1000 dollars. He agrees to pay you only the interest (you charged him 12%) every month for the next year, at which time he still owes you the principal balance of $1000. Meanwhile, you have profited a whopping $10 per month, or $120 for the entire year. He is paying interest of 12%; you are receiving a yield of 12%.

Eight months into the deal, you are tired of getting only $10 per month, wanting all of your money back now. Fred can't afford to pay you $1000 now, nor (you secretly suspect) will he be able to do so in a few months as agreed. Along comes Nancy Note Buyer – someone who is willing to give you cash in exchange for your cash flow. She offers you $920 for your note – you accept.

You took a small discount, selling the $1000 note for $920, yet at the same time, you had already recaptured $80 in payments, and you really wanted all of your money back…now! Nancy now has the right to receive $120 per year, but instead of having $1000 invested, she only has $920 invested. By investing less and still receiving the same monthly payment, her yield is now higher than 12%. In other words, she gets $120 per year on her $920 investment. Fred is still paying 12% interest, but Nancy Note Buyer is now receiving a 13.07% *yield* on her money.

PART FOUR

SETTING UP THE GAME BOARD

"For things to change, I must change…"

In order to best explain the concept of a privately held mortgage, let's enlist the help of a couple of people: *Shirley Seller*, the seller of a property located at 123 Elm Street, and *Bill Buyer*, the eager but unqualified buyer of the property. Later on, we will introduce the third character in our scenario, *Nancy NoteBuyer*. Keep in mind that I will be using a lot of the terms I introduced in the last chapter. Remember what I said about ***preview***, ***review*** and ***do***?

The stage is set…

About three years ago, Bill Buyer came to Shirley Seller and wanted to buy Shirley's house. Shirley readily agreed – after all, Bill offered her the full asking price of $140,000. There was one catch, however. Had this been a traditional transaction, Bill would have come up with a down payment, and then gone to his local lending institution to borrow the balance. Like I said, this transaction wasn't traditional.

In fact, Bill didn't qualify at his bank, even though he was willing to come up with $30,000 for a down payment. Shirley took heart; $30,000 was about all she needed at the time, and she agreed to let Bill owe her the balance of $110,000. They worked it out where Bill would pay Shirley every month instead of the bank.

SPECIAL NOTE: Notice that no money exchanged hands except for the down payment. Shirley Seller didn't exactly *loan* Bill the money; instead, she carried a mortgage, and Bill merely owes her the *equity* to which she was entitled.

Now even though Shirley was generous, she wasn't stupid. She knew that she could have gotten a decent return on her money had she received it all to invest. Instead, she invested her *equity* back into the property and in Bill, and charged Bill 10% interest. Bill agreed to pay back the $110,000 over a 30-year period in monthly installments of $965.33 per month. This was also a fairly good investment for Shirley. The money owed her by Bill represented only 79% **LTV**, and because he had $30,000 of his own money invested, Bill was unlikely to walk away if things got tough.

Well, three years have gone by, and a lot can happen in three years. For whatever reason, Shirley has decided she needs some cash now. In fact, she really just wants to get the cash out of her note and relieve herself of any responsibility relative to collecting the payments, etc. She reads an ad in the newspaper ("Cash in a Flash – Receiving payments on your mortgage? Call Nancy at 555-1234") and does just that…she picks up the phone and calls Nancy NoteBuyer.

Enter…stage right!

Enter *Nancy Notebuyer,* master note buyer, and all around problem solver. Speaking with Shirley, and more important, *listening* to her, she begins to get a sense of Shirley's needs.

Nancy efficiently gathers all of the pertinent information about the note, filling out her Investor's worksheet *completely*, *accurately*, and *legibly*. She now knows that the current balance owed on the note is $107,966.81, which means if Bill were to refinance or sell the property today, he would still owe Shirley $107,966.81. She also ascertains that Shirley wants to sell the whole note, and get *"as much money as possible"* for it. Nancy suspected as much…after all, don't all sellers say that?

Undaunted, she faxed the information to her Note Investor (a company like my company*),* who came back with a price. My company, SMI, agreed to buy the remaining 324 payments (remember, it has been three years since the note was created: 360 – 36 = 324) at a 12.5% yield, paying $89,444.67 for the right to receive them. Now Nancy started thinking a bit, and began to be creative.

Whose money is she using?

Nancy knew that when the Investor offered $89,444 for the note, they would buy the note with their money. She didn't need any money of her own to close on the transaction – the Investor would supply it. She also knew that her profit was represented by the difference between what the Investor was going to pay, and what she would offer Shirley. Here's what Nancy did:

Nancy went back to Shirley, and told her she had ***great news***. Her investment group was willing to invest $85,000 for the right to receive the remaining 324 payments. She pointed out to Shirley that she had already received 36 payments of $965.33 (totaling $34,751.83), plus a down payment of $30,000. Her investment group was bringing an additional $85,000 to the closing table. When it was all said and done, Shirley, she pointed out, would have received a total of $149,751 for the sale of her $140,000 house!

GAME HINT: Nancy put these numbers in writing for Shirley to make it easier for her to understand them:

Money Received:	$ 30,000	(from the down payment)
	$ 34,751	(36 payments @ $965.33)
	$ 85,000	(from SMI @ note sale closing)
Total Received:	$149,751	(total cash for her $140K home)

She told Shirley the basic benefits…

Nancy certainly was not the dullest pencil in the bunch, either! She stressed the benefits to the seller, without getting into details about yields, ITV's, etc. *She told Shirley what time it was, not how to build a clock.* She also managed to put $4,444 into her pocket for just doing the deal.

"Wait a minute, Jayme. How did she do that?"

The process was really very simple. Here are the five simple steps Nancy took:

1. **She Gathered the Information, putting it onto a Note buyer's Worksheet.**
2. **She sent the worksheet to her Note Investor for Pricing.**
3. **The Note Investor communicated to Nancy what they were willing to pay for the note.**
4. **Next, she subtracted her profit from the Note Investor's price, and negotiated the lower, adjusted price with the seller.**
5. **At closing, the investor gave the seller the price she had agreed on, and gave Nancy the difference.**

GAME HINT: Nancy made money by using someone else's money (that of her investor). Here are the numbers:

$89,444	(SMI pay price for remaining 324 pmts)
$ 4,444	(Nancy subtracted this for her profit)
$85,000	(Nancy's offer to the seller).

When the deal funded, SMI sent $85,000 to the seller, and $4,444 to Nancy.

To put it simply, this entire concept is the basis of *flipping* notes. Once again, let's review the five simple steps to buying an existing note:

THE FIVE STEPS TO BUYING EXISTING PAPER

STEP ONE:	**Gather Information**
STEP TWO:	**Send to Investor on a worksheet**
STEP THREE:	**Investor prices deal to you**
STEP FOUR:	**Subtract your profit**
STEP FIVE:	**Offer seller the adjusted price.**

Write down those steps – they make up the nucleus of your new Note based income strategy! Now then, let's learn the Rules of the Game and discuss some *basics* before moving on…

PART FIVE

LEARNING THE RULES

"The seller has options…"

Note Basics…

To recap (there's that repetition again!): When we, in the industry, refer to a ***note***, we are basically talking about a receivable that was "carried" back by a seller when he sold his home. In other words, the buyer of the property, instead of going to a bank or lending institution to borrow the money, went to the seller and said, "Can I just owe it to you?" The ***note*** was created, and now the buyer is making payments to the seller every month instead of to a bank. Because the seller is now receiving payments, he has something of value that he can sell.

Why would the seller sell the note?

There comes a time in the life of many sellers when they tire of receiving those little monthly payments over a long period of time, and would really just rather have the cash. Often, they have a specific use for the cash – maybe there are bills to pay, or higher paying investments that need a cash infusion, or… Of course, in many cases, the seller didn't want to carry the note in the first place, but did so to facilitate the sale of the property. As we've discussed, when giving someone cash NOW for the right to receive payments over a period of time, the **Time Value of Money** comes into play.

GAME HINT: The *buyer* of the property cannot sell the mortgage. He is the one *making* the payments, not *receiving* them. Only the seller, who is *receiving* the payments, has an asset that may be sold.

When we talk about a note, we are really referencing three major elements:

1. The **I.O.U.,** which is the evidence of the debt. This may be referred to as the mortgage **note**. It is executed by the person making the payments (usually called a mortgagor or grantor) in favor of the seller. In other words, the payor owes the seller money.

2. The **collateral** or **security instrument**, which is the actual **mortgage** or **deed of trust**. This is the document that basically says to the borrower: "You don't pay, you don't stay!" This is the document that is filed at the courthouse, and is a matter of public record.

3. The third element is called "**clear title**." In other words, if the property does not have clear title, then an investor's investment (the money they have in the note) is basically unsecured. This is not a good thing!

Collectively, we refer to these items as the **note**, or as buying **paper**. Easy enough? It gets better…

PARTS OF A NOTE…

There are five parts to every note. They are:

- **Present Value (PV):** This is often called the "face" amount of the note. It is the amount that the payer originally "borrowed" from the seller, and is also referred to as the *principal balance* of the note.

- **Number of Payments (N):** In the United States, most mortgages are "amortized" over thirty years, or 360 months. This is the time allotted to pay back the note. On a full amortization, the loan, along with corresponding interest, is paid in full at the end of that time.

  Each payment in an amortized note consists of part principal as well as part interest. In other words, each payment consists of interest as well as principal payback. Unfortunately, the payor is paying mostly interest, especially at the beginning of a note. Only in the last eight years of a 30 year note does each payment consist of more principal than interest. At the end of the term on a fully amortized note, nothing else is owed. The *future value* is 0.

- **Interest (I):** The interest rate reflects the amount of "rent" the payor pays for the money. Oftentimes, in an "interest only" loan, this "rent" is the only thing that is paid. At the end of the term on an interest only note, the payor still owes the full principal amount. (see the earlier example about loaning the neighbor, Frank, $1,000.)

- **Payment (PMT):** Determined by a combination of the three items mentioned above, this is the amount the payor is responsible to pay every period (usually every month). The payment will go ***up*** if the interest rate is raised. It will also go ***up*** if the amortization period is shortened. It will go ***down*** if either the interest rate is lowered, or if the amortization period is lengthened.

GAME HINT: It is very important that you know this. If you are ever interested in creating your own paper for sale, whether through the purchase of notes or of real estate, it is imperative you know how payment is affected in relation to the variables, interest, principal value, and term.

- **Future Value (FV):** If a note is fully amortized over a certain period (let's use thirty years), the value of the note at the end of the term will be zero. In other words, a fully amortized note has a future value of zero.

  There may be instances, however, where the seller did not want to wait for the full amortization period (30 long years), and would like to get the balance of his money in a few short months. If there comes a time in the mortgage when a lump sum, or even the entire remaining balance, comes due before the amortization term, we refer to this as a *balloon*.

Example: Imagine that you are a seller contemplating carrying paper for a prospective buyer. The buyer wants to keep the payments low, so you agree to a longer term, or amortization. On the other hand, you don't want to wait a long time for your money. You compromise: you allow the longer amortization and lower payment, but you make the entire amount due in five years, by putting in a balloon.

FV is another way of figuring what the note will be worth at a specific time in the future (Example: What is the payoff after five years?).

WAYS TO BUY A NOTE...

Let's lay down some ground rules prior to exploring note buying methods:

1. Look at each note as a series of payments. For notes with balloons, view them as a series of small payments, plus one large payment.

2. When a note is sold, it does not affect the payor in any way, except to have him change the address to which he sends his monthly payment. The mortgage/deed of trust is a publicly recorded document; regardless of what the note investor pays for the note, the payor's obligation remains the same.

3. Institutional Investors and Lenders, like Countrywide Lending and their peers, buy ***whole*** notes. In other words, if there are 358 payments left to buy in a note, the Wall Street Gang has only one option: buy all 358 payments. We also refer to this as a *full purchase*.

4. Private sellers, on the other hand, have many different options. They can sell their entire note, or, sell only a series of payments. In other words, if the example note has 358 payments remaining, the seller has the ability to sell just a portion of those. In this case, the payor will pay the Note Investor during the time he owns the note, and will start paying the Seller again when the note reverts back to him.

EXAMPLE: Sara Seller is receiving payments on a note from Bud Buyer on a note they created two years ago. Though she created the note with 360 payments coming to her, 24 have been made (time flies when the checks roll in!), leaving her the option of selling the remaining 336 payments, or just a portion of them. She reaches an agreement with a Note Investor who is willing to buy only the next 36 payments from her.

For the next three years, while the Investor holds the note, Bud pays his monthly payment to the Investor. At the end of 36 months, the note reverts back to Sara, at which time, Bud starts making his monthly payments, once again, to her. Regardless of whom he is paying, his payment amounts never change.

When it comes to selling your note, there must be...

Fifty Ways to Leave Your Payor...

Just slip out the back, Jack! Make a little plan, Stan! No need to be coy, Roy, just... learn your options! Knowing that a Note Holder can sell only a portion of his note should open your mind to the seemingly endless ways a note purchase can be structured. I have attempted to cover the basic ones below, divided into two main categories: notes *with* balloon payments, and notes *without* balloon payments. Remember to view a balloon payment as one payment in a series of payments, only a lot larger.

WITH NO BALLOON:	Full Purchase:	-Buy *all* of the payments.
	Partial Purchase:	-Buy a *series* of payments.
	Split Purchase:	-Buy a part of *each* payment.

WITH A BALLOON:	Full Purchase:	-Buy *all* payments and *all* of the Balloon.
	Partial Purchase:	-Buy a *series* of payments and *all* of the balloon.
		-Buy a *series* of payments and *part* of the balloon.
	Split Purchase:	-Buy a part of *each* payment and *all* of balloon.
		-Buy a part of *each* payment and *part* of the balloon.

You get the picture! There are basically hundreds of ways to buy notes, depending on how much of the payment and how much of the balloon that you buy.

GAME HINT: Find out exactly what the seller needs. Only then can you exercise your creativity by structuring a note purchase that meets everyone's needs.

LTV v. ITV

The last part of our quick review includes two concepts:

- Loan to Value
- Investment to Value

Loan To Value: This is the amount that the payor *borrows*, divided by the value of the property.

Investment To Value: This is the amount that the investor *invests* in the note, or pays for the note, again divided by the value of the property. On an existing note with several payments having been made ("seasoned"), the investor usually concentrates on their **ITV**. Because there is a payment history, **LTV** is no longer that important. Therefore, a note investor may purchase a note that represents a 95% *LTV*, but because they are only buying a portion of the note, their risk, or *ITV*, may be limited to 75% of the property's value.

***GAME HINT*:** Please reread the last sentence of the previous paragraph. Do it now...this is a key concept.

Now then, let's look at the parts of a note in greater depth. You should have a financial calculator at your disposal. You can tell a financial calculator because they have the buttons that correspond to the parts of a note: [N], [I], [PV], [PMT], and [FV].

All of the people at my company use the Hewlett Packard 10B II calculator. They are easy to use – you just need to know how! Moreover, the calculator is a great tool that will help you make lots of money and create solutions for a lot of different scenarios.

PART SIX

LEARNING THE NUMBERS

"Calculating for Dollars"

It so happens that most financial calculators are very similar in function, though they may vary in particulars. I have chosen to write about the Hewlett Packard 10B II calculator for several reasons:

- I have found the HP 10B and its latest update, the HP 10B II, to be very reliable, yet inexpensive.

- It is a very simple calculator to use.

- It doesn't cost a whole lot – you can find one for about $40 or less. They are workhorses and they last! I own several (one each for my office, briefcase, and car) and no, I'm really not a nerd, just a fun person who enjoys doing deals and being prepared!

You don't need to buy anything more expensive than this. An HP 12C is a fine calculator; unless you are an engineer or a financial analyst, you will probably never use all of its functions. Texas Instruments also puts out a nice financial calculator (notice the emphasis on *financial* calculator), as does a company out of California who produces the *Real Estate Master* calculator.

Amortization

As I mentioned earlier, a fully *amortized* note is one whose payments include both principal and interest. This concept is important: an *amortized* note pays back principal with each payment, an *interest-only* note does not. So, if you are following along, you will agree that an interest-only note is probably worth more than an amortized note. Why? Think about it:

At the end of the term (let's use 30 years as an example) on a fully amortized note, the payor owes no more – the note is completely paid down to zero. On the other hand, on an interest-only note, the payor has paid only interest along the way – at the end of the term, the amount still owing would be the same amount that was originally borrowed.

For most of our examples, we are going to use the fully amortized note, as it is the most common.

Before we continue…

You may want to review the section on basics, if for nothing else than to remember that each note has **five** parts that determine its worth:

1. The amount originally borrowed, or the ***Present Value***.
2. The cost of renting the money, or the ***Interest Rate***.
3. The number of payments allotted for paying back the note, or the ***Term***.
4. The amount of each periodic (usually monthly) payment, or ***Payment***.
5. The amount of the note still owing at a certain point in the future. Also known as the balloon payment, or ***Future Value***.

The HP 10B / HP 10B II Calculators…

In addition to the regular numbered keys, you will, in all financial calculations, use specific function keys. ***These correspond to the five parts of any loan***. They are also called cells, and are best imagined as similar to the canisters you put on the kitchen counter: one for flour, one for sugar, one for coffee, and one for tea.

Each cell has a function, and when an amount is entered into a cell, the calculator "remembers" this amount until you either change that amount or you clear the calculator. Just imagine that you are putting sugar in the "sugar" jar, and not in the "coffee" jar. As long as you put the correct information in each cell, you won't have a problem. Only when you try to put coffee in the flour canister will you have a big mess when you try to bake a cake…

Cells and their function…

Now that you know that certain information goes into each cell, it may become necessary to sometimes check what you've entered. Imagine it as taking the lid off of the canister to see what is inside. This can be accomplished by using the [**RCL**], or recall key. To see what is entered in the [**N**] cell, depress the [**RCL**] key and the [**N**] key. The display will show the number that was previously entered. This works with any of the five cells.

You already know that each cell corresponds to a part of the note. Let's look at the function of each of the cells:

N This cell is for the "<u>number of payments</u>". It represents the periodic payments in a mortgage, or the number of periods in an investment. If the term of the loan were 30 years, you would enter **360** in the [**N**] cell or **30,** [**gold shift**] and [**N**] for the calculator to do the math for you.

I/YR This cell contains the "<u>interest rate per year</u>" or ***yield*** on an investment. This is your Annual Interest Rate. It can also represent your annual yield, or return on your investment. The HP calculator will automatically convert this to a monthly figure for you. If you are using a different calculator, you may need to enter this figure as a monthly one.

PV With this "<u>present value key</u>", you enter the principal amount of a mortgage or investment, representing value in today's dollars. This is part of the *Time Value of Money* axiom, which basically says that because of inflation, your dollars are worth more today, in terms of buying power, than they will be in the future. The devaluation of your dollars is directly proportional to the length of time they are outstanding. You use this key to enter either the original principal on a mortgage or loan, or to determine the present value of the loan today.

PMT Represents the periodic "<u>payment</u>" that is paid on the note. This figure includes both principal and interest. On this calculator, the <u>**payment will always be a negative number**</u>. Keep in mind that the "periodic payment" in most cases is one per month (12 per year).

FV This key represents the "<u>future value</u>" of the note or a balance at some point in the future. This key is used to calculate balloon payments and, like the payment cell, <u>**this cell should always show a negative number**</u> (unless it is 0).

Each of the five cells is unique unto itself. You will generally know information to enter into four out of the five cells. You will solve for the cell that you do not know by simply depressing that particular key. It doesn't matter in which order you enter the information.

REVIEW: This is the part where you participate!!! So…(drum roll, please…) the Five Parts of a Loan are (write in your answers here…)

> ***GAME HINT***: They correspond to the five keys on the calculator...

Write them down…

1.

2.

3.

4.

5.

WAIT! Did you write them down??? (just checking!)

Step-by-Step - Real World Examples

This section will deal with the step-by-step method of determining the ***value*** and ***yield*** on notes. Use the accompanying GRID sheets and follow along with the examples. *Write your numbers in the grid boxes that correspond to the calculator cells.*

> ***GAME HINT***: Be **SURE** and **WRITE EVERYTHING**
>
> on the Grid **BEFORE DOING ANY CALCULATIONS!!!**

The Four Steps…

There are four steps you should follow in any note transaction:

A. Calculate Payment

B. Calculate Balloon (if any)

C. Calculate remaining Balance

D. Solve for required Yield

In order to evaluate any deal, you must complete all four steps. These steps **MUST** be done **IN ORDER**, and are:

STEP 1: Calculate the Payment. Often, the note sellers are rather vague as to the exact payment amount they are receiving. Because we are buying payments, we must make sure this number is correct.

EXAMPLE: Note Amount is $80,000. The interest rate is 9%, amortized over 20 years. It is fully amortized; meaning that the Future Value after 20 years is 0, and that there is no balloon. **Now…STOP!!**

Remember: Write Everything First! Your grid should look like this.

N	**I/Y**	**PV**	**PMT**	**FV**
240	**9**	**80,000**	**?**	**0**

Now you now know 4 out of the 5 numbers. The financial calculator is pretty efficient; if you know 4 out of 5 numbers, it will automatically figure the fifth one for you. Here's how to do this:

After writing your numbers in your grid, transfer them to your calculator. First, put the number into your calculator; second, tell your calculator what that number is. In other words, put in the number, and then press the key that corresponds to the box on the grid sheet. To put in the above numbers, you would first input **240**, and then press the [**N**] key. Then put in **9** and press the [**I/YR**] key. You get the picture…

GAME HINT: Fully amortized notes are completely paid off over the term of the note. Therefore, at the end of the term, their future values (FV) will always be zero.

When you told the calculator four out of five things (in the case of our example, you have told it the N, I, PV, and FV), all you need to do is solve for the fifth. In this case, just solve for **PMT** by pushing the PMT key. Your answer will be:

-719.78

Now, **DO NOT** change *anything* on the calculator! **(Do Not** pass go, **Do Not** collect $200, and **Do Not** clear the calculator!) The calculator remembers everything in its cells – we're going to use this to our advantage.

STEP 1A: Calculate Current/Remaining Balance. I know, I know! I said that step two is to calculate the balloon. If there is not balloon in a note, this *is* our next step! To find the remaining balance (or present value), subtract the payments made from the original amount of payments, and put the answer into the [**N**] cell. Solve for [**PV**].

EXAMPLE: Carrying over the previous example - the Note Amount is still $80,000. The interest rate is still 9%, and it is still amortized over 20 years. Amazing! It is fully amortized, meaning that there is no balloon. Now, 15 months have elapsed, and 15 payments have been made. What is the **P**resent **V**alue of this note??

	N	I/Y	PV	PMT	FV
step 1	**240**	**9**	**80,000**	**?**	**0**
step 2	**225**	**9**	**?**	**-719.78**	**0**

Note that all of the cells remain the same, except [**N**]. All you need to do is change the number of months **(N),** and solve for [**PV**]. Your answer should be:

$78,105.83

> ***GAME HINT:*** The word *Amortize* comes from the Latin word *Amorte*, meaning *Death* (pleasant, huh?!). A fully amortized loan is one that is literally "*carried to the death*." No balance remains at the end of the term.

STEP 2: <u>Figure the Balloon.</u> Remember, this applies ONLY when there is a balloon in the note.

Balloon Notes: When running the numbers on a note that has a balloon, you must first figure the payment, putting **0** into [**FV**]. The payment is based on the full amortization. Then (step 2), you need to put into [**N**] the number of payments before the balloon, then solve for [**FV**]. Your answer (the balloon) represents the principal amount still owed on the note after those payments have elapsed.

EXAMPLE: Using the previous figures, let's do a new example and put in a ***10-year balloon.***

> ***SPECIAL NOTE:*** Warning, Will Robinson! This is a new example – be sure and clear your calculator before moving on.

Your grid should appear as follows:

	N	I/Y	PV	PMT	FV
step 1	**240**	**9**	**80,000**	**?**	**0**
step 2	**120**	**9**	**80,000**	**-719.78**	**?**

> ***GAME HINT:*** Changing the number of months to 120 and solving for **FV**, your answer will read: **-56,820.71**

In other words, after 120 payments have been made on this note, there will still be an outstanding principal balance of **$56,820.71.**

STEP 3: Calculate the remaining balance. All cells remain the same; merely recalculate [**N**] and solve for [**PV**].

13 payments have been made, so we change the [**N**] key to **107**, and solve for **P**resent **V**alue. Our grid (your grid!) should now look like this:

step 3	**107**	**9**	**?**	**-719.78**	**-56,820.71**

GAME HINT: After 13 payments have been made, the **Present Value** of this note, with **107** payments and a **$56,820** balloon payment remaining, is: **$78,370.81**

STEP 4: Solve for required yield. All of your cells will remain the same. You merely need to put your desired yield rate into the [**I/YR**] cell, and solve for [**PV**]. The answer will show you what you can pay for this particular note to achieve your desired yield.

Let's say that you want a 16% yield on your money by investing in this note. Your grid should now look like this (of course, yours should have the answers filled in):

	N	I/Y	PV	PMT	FV
step 1	**240**	**9**	**80,000**	**?**	**0**
step 2	**<u>120</u>**	**9**	**80,000**	**-719.78**	**?**
step 3	**<u>107</u>**	**9**	**?**	**-719.78**	**-56,820.71**
step 4	**107**	**<u>16</u>**	**?**	**-719.78**	**-56,820.71**

If you have followed along correctly, you have now figured out that in order to achieve a 16% yield on your money, you can only pay:

$54,671.23

Look carefully at the above line. It tells you that if you invest $54,671.23, you will receive 107 payments of $719.78, and one balloon payment of $56,820.71, which will, over that period of time, return a 16% yield.

Let's recap the previous example. The steps were:

Step 1: <u>Calculate Payment</u>

Step 2: Calculate Balloon

Step 3: Calculate Remaining Balance

Step 4: Solve for Desired Yield

Your Grid should look something like the following (keep in mind that the numbers we changed are underlined, while the ones we solved for are in **BOLD**):

N	**I/YR**	**PV**	**PMT**	**FV**
240	9	80,000	**-719.78**	0
120	9	80,000	-719.78	-**56,820.71**
107	9	**78,370.81**	-719.78	-56,820.71
107	16	**54,671.23**	-719.78	-56,820.71

REVIEW: Here's that participation part again!! The steps you should take in evaluating a note are, in order:

Write them down...

1.

2.

3.

4.

GAME HINT: Each time you progress to the next step, you only need to change one cell in the calculator, then solve for the unknown!

Some final thoughts…

When working with the calculator, just take your time. If you don't totally *get it* right now, you will eventually. I know a great couple that is very successful in the note business, working together out of their home. Mrs. T. (no names here – sorry!) does all of the processing, structuring and information gathering. Mr. T. does all of the marketing and the negotiating. This is a great arrangement for them, as Mr. T. still hasn't figured out how to make the calculator work!

The Time Value of Money…

Remember, too, the **Time Value of Money**. People take a discount on their notes because they would like cash now rather than small monthly payments over a period of time. When I first moved to Texas, I negotiated with the seller of a $30,000 home, which I was able to pick up for $18,000. He, along with his brothers, grew up in the house, and had since rented it out for $250 month. Yes, that meant that each brother received $80 per month, and the third one received an extra $10 per month for dealing with the problems of tenants and toilets.

I explained that I was a real estate investor (they had called on an ad I had placed saying that I bought mortgages…I got a house instead!), and would need to buy it at the right price. I offered to put $6000 into each of their pockets within two weeks. They said yes!

Think about it for a minute. What would you have done, when faced with the two options? Would you have kept the $80 per month, or would have taken the $6000 that was behind Door Number Two? They were happy, and my partner and I picked up a $30,000 house for $18,000.

The Cash Flow Business…

Real estate notes aren't the only things you can buy at a discount, using the time value of money. There are many companies who carry a lot of receivables. They need cash instead of receivables, and so are willing to sell them at a discount. In other words, they'll take less cash now in exchange for more cash trickling in over the long run. There are also buyers out there who will exchange cash now for the right to receive insurance annuities, judgments, structured settlements, and…lottery winnings.

There is a lesson to be learned here. Speaking of lottery winnings, there are statistics showing that a high percentage of lottery winners declare bankruptcy within the first three years. I have a friend who sold her house on a lease option (lease with an option to buy) to one of the State Lottery winners. They gave her a large down payment, and didn't pay her again for 8 months. They were such poor money managers that they had to sell their future earnings in exchange for a discounted cash amount now.

GAME HINT: If you can't make money *without* having money, chances are you won't be able to make money when you *have* money.

PART SEVEN

PLAYING WITH A FULL DECK

"The Note, the Whole Note, and Nothing but the Note…"

You will encounter many situations where the seller wants to sell the entire note; something we call a *full purchase*. A full purchase may not always be the best option for the seller because the discount is so readily perceived. Before going on, it is imperative that we are clear on one thing:

The difference between the note rate and the Investor's required yield rate represents the discount.

In the "good ol' days," Note Investors based their pricing on a whim, often putting in a standard discount without any evaluation. If a seller wanted to sell his note, the usual discount was 25%, which meant that a $100K note sold for $75K. This was obviously a pretty steep discount, and predicated the standard customer question, "How much is your discount?"

As the industry began to be more competitive in the early 1990's, Investors started to buy notes based on their *yield*, or a rate of return on their money. In order to offset risk and allow for a decent profit margin, many investors at that time had a 13% standard yield rate, which increased, as the risk got higher. If a seller had a note for sale that was secured by a nice house but had a lousy pay history, chances are the Investor would require a 14% yield. Let's compare a couple of different notes. The first note will have an interest rate of six percent (6%); we will buy it at a 12% yield. The second note will have an interest rate of 11%, which we will also buy at a 12% yield. Note the differences:

NOTE NUMBER ONE:

Our first step is to define the note. You are looking at a $100K note, fully amortized over thirty years. This means that the note will have fully paid off and have a zero balance after those 360 months have elapsed.

N	**I/YR**	**PV**	**PMT**	**FV**
360	6	100,000	-599.55	0

If we were to buy that at a 12% yield, we, in effect, are trying to determine how much money we would pay for the note in order to get that rate of return. We know it will be less than the face value of the note; we just don't know how much less. We know that we want a 12% yield, and that we are buying the full note. Therefore, we also know we will not be changing any numbers in the calculator except the yield.

> ***GAME HINT:*** When you go to each successive step in the calculations, do NOT re-enter all of the information. The calculator remembers what you have put in the individual cells. Change *only* the pertinent variable, and solve for your new number.

Here's how the numbers change:

N	I/YR	PV	PMT	FV
360	6	100,000	-599.55	0
360	**12**	___?___	-599.55	0

Changing only the [**I/YR**] key to our desired yield, we have only to solve for [**PV**] to figure out how much we can pay. If you have followed along on your calculator, you'll find that answer to be **$58,287.30**. That's a HUGE discount! And the reason is? You're right – the distance between 6% interest rate and a 12% yield is substantial.

NOTE NUMBER TWO:

Okay, let's look at a second note. We will also buy this one at a 12% yield (it's the base return we need on our investment); only this time the note will have been written at 11%. Let's see how they compare:

N	I/YR	PV	PMT	FV
360	11	100,000	-952.32	0
360	**12**	___?___	-952.32	0

Notice how much bigger the monthly payment is at the higher interest rate. If you were to find a note written at 11% and you wanted to buy all of the payments and receive a 12% yield, how much would you pay? If you figured **$92,583.29**, you are correct. In other words, you will receive a 12% return on your money if you invest $92,583.29 for the right to receive 360 payments of $952.32.

Looking at an example…

Let's talk about two examples of a full purchase, or, buying all of the remaining payments. On new (unseasoned) notes, the number of remaining payments will equal the term. On seasoned notes (where payments have been made), the number of remaining payments will be the original term less the payments that have already been paid.

Before we get into the actual numbers, let's take a minute and discuss the merits of a full purchase. The *upside* is that you are taking the note completely out of the hands of the seller, who has no future liability, nor any future responsibility. His ownership ends here.

> ***GAME HINT:*** Most Note Investors buy their notes on a non-recourse basis. This means that once the seller relinquishes his interest in the note, the Note Investor assumes all responsibility. If, for whatever reason, the payors stop paying four months down the road, the seller has no liability whatsoever. In other words, the Investor has no ***recourse*** to the seller.

When to suggest a full purchase…

We've already discovered that there are multitudes of ways to purchase a note, buying a part here and a part there. Why in the world would the seller want the to sell the whole thing? Here are some reasons:

- The seller is tired of collecting the monthly payment. (***Hint:*** This should raise a red flag, as maybe the payments are hard to collect or in arrears.)

- The seller needs all of his/her cash now.
- The note is a part of an estate, or a divorce settlement.
- The seller doesn't know that he has the option of selling a series of payments, which will give him less cash now, but more in the future. *(More about this concept in the next chapter…)*

The Full Purchase Technique…

The full purchase is probably the technique that is easiest to grasp. The seller agrees to sell all of the remaining payments to the investor. You take your profit out of the middle, subtracting it from the Note Investors Price, and offering your seller the balance.

At the closing table, the entire note is transferred to the Investor. No smoke, no mirrors. The seller assigns the right to all future payments to the Investor in exchange for cash. He signs an assignment (kind of like endorsing a check) of the note, as well as an assignment of the security instrument (mortgage or deed of trust). The Investor brings the money; the seller gets what he agreed to, and you get the balance.

Is it live, or is it Memorex?

This is a very straightforward deal. You, the note buyer, have found an existing note that was created about two years ago. In other words, the house sold two years ago, and at that time, the buyer gave the seller an I.O.U. for $125K, with an agreement to pay him back in monthly installments at the rate of 9% interest over the next 240 months. Twenty-four months have elapsed since that transaction; the buyer has made all of his scheduled payments during that time.

Granted, you will need to gather some information about the note in order to evaluate it, or have your Note Investor evaluate it. You will find that sheet, along with its instructions, later on in the manual. In the meantime, let's concentrate on the concepts and the numbers. Here's how we would look at that note:

The numbers:

When a seller tells us the specifics of a note, our first job is to verify those numbers. The easiest way to verify numbers is to put them in our calculator grid sheets (one at the end of the chapter), and then transfer them to our calculator. If we did that, we would have:

STEP ONE: Figure the Payment

N	**I/YR**	**PV**	**PMT**	**FV**
240	9	125,000	?	0

FV is zero because the note is fully amortized. Checking the seller's numbers, and solving for **PMT**, we are able to verify that the payment is **$1,124.66**. It should be a negative number. Now your grid will look like this:

N	**I/YR**	**PV**	**PMT**	**FV**
240	9	125,000	-1,124.66	0

STEP TWO: Figure the current balance.

We know that 24 payments have gone by, and that we need to determine how many are left for us to buy. In other words, what is the Present Value (PV) after 24 payments have been made? To figure this, merely subtract the paid payments from [N], and put the adjusted figure back into [N]. Then, solve for [PV]. In other words, we had 240 payments to start with, of which 24 have been made. This leaves us with 216 payments remaining. Your grid should now look like this:

N	**I/YR**	**PV**	**PMT**	**FV**
240	9	125,000	-1,124.66	0
216	9	?	-1,124.66	0

Notice that we haven't changed any other numbers except [N], and that we are solving for [PV]. If you do that, you will find the current or Present Value to be $120,098.63. Keeping in mind that I have made the changes in **bold**, and underlined the answers, your grid will now look like this:

N	**I/YR**	**PV**	**PMT**	**FV**
240	9	125,000	-1,124.66	0
216	9	120,098.63	-1,124.66	0

What does this mean?

This means that, after paying 24 payments on this amortized note, the payor still owes $120,098.63 on this note. Remember when I said that each payment includes some principal and some interest? It should be obvious that most of the payment goes toward interest.

After making 24 payments of $1124.66, which is approximately $27,000, the payor has only paid down his principal by about $5000. If he were to refinance or sell his house today, he would still owe the original seller $120,098.63. This is his *payoff*. In other words, of the $27,000 in payments, $5000 went toward paying down the principal; $22,000 went toward interest. Whoever figured out the amortization tables can never be accused of being dumb!

***GAME TRIVIA*:** The famous humorist, Will Rogers, once said of bankers, "They are the type of people who will give you an umbrella when the sun is shining, and want it back when it starts to rain." And even though I am, technically speaking, a banker, there is certainly both humor and truth in this statement!

STEP THREE: Figure the pay-price based on a 14% yield.

You know that you, or your investor, want a 14% return on his money. This step takes that knowledge in account by changing [**I/YR**] to 14%, then calculating for the present value [**PV**]. The resulting answer determines how much money the investor can pay in order to yield 14% when receiving the remaining 216 payments of $1124.66. Here's how the grid should look:

N	I/YR	PV	PMT	FV
240	9	125,000	-1,124.66	0
216	9	120,098.63	-1,124.66	0
216	**14**	**?**	-1,124.66	0

Solving for [**PV**] your answer will be **$88,529.00**. That is all of the money you (or your investor) can invest in order to receive a 14% yield. Doesn't this look like a large discount to you?

Let's cover two more items:

- Why is this discount so big?
- What will you offer the seller?

Why is this discount so big?

If you remember from the example earlier in the chapter, you learned that the difference between the face rate of the note and the required yield rate represents the discount. The numbers 9 and 14 are miles apart when it comes to figuring yields; had this note been written at a higher interest rate, and had we still purchased it at the same 14% yield, the discount would have been smaller.

EXAMPLE: Had this note been written at 12%, the Investor's price would have, based on a 14% yield, been $108,341.94.

What will you offer the seller?

If you are the one investing $88,529 to buy this note, then that is your purchase price. On the other hand, if your Investor is paying $88,529 to buy this note, how will you make money? The answer is simple: subtract your profit, and pass through to the seller the adjusted price.

Jayme, how much should I make?

I get this question quite often! Unfortunately, there is no hard and fast rule. In most cases, you can make what the deal will bear. This isn't to say that you should be a pirate and rape, pillage, and plunder! On the contrary, you should always make a fair profit, one that allows you and the seller to sleep at night.

As a rule of thumb, most note brokers make three to four percent of the amount purchased. In other words, a $2500 to $3500 profit on this deal is reasonable. If the Note Investor offered you $88,529, and you wanted to make $3500, how much would you offer the seller?

Exactly! You would offer the seller a little over $85,000. And yes, it appears a lot better to the seller if you offer him just a little bit more than that easy round number. This shows that you really did calculate a number, rather than pull it off the top of your head.

PART EIGHT

PLAYING WITH A PARTIAL DECK

"A piece of pie is better than no pie at all…"

In the previous chapter, I discussed the upside of a full purchase. I didn't discuss the downside, which is a correlation of the Time Value of Money:

1. The ***more*** money the seller gets right ***now***, the ***less*** he gets ***overall***.
2. The ***less*** money he gets ***now***, the ***more*** he gets ***overall***.

In other words, suppose the seller wanted to only sell a portion of his note instead of the entire note. Remember that he has the ability, should he so choose, to sell a series of payments. This means that he will get cash now in exchange for giving up some payments; when that period has elapsed, the note will revert back to him.

Back to our example in the last chapter…

Let's say that the seller in our previous chapter wanted to go to Europe for an extended stay, and only needed $25,000 now. It certainly doesn't make sense for him to sell the entire note for $25,000. In fact (and I'll show you the numbers in just a minute) the Investor will gladly pay $27,500 (that's $25,000 for the seller and $2500 for you) for the right to receive just the next 29 payments. Better yet, when the note reverts back to the seller, the principal balance on it will still be $112,874.84. If you combine that number with the $25,000 he is getting right now, he will eventually receive $137,874 for a note that is worth only $120,098 in today's dollars!

Confused?

It's okay; I will explain everything to you in detail in just a minute. However, before I show you the actual numbers, let's talk about the advantages and specifics of this, the ***partial*** technique.

The advantages…

There are significant advantages to offering the seller only a portion of his money now. The time value of money says that the longer he has to wait for his money, the more he will get overall. In this case, he gave up 29 payments and received $25,000 for them.

For the next 29 payments, the payor will pay the Note Investor. After 29 payments have gone by, the payor will resume paying the seller directly. This is all handled at the closing table through a document called a Fractional Interest Agreement. Here's the best part: when the seller gets the note back in his possession, it will still have 187 payments remaining on it.

GAME HINT: There are 216 remaining payments that it is possible to buy. If the investor buys 29 payments, 187 revert to the seller.

The present value of those 187 payments will be $112,874.84. In other words, the seller has received, and is receiving:

24 payments, to date, of $1124.66	$ 26,991.78
Money from the Investor, for the right to the next 29 payments:	$ 25,000.00
Balance still owed on note when it reverts back to him:	<u>$112,874.74</u>
Total Monies Received for a $140,000 note:	**$164,866.52**

Why is he getting so much more than with a full purchase? Because he has to wait for the balance of his money. It's that *Time Value of Money* again!

The numbers…

Going back to our previous example, let's review the numbers:

<u>**N**</u>	<u>**I/YR**</u>	<u>**PV**</u>	<u>**PMT**</u>	<u>**FV**</u>
240	9	125,000	<u>-1,124.66</u>	0
216	9	<u>120,098.63</u>	-1,124.66	0

The difference in a partial purchase is that we are *not* buying all of the remaining payments, so we know that [**N**] will not stay the same. In fact, knowing the needs of both you the broker and the note seller, we will end up solving for [**N**]. We know that the Seller needs

$25,000 and that you, the broker, needs $2500, for a total of $27,500. We also know that the Investor still requires a 14% yield. Here's how the numbers change:

N	**I/YR**	**PV**	**PMT**	**FV**
240	9	125,000	-1,124.66	0
216	9	120,098.63	-1,124.66	0
?	**14**	**27,500**	-1,124.66	0

Solving for [**N**], we get 28.96. We can't buy .96 of the last payment, so we need to round it up to 29 payments. In other words, the Investor needs to buy the right to receive 29 payments in order to achieve a 14% yield on his $27,500 investment.

Balance Back…

I've also discussed the fact that when the seller got the note back in his possession, it would be worth $112,874.74. In other words, should the payor refinance or sell the property on that day, the seller would still be owed that amount. Here's how you, too, can figure that number:

Once we have determined that the Investor will buy the next 29 payments, and that there are only 216 remaining as of today, we can easily figure the note's value at that future point in time. First of all, we subtract the 29 payments from the current 216, and discover that when the note reverts to the seller, it will still have a balance based on 187 remaining payments at 9%.

> ***GAME HINT*:** Read the last sentence of the previous paragraph again. It is very important!

Here's how the final calculations look:

<u>**N**</u>	<u>**I/YR**</u>	<u>**PV**</u>	<u>**PMT**</u>	<u>**FV**</u>
240	9	125,000	<u>-1,124.66</u>	0
216	9	<u>120,098.63</u>	-1,124.66	0
<u>28.96</u>	**14**	**27,500**	-1,124.66	0
187	**9**	<u>112,874.74</u>	-1,124.66	0

Notice that in the last calculation, I used 9% in [**I/YR**]. Nine percent is the *face rate* on the note itself, and we are figuring what the payor owes. We no longer use 14%, because that was the Investor's yield, and has nothing to do with the payoff of the note.

When to use the partial…

I suggest using the partial technique as often as possible. Here are two major reasons:

1. The seller gets more money overall.
2. The discount is less apparent.

Word of caution: In many cases, the seller will tell you that they need, "…all the money they can get." That is great! Tell them so, but also immediately tell them that you have some options for them that they may not know. Tell them that you (and your investment group) have several different ways of structuring your purchase, and that you have a way that gives him some cash now, more later, and that, in many cases, you can buy without a discount.

> ***SPECIAL NOTE:*** In our previous example, our seller, by his willingness to wait for his money, actually received more than the note was worth.

You now know enough to fill in your own grid sheets.

PART NINE

FINDING PRETTY PAPER

Tell the world, "I buy mortgages on the secondary market."

Create a Successful Mindset…

The really good deals don't just fall in your lap; you must go out and find them. They are out there if you just know where to look. Careful and consistent attention to your marketing program will provide a sound foundation for your paper investment business. You are now setting up a multifaceted, all encompassing marketing effort specifically aimed at letting the community know you buy notes. The campaign will incorporate contacting both direct and indirect sources on a consistent basis.

It is imperative that you track all marketing methods you use to determine which methods are more productive. Constant attention to your marketing efforts will pay huge dividends. By developing a creative, all consuming drive to succeed and becoming solution-oriented, you will find yourself doing deals when others around you cannot. Develop a reputation as an honest, ethical businessperson and you will soon find yourself with a powerful referral network established, generating deals from a variety of sources. The deals will pour in and the competition will be left behind.

Marketing for Existing Notes…

There are literally millions of notes running around the country today. Let's look at some of the ways we can find the sellers of those notes and put cash in our pockets. Remember that marketing is like fishing -- if you only have one hook in the water, you're only going to catch one fish! Choose a couple of marketing techniques and work them.

The County Courthouse – When a mortgage or deed of trust is created, the original document will be recorded at the courthouse in the county where the property is located. This provides an opportunity for note buyers because when a document is recorded, it becomes public record. The person or institution receiving payments on a note secured by that deed of trust or mortgage would be noted in the document. Anyone can scan the recordings and pick out deeds of trust where an individual name is the beneficiary. The beneficiary is another name for the person receiving the payments. If you choose to get names of individuals who hold notes from the courthouse, follow these simple procedures.

1. Search the real property records for mortgage or deeds of trust where an individual is the beneficiary.
2. Copy the name and address of the beneficiary into your records.
3. Look in the "Forms and Documents" section of your manual to come up with a dynamite marketing letter to mail to these note holders.
4. Send out about 10 to 15 letters per week to the first note holders on your list. Be sure and keep track of the people you mail to so you don't duplicate your efforts with the same letter to the same people.
5. With all the information available today, try and obtain these note holders' telephone number and follow up your letter with a phone call. Your success rate will double if you follow up with a phone call.

Direct Mail Marketing Lists – For those of us who have better things to do than spend the day at the courthouse, these is another way to get the same names for a fee. Since the information on note holders is free to the public, there are companies that compile lists from public records and sell the names. The advantage to using lists is that you can specify exactly what you want and it comes sorted in alphabetical order with preprinted labels and telephone numbers. The disadvantage is that, if you can buy this information, your competition can, too!

Buying the names…

Names run about 50 to 65 cents per name depending how many you buy at a time. When you buy a list, do the same steps you would do if you had gotten the names from the courthouse yourself. Don't mail more than 10 or 15 pieces at a time or you will not be able to follow up with them in a timely manner. You should only mail 1000 letters if you can follow-up on all of them within a week.

If you want to buy a list, use the following criteria to order your names:

- First lien deeds of trust or mortgages
- The property should be single family residential only
- The deed or mortgage should be over 12 months old
- The original balance should be over $35,000

The following is a list of companies that provide list services. They are familiar with seller-financed notes and are very reputable.

➢ DataQuick	888-604-3282
➢ DMG	888-282-2122
➢ InfoUSA.com	800-321-0869
➢ AccurateLeads.com	800-685-4787

Be sure and check the terms of the list company and abide by them. Some companies will only allow you to mail to that list once. They put in dummy names to make sure you do not violate the terms of the agreement. However, they provide the telephone numbers with the list and you can call the note holders as much as you want. Personal contact is what is going to get the sale for you!

Post cards vs. letters

Post cards are less expensive to mail and you can use the preprinted name labels from the list company without it looking like bulk mail. Use brightly colored card stock to get attention and don't clutter the card up too much. Keep it simple and make sure your phone number is prominently displayed. Don't make your prospects search for your number!

Letters seem to get more response if you hand address the letter (which is time consuming and why God made teenagers) and put something bulky in the letter. For example, you are more likely to open even junk mail if you think there is a prize in it! I have seen people put in refrigerator magnets with their company name on it that add bulk or even cheap pencils with their name and telephone number printed on it. Your goal is to get that note holder to open your letter. Make it different than the rest of the mail.

Regardless whether you use letters or postcards, make sure you follow up with a phone call. The conversation should go something like this:

"Hello Mr. (or Ms.) ____________________. My name is ______________ and I am with XYZ Funding. I was at the courthouse the other day and saw in the public records where you sold a piece of property and carried back a note. I sent you a letter (postcard) recently that my company purchases seller financed notes. Did you receive my letter? (It doesn't matter if they reply yes or no.)

I was following up to see if I could answer any questions or perhaps give you a no obligation evaluation of your note. There is absolutely no obligation on your part, but wouldn't it be nice to know what your note is worth today? If you have a few moments to answer a few questions, I can give you an assessment of the value."

YOU CAN TAKE IT FROM HERE………

Telemarketing – Some people skip the letter or post card step and go straight to the phone call. It takes a special kind of person that doesn't mind making "cold calls" to make that initial call. If you look at your own experience with telemarketers, you hate it when your dinner is interrupted by unwanted calls. Sometimes the person receiving the call can be down right rude! This is why, if you choose to go the telemarketing route, you should hire some local college students to make that initial phone call for you. Your goal for them is to set appointments for you to call the note seller back. Your *cold call* then becomes a warm lead. The seller has already made a commitment to your front person that he is interested in selling his note or at least getting more information.

A good rule of thumb when paying college students is a small hourly rate plus $5 to $10 for every appointment that is set. If the deal actually closes, you can offer an incentive bonus of, say, $50 per file. Give your telemarketers a script that goes something like this:

"Hello Mr. (or Ms.) ____________________. My name is ______________ and I am with XYZ Funding. Public records indicate that you recently sold a piece of property and carried back a note. A note can be a very valuable asset and a lot of people in your situation don't realize how valuable. I am calling today to see if you are interested in cashing in your asset and to offer you a free, no obligation consultation with one of our investment specialists." (If they are interested, then set a time when you can call them back; if they are not interested, ask if they can send them some information in the mail that they can keep in case they change their mind).

GAME HINT: Don't teach the telemarketers anything about the note business. The less they know, the more appointments they'll set because they can't answer any questions!

If you are unable to find college students to set your appointments, there are professional telemarketing operations that will set appointments for you from a list you provide. However, they are considerably more expensive than the college students.

Real Estate Agents – Realtors are an excellent source of notes. Make sure they have plenty of your cards. After all, they are the ones facilitating the sales of real estate so they know when the notes are created. Realtors also have access to the Multiple Listing Service that shows properties sold and properties held for sale. Under the financing section of each property, it shows how a property was financed, including owner financing. The MLS may take a little more legwork than just buying lists because the seller of the property may have moved and probably did if the house was his primary residence. It may be difficult to track the seller down but a good telephone directory can be worth its weight in gold. Again, send them a letter and follow up with a phone call.

SPECIAL NOTE: The word Realtor is trademarked and denotes a member of the National Association of Realtors. All Realtors are real estate agents; not all real estate agents are Realtors.

Title Companies – Title companies are a great source of referral business. Anytime a property is sold or a note is sold, the transaction is "closed" or settled at a title company. Title agents will generally help a note buyer because that is another source of income for their title company. Title companies get a fee for closing a transaction and they receive 85% of the title insurance premium if a new title policy is issued.

If title insurance already exists on a note, the Investor must get that insurance updated, for which the title company receives a fee. I have had title agents call me after a note transaction was closed and say, "I know someone that had to carry back a note when they sold their property and they really need some cash. Can you help them also?"

A little *schmoozing* with an agent goes a long way! I have never known an agent to not like gifts, especially food! Cookies or doughnuts are a good excuse for you to go by their office. However, be considerate of their time. The last week of the month is extremely hectic and stressful for a title agent. Everyone wants to close their real estate transaction before the end of the month so try and make your sales calls when you know they are not quite as busy. Make sure the title agent has plenty of your cards.

Attorneys- Divorce attorneys, real estate attorneys, probate attorneys, bankruptcy attorneys: attorneys, in general, are a great source of leads for notes. Think about this; a husband and wife get divorced and in the settlement, the wife gets the house but the husband is entitled to his portion of the equity. Rather than selling the house outright, the husband sells his equity to the wife and carries back a note. That note can be purchased just like any other seller carry backed note. The divorce attorney is generally the one that drafts the documents to create the note.

Probate attorneys are always anxious to settle a client's estate, and if there are a number of seller carried notes in the mix, the attorney must find someone to purchase them. The estate must remain open until all the assets are liquidated, so you have a willing seller at your disposal. Make sure the attorney has plenty of your cards! The same can be said of bankruptcy attorneys. The bankruptcy must remain open until all the assets are liquidated. If there are any notes that are being collected, you can sure cash them out.

It's not always easy getting in to see attorneys; they are typically very busy. The best way to meet professionals is in a social setting. I have met a lot of the people I know by networking at charity fund-raisers and mixers. The local Chamber of Commerce here in my city sponsors a "Business after Hours" mixer where professional people can pay $5 to $15 dollars and network with other business people in a social setting. The American Cancer Society has a similar event that is generally held once a month, that allows professional people to network in a social setting while all the proceeds of the event go to charity. Get involved with fraternal organizations, or any other non-profit, volunteer agency. Not only are you furthering your business but you are also contributing to your community.

Retirement & Nursing Facilities – The over-55 age group is the fastest growing segment of the population; the demand for nursing and retirement facilities is at an all time high. The problem is, as it has always been, in order for Medicare to pay for these services, the retiree cannot own any property. In order to sell a home quickly, chances are they had to sell their property owner financed. What an opportunity for you! You must get to these people in order to explain what you can do for them. The best way to get to people in nursing facilities is through the administrator. Make sure they have plenty of your cards!

What about retirement communities? Planned developments, such as Sun City, are being built all over the United States, specifically with retirees in mind. A lot of the people moving south to retire in the warm weather came from the North Eastern part of the U.S. The real estate market has been hard hit in the northeast and it is very difficult to sell property without some owner concessions. Chances are a lot of the people in retirement developments carried back notes to sell their houses to get out of the snow. Each of these developments probably has a clubhouse with an active homeowners association. If you were to provide a talk at their monthly meeting as a paper specialist, you could probably provide a great service in helping them cash out their notes.

Builders, Developers and Rehabbers – Builders are interested in one objective: sell the inventory they have and move on to another project. A lot of times, they will *fire sale* the unsold houses they have left in a development in order to move on to a new location. Think about all the people in that subdivision that paid full price for their houses just to have the value decreased by the builder dropping the prices on the last few houses. I am sure they would not be too happy if a house similar to theirs suddenly sold for thousands less and brought down the value of their home.

If you could show that builder how he could sell those remaining properties for full value and still sell quickly by owner financing with you purchasing those seller financed notes, you would be a hero all the way around. Since the builder was willing to drop the prices, you know that he is willing to take a discount on the notes. By selling with owner financing, the property can still be sold quickly, at full value, which keeps the values in the neighborhood up. Get to that builder before he gets in a "fire sale" situation and make sure he has plenty of your cards.

GAME HINT: The most important concept you need to grasp about marketing is that "No one knows what you do until you tell them!" Open your mouth and shout it from the rooftops that you are a paper buyer and you are an expert at what you do. Give your cards to everyone.

PART TEN

ASK THE RIGHT QUESTIONS

"Until you know value, you know nothing."

Congratulations! Your marketing efforts have paid off, and you finally have contact from a note holder. Great! Uh…now what? This chapter gladly covers the finer points of gathering the information…

What's The Deal?

Your ***first*** conversation with the note holder should be to gather information and make sure that it is accurate. Though you don't want to put the seller through a lot of hassle just for him to get a price from you, there are going to be times when you need to see a copy of the note in order to clearly ascertain the terms.

If you ask the right questions in the right manner, you will usually be able to get the information quickly over the telephone. Remember, on the first call, all you are really trying to accomplish is to find out what they hold, and what they need in order to do the deal. The basic information you will get is:

- Property Type
- The sales price of the property.
- The down payment
- The note amount
- The terms of the note
- The date (past or projected) of the property sale

You will need one final, very important piece of information from your initial call. In fact the seller's motivation is best summed up with three vital questions:

- **How much cash does the seller need from the sale of this note?**
- **When does he need it?**
- **Why does he need it?**

The Seller's Needs…

Let's talk about those first. The amount of cash they need isn't something most people are readily going to tell you. They've been told their whole lives not to trust strangers. They've also been told that people are "out to get you" when you deal in finances. Here you are, a stranger talking to them about their finances! It is very important that you phrase things in a non-threatening way. Yet it is imperative that you ascertain them: ***there are so many ways to structure deals to the seller's advantage – how will you know what to do if you don't know their needs?***

Instead of asking bluntly, *"How much do you need?"* try engaging them in conversation by asking why they are selling the note. This will very often lead to what they actually need.

If they, for instance, tell you that they're selling the note to buy a new car, you can then respond with "What kind of car are you thinking about getting?" They will respond with the model or general type of car. You can do some research and find out the cost of that particular automobile, and determine their current needs.

They may say "My daughter is going to college in the fall and I need some extra cash." You should then ask them how much that tuition is going to be; they will usually answer you with a number. Now you know how much cash they need!

The bottom line is that they are going to respond with the reason that they are selling their note; you need to investigate further by asking questions. By being a little creative, it is easy to find out the actual dollar cost of their intended objective.

Then there are the troublemakers…

Ha! Not really, but there *will* be instances where they tell you they are just looking to see how much they can get. Yes, it is worthwhile to give them a price, because very often those inquiries will result in actual deals. The bottom line is to take the time and truly find out the seller’s needs. It is impossible to make an effective offer without some feeling for what the seller is trying to accomplish.

Now let's go back to gathering the actual information about the note so that you can give them an accurate price, and look at an essential tool, the note buyer’s worksheet.

GAME HINT: It is imperative that you fill this sheet out completely, accurately, and legibly. Do not second-guess the Note Investor: they have been buying notes a lot longer than you have, and have a very specific reason for asking this information. By the way, this information is vital to any note purchase by any investor, including the Wall Street firms.

INSERT NOTE WORKSHEET

YOUR INFORMATION

Date: The Date the Sheet is Prepared.

Contract Buyer: Most investors will assign a ***contract buyer*** to work with you.

Name: This is YOUR name, NOT the name of anyone else!

Company: YOUR Company.

Phone: YOUR phone number, or the best place to get hold of you.

Fax: YOUR fax number, or where you would like us to fax your offer!

TRANSACTION INFORMATION

It is important for us to know the details of the original transaction when the note was originally created. They tell us the value of the collateral, and the risk-related factors of **LTV** and **ITV**.

Names: We ask for the buyer and seller's last name only to reference the file. We refer to the file in our office as "Seller pays Buyer". This will be especially helpful to all of us if the seller has more than one note he is carrying.

Down Payment: It is important that we know how much money the buyer put down on the property. This determines LTV, and also equity, each of which is a risk factor. The greater the down payment in relation to the sales price, the lower the risk.

Sales Price: The sales price comes into play because it gives us a rough estimate of today's property value. SPECIAL NOTE: If the property has sold within the last 12 months, the Note Investor will use the sales price, or the appraisal, whichever is ***lower***, to determine value. On the other hand, if the original sale is over 12 months old, the Note Investor will only use the current appraisal to determine ITV.

Lien Position: We discussed this in an earlier chapter; obviously a 2nd lien carries a lot greater risk than a first lien. Most institutional note investors do not purchase 2nd liens, unless they meet stringent criteria: they must be at least ½ as big as the first. Private investors, however, have more lenient guidelines.

Buyer's Credit: Though at this point this is an arbitrary question, the answer will give the Note Investor guidance in pricing the note. The worse the credit, the more risk to the Investor; the ITV will be lower, and the yield higher.

It used to be (back in the good ol' days) that Note Investors would buy a note regardless of the buyer's credit, as long as the buyer had made the most recent 12 months house payments on time. This is no longer true! Today's Note Investor considers credit as a factor:

SPECIAL NOTE: Most Note Investors will not touch a note where the payor has a credit score below 525. The risk simply outweighs the potential return.

MORTGAGE/TRUST DEED INFORMATION

Date of Mortgage: It is important for the Note Investor to the date the mortgage was created, which usually corresponds to the date of the sale. This indicates the age, or *seasoning* of the note: the more *seasoning* the note has, the lower the risk.

Loan Amount: To accurately price a note, the Note Investor needs to know all of the terms of the note, including the original principal balance.

Term in Months: Most calculators use months (rather than years) in their calculations. You should get in the same habit. The term indicates how many payments were originally associated with the note. The shorter the term, the sooner the Investor gets his money back and the higher the yield. It's that *Time Value of Money* thing again.

Interest Rate: Obviously, this is an integral part of the note, directly affecting the amount of the monthly payment. The higher the interest rate, the more the note is worth. In fact, the closer the interest rate is to the Investor's required yield, the smaller the discount.

Payment Amount: Payment is very important; Note Investors are buying a series of payments (cash flow) that directly affects their yield. Most sellers will know this amount, though occasionally, the buyers will round out their payment to a different number ($497 payment; payer pays $500 month). Though this messes up the calculations, it is easily fixed – get a copy of the note itself.

GAME HINT: When you are filling out the worksheet, get a copy of the note whenever possible. This accomplishes two things: **1)** You will always submit accurate information to the Investor, and **2)** It helps you quickly determine whether the seller is really serious about selling his note, or if he is just *looking*. If he balks at letting you see the note, he, in effect, is asking you to make him an offer on his car before you have even seen it!

Balloon Date: If the note is due sooner than the amortization term indicates, there is a balloon in the note. It is imperative the Investor knows when this large payment is due: it determines how many payments remain for the Investor to purchase.

Example: Suppose a note has a 360-month term over which it is amortized, with a balloon due in 60 months. Even though they used a long term to determine the amortization (this keeps the payments smaller), there are actually only 61 payments in this note. There are 60 regular payments, and 1 large, balloon payment.

Balloon Amount: By now, you should know that Future Value determines the balloon amount. (What is the above note worth 60 months into the future from the start date?) This is very important: Investors want to make sure that the payor can pay this large payment through refinancing or selling his home when the note (balloon) comes due.

Payments Made: If the payers haven't made all of their payments, the note is considered to be *delinquent.* Because the risks are so high, most Investors do **not** invest in delinquent paper. Sometimes, this line may reflect that 49 payments have been made to date, when, in reality, 53 *should* have been paid.

Pmts. Remaining: An Investor is purchasing Cash Flow. In other words, when sellers want to sell their entire note, the first question you/Note Investor should ask is, "How many possible remaining payments are there to buy?"

Current Balance: All fully amortized notes decline in principal each month. In other words, each payment includes some interest in it, as well as some principal. If the payer were to refinance today, how much would he owe? *This* is the current balance.

PROPERTY INFORMATION

Type: The property is the collateral for the note, and the investors need to know what their security is. Obviously, their risk is different with a single-family home as collateral than it is with a commercial piece of land. Different answers to this question determine different yields required by your investor.

Owner Occupied: This is, again, a risk-based question from the note investor. The risk is less if the buyer occupies the property, rather than if they are purchasing it for rental property. The rental income (if applicable) should be high enough to offset the payment on the note.

Location: While most investors invest all over the country, some areas have actually *depreciated* over the last several years. Giving your investor the zip code of a property helps them make a more educated decision on how much to invest in the note.

NEEDS & COMMENTS

The comment lines are for you to give your investor any supplemental information about the property. The seller's needs are very important. Either this is a line neglected by most brokers, or they put in "as much as possible." You and I both know that this is never really the case. *This is probably the most important line on the entire form.* The information on this line will allow you, or your note investor, to creatively structure your note and your offer.

Asking the right questions…

There are several ways to get information from the seller to fill out the worksheet. Don't be bashful; just be yourself. You may decide to tell the seller that you need certain information in order to *"give him a fair and accurate price"* for his note, and that you have a list of questions. Then you won't feel so bad about just going from one line to the next on the worksheet.

On the other hand, you can ask conversational questions. I have listed some possible questions and scenarios that will help you in getting the information.

Property Type

What type of property is it? Don't just ask that question without clarifying it. Very often they may say, "Oh, it's 10 acres in Williamson County." Ask further: Does it have a building on it? Is there a house on that property? They may answer, "Oh yes, the folks live in it." Now you know it's a single-family, owner occupied property. If you had just accepted their first answer, you would have believed it was 10 acres of raw land. Again, take the time to ask questions to qualify the answers they give you so that you have complete information.

Sales Price and Down Payment

How much was the sale for? It's very common that note holders will misunderstand this question and instead tell you the original balance of the note. Make sure that you follow up "How much was the sale for?" with "How much was the down payment when they bought the property from you?"

Example:

You:	"How much was the sale for?"
Note Holder:	"Oh, the sale was $30,000.00."
You:	"How much did the buyers put down?"
Note Holder:	"$5,000.00."
You:	"So you took back a note for $25,000.00?"
Note Holder:	"Oh no, we took back a note for $30,000.00! So I guessthey paid me $35,000.00 for the property."

This is not an uncommon conversation. When you ask them about the down payment, take the time to review the numbers with them (as in the previous example) to make sure that they add up. Sometimes they'll tell you "They put down $5,000.00" and when you run back through it, you may find that the buyers actually put down $3,000.00 (or some amount other than $5,000.00). Again, take the time to ask qualifying questions to verify the information they're giving you. This doesn't need to be confrontational - you can do it in a very friendly, conversational way.

Note Amount

What was the amount of the note they took back? By asking how much the sale was for and how much the down payment was, you should be able to determine the note amount. Again, ask the question. The answer they give you may be different and will help you to uncover incorrect information in the first two answers.

Terms of the Note

Talk to the seller about the terms of the note. Ask them how much the monthly payment is. Occasionally, the seller won't know the exact figure. When this happens, it is up to you to extrapolate the answer. Start by asking them whether the payment amount includes just principal and interest, or principal, interest, taxes and insurance. Ask the interest rate of the note. With this information, you should be able to calculate the amortization.

Now that you have a good idea of the structure of the note, ask the seller the term of the amortization. If your figures show a 30-year amortization and you say, "So this note was to be paid over 30 years?" and they respond, "No, it was to be paid over 15 years", you know that you've got to do some more digging.

Repeat the questions (though in a different way) regarding the interest rate and what is included in the payment. Is there a balloon payment – maybe in fifteen years? Play around with the numbers and find out if perhaps a different interest rate and different amortization would produce the correct payment with that mortgage amount. Keep asking questions until you get to the bottom of it. Very often there will be a simple misunderstanding or a lapse of memory that caused the numbers to be different.

Again, asking the right questions in a conversational format will usually produce the answers you need. However, if you are unable to make sense of the numbers they have given you, then you must ask them to see a copy of the *closing statement* and the *note*. Those two documents will give you the definitive information that you need.

Date of Sale

The date of the sale is really not as important as the date of the first payment. By asking for the date of the sale, you create an opportunity to cross-reference the date of the first payment.

Note sellers often need help in remembering the date of the first payment. The following exchange is usually successful:

You: "Do you remember what year you sold the property?"
Note Holder: "I think it was three years ago."

You: "So it was in 1999?"
Note Holder: "No, that's not right. My cat died in 1998, and that was just after I sold the house."

You: "Do you remember what month that was?"

Note Holder: "Yes, it was June. I remember now because Fluffy died in July. Fluffy was my cat."

You: "Let me clarify, the buyers made the first payment to you on July 1, 1998?

Note Holder: "No, they make their payments on the 12th of the month, but now that I think of it, it was July 12th of 1998."

You: "I'm sorry to hear about Fluffy – did you get another cat?"

Note Holder: "Of course!"

You just verified that the date of the first payment was July 12, 1998, and you did it without pressuring the seller for information.

Once you have obtained all of the information on the note, make sure that the seller understands that these are the numbers you are working with, and that ***any differences could result in a change to your offer***. Don't make a big deal out of it; simply make sure that you don't leave yourself open to the problems later on if the numbers change.

Taking the next step…

Tell the sellers that you have several investors that you are going to check with, because you want to get them the best possible price for their note. You will contact them within a day or two to let them know what the price is. Thank them for their time and move on to the next prospect.

PART ELEVEN

RULES FOR THE NOTE INVESTOR

The Golden Rule: "The Note Investors have the gold; they make the rules."

Just to recap: You have found a note holder (or one found you), and have gathered all of the pertinent information about the note to send to your investor. You have filled out the Note buyer's Worksheet, *completely*, *accurately*, and *legibly*, (beginning to sound familiar?), and have faxed it to your Investor. Now is the time that the Investor considers the merits of the transaction, and weighs them against your needs and those of the seller. Your pricing is a result of this contemplation.

Investing is risk based…

You will notice that I have made several references to the Note Investor's evaluation of risk. After all, their business is based on risk: *What is the probability that the payer will pay them back? What risks are involved, and do they outweigh the benefits of doing the deal?* Here's how an investor looks at risk...

BRIEF ASIDE: By the way, I should know all about risk. When I first started out, I was, like you, an independent broker/buyer. I sold all of my notes to my backend Investor and, frankly, all I cared about was getting the deal closed. I didn't really take into consideration all of the risks involved because my Investor assumed them all. Ha! My company is now the Investor, and the shoe is on the other foot. We write the checks, and now we assume the risk!

Let's discuss these:

Investors are faced with multiple risk factors, each of which affects their decisions when structuring a particular transaction. Risks alter two components of a transaction:

- The amount the Investor is willing to invest as compared to the value of the property (***Investment to Value*** = ITV). To clarify: ***the higher the risk, the lower the Investment to Value.***

- The Investor's required ***Yield Rate***. The higher the risk, the greater the possibility that the Investor will have to take the property back, a procedure that almost always results in a financial loss. In order to offset that loss, the Investor needs to charge more when the risk is greater. In other words, the ***higher the risk, the higher the yield.***

Risk Factors

As a note investor, people often approach me with this question about my company, *"How much is your discount?"* I laugh (not in their face, of course!) and reply, *"Asking that question is similar to asking a real estate agent how much a house might be."* It really depends, doesn't it?

In order to find out how much a house is worth, you need to know its construction, square footage, neighborhood, location, condition, and a host of other factors. The same thing applies when purchasing a note.

Most Note Investors have a series of internal guidelines that determines their required yield on any given note. In most cases, when the risk goes up, the required yield goes up and the ITV goes down.

GAME HINT: I have not included a pricing matrix in these materials. Due to financial market fluctuations, the various Investors' required yield rates change on a regular basis. Note Investors also take into account a tremendous amount of information not listed on their rate sheets. **Your best bet:** Fax your worksheet to your favorite Note Investor, and have them evaluate each note on an individual basis.

The Investor has to take into account many different things when structuring a purchase offer. *Why do you think we ask so many questions on the Note buyer's Worksheet?* Here are just a few of them:

Down Payment: The size of the down payment as compared to the property is a very good indicator of risk, because it reflects the buyer's ability to save, and indicates how much they have vested in the property. If someone has bad credit and a very small (or no) down payment, we consider that to be very high risk.

Sales Price: The sales price of a home can be a good indicator of another type of risk: that which determines the resale value of the property. Property values are often driven by demand: It may be just as difficult to resell a $500K house as it is a $20K house, because there are fewer buyers who want homes in these price ranges. And of course, the Investor is always looking at the resale value of the house, because that is his only collateral in case of default.

Property Type: An investor evaluates this type of risk by the ease with which the property can be resold. Obviously, there are a lot more buyers looking for a typical single-family home in a typical neighborhood, than there are buyers looking for 500 acres in the middle of Nowhereville, USA. Single-family homes represent the least risk, followed by condominiums, multiple unit apartments, commercial, improved land, and raw land.

Each time you take a step up the ladder, the ITV gets lower, and the Yield goes up. Typically, an Investor will go up to 75% ITV on a single family home, and only up to 50% ITV on raw land, with the others falling somewhere in between.

Occupancy: If the house is, or will be, occupied by the owner, the risk is substantially less that if it were held for rental. Non-owner-occupied houses (N/O/O) represent the greater risk, resulting in a lower ITV and a higher yield requirement.

Loan to Value: Many times, the buyer of a property will choose to put very little money down when structuring the deal (*imagine that…*). While this is great for the buyer, it makes the deal riskier, because the buyer has little to none of his own money invested, which makes it easier to walk away should things go bad. Note Investors will allow **LTV's** up to **100**% with good credit, but they will limit their **ITV** to around **75**%, meaning they will only buy a *portion* of that note, thus limiting their risk.

Buyer's Credit: I will be the first one to tell you that I don't think very highly of credit scoring, but I also understand this: the incidence of foreclosure is 7 times greater at a 620 score than it is at 680. In other words, if you have a credit score of 620 (which is still pretty decent), the likelihood of you going through a foreclosure is 7 times greater than someone who has a score of 680 or greater.

The lower the credit score, the greater the risk to the Note Investor. <u>Most note investors will *not* invest in a note where the mortgagor (payer) has a credit score of 525 or less.</u> It stands to reason that the lower the credit grade of the payer, the lower the Investor's ITV, and the higher their required Yield.

Payment History: Regardless of credit, a payer's mortgage history is the most accurate indicator of whether or not he will repay the note. When buying a note, Note Investors will look at the most recent twelve months payment history, making the Seller prove that he has received at least 12 house payments from the Buyer/Payer within the last twelve months.

Seasoning: Seasoning is the amount of payments that have been made, and this issue is a biggie! The more payments that have been made on a note, the greater the probability the payers will continue making them. Lots of seasoning means less risk – Note Investors love notes that have been around for several years or more.

On the other hand, Note Investors will also buy notes with no seasoning on them: brand new notes with no payments having been made. *See more about this in my volume on simultaneous closings, Paper Magic – Profits in Pretty Paper.*

Lien Position: Because of the rights associated with each, a 2nd lien is far more risky than a 1st lien. Keep in mind that most Note Investors specialize in the purchase of 1st liens only. Those who do buy 2nd liens have specific buying criteria: the 2nd lien must be at least ½ as big as the 1st lien, and then, because the risk is so much greater, the Yield will be considerably more.

SPECIAL NOTE: Most Institutional Note Investors (v. private ones) will not buy small 2nd liens behind large 1st liens. In other words, don't pursue these types of notes, not even for your own portfolio. 2nd liens are very risky, and even if you could find someone to buy them, the Yield is usually so great that the purchase price would be down around 50 cents on the dollar!

Terms: The terms of the note also help determine how the Investor prices it. Terms affect the payment; Investors pay more for higher payments.

So what does all of this mean?

All of this means that you need to give the Note Investor a lot of accurate information in order for them to structure a deal to everyone's best advantage. At first, you will not be an expert deal architect. Later, as you get more transactions under your belt, you will be better equipped to evaluate a deal and figure its best structure. In the meantime, that is why you have developed a relationship with a Note Investor – let them do all of the work!

Risk Factor Pricing

Every investor has a list of things they will and will not do.

> ***GAME HINT:*** Most true Note Investors don't invest in anything that can fly or crash, drive or drive away, float or sink, or that eats. In other words, they don't buy paper secured by airplanes, cars, boats, or racehorses - just real estate.

Let's look at a specific example:

You go out and find a note with the following parameters: It is a single-family, owner occupied home, with two years of seasoning. The buyers put 5% down when they bought the property; the seller carried a 95% LTV 1st lien. There are, however, a couple of issues associated with this note:

- The buyers have made all of their house payments on time, though they have horrendous credit.
- The property is in very poor condition, although in a nice area of town.
- There are back taxes due on the property.

Question: Is this a good note to buy?
ANSWER: NO!

Okay, maybe we can make some lemonade out of this lemon, but we need to explore the reasons why most investors would not buy this note, and even if they did, why the Investment to Value (ITV) would be so low.

Credit: Though the house payments have been made on time, the payors have horrendous credit. This is compounded by the low amount they put down on the property in the first place. They have already demonstrated that they don't manage their money well; if and when they get into a bind, it will be easier for this payor to walk away than it would others who have more money invested.

Property Condition: Your Note Investor will require that the property be in at least *average* condition for the neighborhood, as determined by an appraiser. The Investor wants to receive cash flow secured by the rights to a property; your investor does *not* want to inherit a property that requires an additional cash outlay to bring it up to standards.

Back Taxes Owed: This raises a couple of issues. If property taxes are owed, the local taxing entity (school district) could conceivably foreclose on the property, foreclosing out all other liens. A local school district property tax lien takes precedence over all other liens, including purchase money liens. In order to protect his position, the seller would have to bring the taxes current, and then bill the payor.

The borrower/payor has shown an inability to save money to pay the taxes. Even if the seller or the new Note Investor were to pay them, the payors would probably not have the resources to repay them.

GAME HINT: It is not the responsibility of the Note Investor to pay the back taxes. Those are the responsibility of the payors on the note. They bought the property; they pay the taxes.

Even were the Note Investor to buy this note, they would limit their ITV to a low amount, probably not exceeding 65%. Why, you may ask? This note has a high foreclosure risk (back taxes owed plus bad credit), and if the Investor had to foreclose, it would be difficult to resell the property without infusing more money to fix it up.

Pricing Summary…

Most investors have a base-yield upon which they base their pricing. Please understand several vital issues:

1. When the risk increases, the Investor increases yield requirements to offset that risk.

2. When the risk increases, the Investor lowers the ITV.

3. Pricing varies from note to note, depending on the risk factors involved.

4. Prices are subject to change. Oftentimes an Investor will price a note without having yet reviewed the payor's credit or the appraisal. If the credit comes back negatively, or the property appraises for an amount lower than expected, the Investor may still buy the deal, though at a reduced price.

Keep these parameters in mind, and let's talk about the next step in the process: ***Presenting the Offer…***

PART TWELVE

GAME WINNING STRATEGIES

"Stress the benefit, not the techniques…"

Let's review the steps you have taken thus far in the process. So far, you have:

1. Marketed to find the notes, and, having found one…
2. Gathered the Information (filled out an Existing Note Worksheet).
3. Faxed it to your Note Investor.
4. Received the Note Investor's price, based on their risk evaluation.
5. Subtracted your profit.

Now you are ready to present the offer to the seller.

Time for negotiation?

I have a good friend who teaches negotiation as a separate step in note purchasing. I have to disagree with him on this point – I feel very strongly that your primary negotiation should be during your 1st contact, your information gathering call. That is the time to determine the seller's needs, and to ask the all-important question, "Mr. Seller, if I can meet your needs, do we have a deal?"

Then, when you actually present the offer, you can refer to the seller's earlier agreement with you. Of course, there is a certain mindset you must develop when making your offer…

GETTING TO YES

How much is a note worth? This is an important element to grasp if you are going to get your offers accepted. The principal balance of a note is the amount due at maturity or upon payoff; it is *not* the value of a note being sold on the open market. Many individuals holding notes, and more than a few brokers, fail to make this distinction.

Let's think about what gives any asset its value. What established the sales price of the real estate that secures the note? Any asset (house, car, painting, stock, bonds, or even a note) is worth what the market will pay for it. Your job is to tell the note seller this in a non-threatening, non-confrontational way.

Keep the Proper Perspective

The best way to accomplish this is to refer the seller back to the sale of the underlying real estate at every opportunity. This is most effectively done by comparing your offers to the sales price of the property, ***not*** the remaining balance of the note. The sales price of the real estate is an established figure that the seller has, in effect, already agreed to. Take time to help them see how much cash they are getting from the <u>sale of the real estate</u> when they sell you the note, ***not*** how much they are getting for the note.

Example:

A house sold for $100,000 with $20,000 down and the seller took back a note for $80,000 with terms (20 years at 9% with a payment of $719.78). Let's say the seller has received 24 payments (that's $17,275!). You offer $65,000 for the remaining principal balance of $76,863. If the seller looks at what he's getting for the note, he's "losing" $11,863. This is untrue!

The seller has already received $37,275, (down payment plus payments received), and $65,000 from you, which totals $102,275! Remember, he only wanted $100,000 for the house in the first place.

Question: If he sold the house today instead of two years ago, would he take a cash offer of $102,275? He would probably think he made the shrewdest deal of his life by waiting two years to sell!

> ***GAME HINT:*** This principle applies whether you are dealing with existing notes or creating new ones. Make sure that you help your client to see things in the proper perspective. ***You*** are the professional; it's ***your*** job.

Everything you've done up until now has been to position yourself as the person with authority and knowledge. You are the expert that the note holder is waiting to deal with. You have invested time, energy, effort and expense to put yourself in this position. Now is ***not*** the time to blow it. Now ***is*** the time to be extra sharp. Make sure that you present the offer in a fashion that makes it easy to accept. You should be easy to work with and exciting!

Making the Offer

Your ***second*** contact (Remember your *first* contact with the seller? It was way back during Information Gathering!) with the prospect should be to make your offer on the note. Do everything you can to make it exciting for them and to make an event out of it. When you call somebody with a price - no matter what the price is - you've got great news!

It's important for you to have the right mental attitude so that you can get your client into the right mental attitude. You are offering your client United States currency (the most liquid of ***all*** assets) in exchange for a piece of paper with some typing on it! Don't get caught up in comparing your offer to the principal balance of the note. The seller you are talking to made an inappropriate business decision by agreeing to take back a note in the first place. They did it to make the sale of a piece of real estate they no longer wanted. The whole concept of taking back a note for them was probably a move of desperation. ***You*** are offering them an exit from that bad decision. ***You*** are offering them a way to close that chapter of their lives and cash out. Never, ever make an offer with a "hat in hand" attitude!

Very few people understand the nature of a debt instrument as an asset; the people you are talking to certainly do not. Make sure that you take the time to refer them back to the real estate. Take the time to add up the amount of money you are giving them, the amount of money that they've already received on the note, the amount of down payment that they received and any future balance that might revert back to them on a partial. Make sure that you give them **this entire lump sum figure**. This is what they're getting out of their real estate and is a true representation of the note purchase.

GAME HINT: If you'll refer back to the chapter entitled, *Discounting the Partial*, you'll see that I used this technique: adding up the payments already received, the cash pending at closing, and the value of the note when it reverts back to them in the future.

Amateurs will very often look at a $100,000 note balance, see that they are only offering $75,000, and feel embarrassed about making the offer. It's easy in those situations to feel like you're offering a low amount of money to the client. *This type of thinking, though, is erroneous.* It doesn't take into account any down payment on the property, or any payments that the seller has already received.

Don't make God-like decisions for your client by looking down on your own offer. Make them that offer with all the enthusiasm you can muster! That $75,000 may save their life. It may be all that stands between them and foreclosure on another property. It may be that they're delighted with that offer! Don't make decisions on behalf of your client - let them make their own decisions!

GAME HINT: Never confuse the needs of the seller with your opinions. It's your responsibility to professionally present every offer to them with as much excitement as you can.

Once you've made the offer over the telephone, tell them that you will be getting a letter out to them because you understand that it is difficult to discuss financial matters over the telephone and you want them to see the offer in writing. Remind them to call you with any questions. The following works wonderfully:

You: "Mr./Ms. Seller, I am going to put this offer in a letter and send it over to you. I know that this is important to you and I want you to have my offer in writing. This way, you can look it over thoroughly at your convenience, and if it makes sense to you, we can go to the next step. Also, if you have any questions, I will be right here to answer them. There's no rush."

This approach will get you an enormous amount of credibility with the client. You have been clear and concise. You have taken away all the pressure, which makes them comfortable with you. When they receive your letter, they will recognize that you lived up to the promise you made to them. To top it all off, that letter will have a much greater psychological impact than anything you could ever say.

A letter presented to them in this format accomplishes two things. First, everyone appreciates an offer in writing. It seems to carry more weight. Second, they can't argue with a letter.

The Seller's Perception

You're a stranger discussing financial matters with them. In their mind you probably are telling them things that are untrue and you're not to be trusted. However, something magical happens once something is written down on paper. It's irrefutable. When they see the amount they sold the property for, the amount they received for a down payment, the amount that they've received in payments to date, and the amount you are offering them, it suddenly becomes very real.

If you tell someone they've received $15,000.00 in payments over the last five years, it's easy for them mentally, (subconsciously) to shrug it off and say *"That couldn't be!"* When it's written down on a piece of paper they are forced to pull out their calculator and add the figures up and discover that it is, in fact, true and that they have blown all that money. There's no one to argue with, and no one else at whom to point their finger. It's simply a fact that they must accept.

Many people who are not excited about your verbal offer over the telephone, when forced to face the situation in writing, very often will have their own mind go to work convincing them to sell their note to you. The proper letter will generally triple the results of your telephone offers.

Once you've sent out your letter, if you get no response from the party within two weeks, follow up with a call to make sure they received the letter. Never, ***ever,*** press for acceptance of your offer. It's okay to tell them that you have a number of deals you are reviewing and you'd like to know if theirs would be included in your purchases for the month, but don't give ultimatums. People have to make decisions in their own time at their own pace. People may receive an offer from you and not respond to it. Six months later, they call back wanting to sell the note immediately because they thought you were fair with them and didn't push them.

Very often, when you call to make sure they received your letter, they will engage you in conversation, wanting to know how the closing process works. At that point, it's important to "lead them down the path" and make it simple for them to sell their note to you.

OK, Jayme. The seller finally said, "Yes!" Now what?

Congratulations! Jump up and down, and then lock in the sale by getting them to sign an agreement. This agreement gives you the opportunity to purchase the note at a predetermined price, subject to your due diligence. In other words, you (or your Note Investor) get to do your homework before purchasing the note. The best document to use is an Option to Purchase Agreement.

> ***SPECIAL NOTE***: Though I cannot speak for other Note Investors, I can say that my company has spent a considerable amount of money developing this agreement. In that spirit, we will not allow any changes be made to it.

PURCHASE AGREEMENT FOR PROTECTION

You and the seller, at this point, have negotiated a price of the note and now you want to "check out" that particular note to see if it meets your investment criteria. Once you have put an acceptable offer together with the seller, you should reduce the agreement to writing. There is a sample purchase contract on the following pages, along with a description of the salient points. **You should have your attorney prepare your own purchase document with the necessary changes made to conform to your applicable state and local laws.**

You need to enter into a contract with the seller for the purchase of the note for two reasons:

1. To gain control of the note and effectively take it 'off the market', while you get your financing together or procure a buyer for the note.
2. You will also need time to review the particulars of that specific note to make sure it meets your investment objectives. By contracting to purchase the note, you are then able to conduct your pre-purchase review of the note, the person making the payments and the property securing the note.

The purchase agreement should also clearly set out the terms of the purchase and any contingencies that you may require. You should make sure the seller understands that your pricing is predicated on you checking the documents for accuracy, confirming the value of the real estate acting as collateral on the note and checking out the person making the payments.

[INSERT Option to Purchase]

[INSERT Option to Purchase – page 2]

The Option to Purchase Agreement…

This form (see preceding pages) is what locks the seller into selling his note. ***Your Note Investor will prepare this document for you.*** In effect, it is a purchase agreement, whereby the Note Investor agrees to buy the note (or a portion of) for a specific, pre-determined price. It differs in that it gives the Note Investor the *option* to buy that note, depending on the outcome of the Investor's due diligence (a.k.a. *homework*). Furthermore, it is divided into several major sections:

Description: The first section outlines the description of the note, including its original amount, and the property that secures it.

Sale and Consideration: This section outlines the purchase specifics, including how much the Note Investor will pay for a certain amount of payments, including the date of the first payment that goes to the Note Investor. The pay price listed here is the adjusted pay price (Note Investor's price less your profit).

It also lays out the Note Investor's requirements: the property must appraise for at least a certain amount (usually the sales price). In this section, the Note Investor also reserves the right to approve the mortgagor's credit report, as well as clear title on the property.

Exclusivity: This gives the buyer (Note Investor) 45 days from the receipt of the *last required document* to close the deal. During that period of time, the seller may not shop the note with other investors. This protects the Note Investor; it also protects the note broker.

GAME HINT: A lot of sellers will try to back you into a corner and get you to buy their note in a ridiculously short period of time, like three days. Don't fall into this trap. You are in control of the deal, and besides, they probably had it with another Note Investor who was unable to close the deal. *A lack of planning on their part does not constitute an emergency on your part.*

Remedy for Default: If the payor fails to make the first three payments to the Note Investor, the Note Investor may, at their discretion, demand the seller to repurchase the note. Now don't go jump off a cliff – this is not as bad as it seems.

In over 90% of first-payment defaults, there was fraud involved. A lot of sellers are just trying to get rid of a bad note, and want to put the proverbial monkey on the Note Investor's back, take their money, and run. It's kind of like that old cereal commercial, "Let's get Mikey – he'll eat *anything*!" They will often falsify information in order to do so. Not good…

The seller should help make the note sale and transition go smoothly. If he is willing to be responsible for three months, it assures the Note Investor that there is no hanky-panky being committed.

Closing Costs: In most cases, the Note Investor will pay for the costs of transferring the note. In rare cases where there is very little room for error, the note broker may be asked to help defray that cost from his proceeds.

SPECIAL NOTE: In no case should the Note Investor or the Note Buyer ever pay for any costs to cure title, or for a title policy. That is the responsibility of either the person living in the property, or of the seller.

Remedies for Breach: There are occasions when the seller will try to back out at the closing: their next door neighbor has offered them more money for the note, the payer has offered to refinance or some other force has come into play that makes your offer not seem as palatable. You have gone to the time, effort and expense of doing due diligence on the package, finding a note investor and putting the deal together. Your Note Investor has incurred costs as well. A 15% liquidated damages clause makes the seller think twice about backing out of the transaction.

When presenting an agreement with a liquidated damages clause, it is important that you present it properly. If the seller of the note does not ask questions about it, don't bring it up. Let them sign the agreement and move forward with the transaction.

What if the seller questions this clause?

If they do question the clause, quickly and fiercely point out to them that it only pertains to them if they try to defraud you. You are willing to advance money on their behalf for appraisal, title update and preparation of the closing documents. It is entirely reasonable to ask them for a commitment that they won't leave you hanging. You have nothing to hide; you have nothing to be afraid of. The clause is only designed to keep them from defrauding you.

Stick To Your Guns…

When you send your agreement to the seller of the note, <u>do not</u>, and I repeat <u>do not</u>, allow them to alter it in any way. There are two very serious reasons for this warning:

1. You will have other issues that are going to come up that you need to be in control of. If you can't get them to sign the agreement to sell you the note in the first place, you are never going to be able to control those other issues later on.

2. You probably won't encounter anyone who knows more about notes than you, but it is *very* likely you will encounter people who know a lot more about writing real estate contracts than you do! I once saw a relatively "green" note broker allow a commercial real estate developer to make a "small" change to its purchase agreement, which forced the note broker to pay for a $6,000.00 commercial appraisal! I've seen a number of amateurs wind up being financially responsible for various aspects of transactions because they allowed the seller of the note to change their agreement.

Stay in control…

You are the expert! ***You*** are the one that knows how to make this happen! Don't allow someone who doesn't know anything about it to lead you around. ***You*** stay in charge! Be in control!

Remember - ***you*** know who ***you*** are. You know you're not going to do anything to damage the sellers. On the other hand, they may very well be out to damage you in any way they can. Always protect yourself - never be bashful - never back down if they question your agreement. Be very confident. That confidence, more than anything else, will cause them to immediately sign it and drop the issue.

Final Note: If you deal with my company, we will insist that the Option to Purchase Agreement be between my company and the Seller. We have the teeth to enforce it, and besides, in case of fraud, we want to go after the offending party, not you.

GAME HINT: There is plenty of business out there; there is never a reason to commit fraud in order to get a deal done. Note Investors have a dim view of fraud – they have lost literally millions of dollars in the last few years because of it. If you commit fraud, your Note Investor will immediately sever all ties with you and your company. There is no room in this industry to tolerate it.

PART THIRTEEN

CROSSING THE FINISH LINE

"Lucky thirteen: Here comes the money!"

We've all seen those bumper stickers that say "Stuff Happens". That may be so, but closings don't happen unless we make them. Thanks to Mr. Murphy and his Law, anything that can go wrong usually will. Once your offer has been accepted, the hardest part of the note transaction begins. This is the stage where you must collect the documentation to provide to your note investor.

SPECIAL NOTE: In this section, I use you as the buyer and the Note Investor as the buyer interchangeably. There will be many occasions when you flip the note to your Note Investor. There may be some times when you, personally, invest in the note. In the latter case, you need to perform the same due-diligence as your note investor.

You should make every effort to review the requested documents as soon as possible after they are received. The seller has agreed to a pricing on the sale of the note and you always want to keep the "deal" moving forward. Accomplish this by getting *all* the requested information quickly; then efficiently evaluating the information. Allowing the buyer and the seller to "piece meal" the information to you will only slow you down.

An even more serious consideration is that the closing cannot occur until all the required steps are completed. This is particularly true when selling or flipping the note to another note investor. The seller that you allow to slowly provide the needed information, will also be the same seller who will get upset if the deal does not close on time (even though you did not receive the information in a timely fashion). This compilation of documents and material allows you to fully evaluate the "quality" of the note as well as confirm the information previously provided by the seller and the buyer.

Gathering Documentation and Staying Friends

There is a perverse logic that seems to overtake a portion of note sellers at this point. Sellers seem to feel that you won't need certain information if they make it hard enough to obtain. There are only two ways around this phenomenon:

- You could gently "trick" them into giving you the information (see the dialogue below) or…

- You can be very forceful, making it clear that you absolutely must have each item you requested or there is no deal. Personally, I find this second approach generally creates hard feelings and only use it in case of emergencies.

There are, however, several qualifying questions you should ask the seller immediately upon acceptance of your offer. These will save you an enormous amount of time and aggravation in the process of collecting needed documentation. This will also allow you to "corner" the seller into the truth regarding the availability of documentation without creating any hard feelings.

GAME HINT*:** Get ***all of the information as quickly as you can after you have cut the deal. Waiting on information in this business is formula for disaster. Do ***not*** let it happen to you!

EVALUATION

Note Investors divide this evaluation process of reviewing the information on the note into these three categories:

1. The PAPER: All documents relative to the transaction.

2. The PROPERTY: Information on the property that secures the note.

3. The PAYOR: Information on the person(s) making the payments.

Let's review the action steps necessary to address the three "P's" of paper…

THE PAPER

Documenting The Debt

The first question you should ask is: "Did you close the transaction at a title company, or at an attorney's office?" If the response is yes, then you know that basic documentation is available from either of these two entities. These documents would include a copy of the closing statement (HUD 1), note, mortgage/deed of trust, and title policy.

READ THE DOCUMENTS

It is imperative that you read all the documents involved with the purchase of the mortgage or trust deed note. You never want to become so lackadaisical in your investment pursuits that you fail to pay careful attention to the content of the documents involved in your note purchase. If you are not well versed in the legalities pertaining to the instruments involved in the transaction, you would be well advised to have an attorney review this information (particularly in your early note purchasing endeavors).

Please be aware that each mortgage and note can potentially contain clauses that may adversely effect your investment. In conjunction, the omission of various clauses in the instruments could prove disastrous to your investment. Never make the mistake of not carefully reviewing the documents.

The second question you should ask is: "When the Payors made payments, did they make them in cash or did they write a check?" Whatever the response, the follow up question should be, "Did you deposit those payments in the bank or did you spend them?" Make sure that you stress the words “or did you just spend them”; in a way that implies that NOBODY would have “just spent them!” The answer most people will give you is that they deposited the payments in their bank account. Properly asked, this question eliminates the possibility of the seller giving you a hard time about providing the payment history. By asking these two simple questions, you have pinned them down. You know the payment history is available and you won’t have to get into a disagreement or be argumentative about it later on.

It is very common for sellers to indicate that they were paid in cash, which was then spent. This may go back to the idea that you will quit asking if they say they don’t have it. Fat chance!

GAME HINT: It has been my experience that proof of payment history is the most difficult information to get from the seller and oddly enough, one of the most important items for the note investor. Many times the seller will have to go to the bank and ask the bank for copies of their deposit slips. Even worse (oh no!) they may have to dig through their check book and find those deposit slips.

Payor Background

The third major question you should ask is: "Did you run credit on the payor when you sold them the property?" If the answer is no, that's fine - you know you've got homework to do. If the answer is yes, then you know that they have immediate availability of social security numbers and general credit information on the payers. Very often, credit reports will even contain employment information. This will save you a lot of legwork later on if it's available.

Know What You Need

You have established the availability of the documentation you need by asking those simple qualifying questions. The documentation that you will require is as follows:

1. Copy of the Note
2. Copy of the recorded Deed of Trust/Mortgage
3. Closing Statement
4. Mortgagee Title Policy
5. Proof of Hazard Insurance
6. Payment History

7. Location Map
8. Color Photograph of the Property
9. Information on the Payors

You should ask them to get a pen and write those items down in your telephone conversation. You should, however, also send that list of required documentation to them in writing as a follow up, along with the agreement for them to sign to sell you the mortgage, a.k.a. the *Option to Purchase Agreement*.

Working Together For Closing

Once they have signed the agreement, it's important to head off potential problems. Don't let them set their own closing date. Your Note Investor has the money, and that money isn't being sent to anyone until all of the conditions have been met.

A Documentation Checklist…

I've included one of these in the Forms & Documents section of this manual. The purpose of giving them this checklist and reviewing it with them is to give them an understanding of what's about to occur. People only get scared when they don't understand things. Help them to see the process you're going to go through for them. Educate them as to how you are going to actually utilize your own funds, your own contacts, your own note investors to get them the money they need. It's not a bad thing to let them see the complexity of the transaction; then they don't take it for granted.

As you go through each process, write down a specific date. Ask them to help you fill it in. For instance, concerning documentation received from seller, ask them when you can expect it and then get a commitment. Write that date down and have them do it on their copy as well.

THE PROPERTY

APPRAISAL OF THE PROPERTY

At this point, your Note Investor will want to determine the true value of the real estate securing the note they are considering purchasing. The method most of us utilize is to get a third-party appraisal performed on the property. Generally, we prefer a "quick sale" appraisal, which is an appraisal of the property performed by a real estate appraiser giving you a value of the property if it had to be sold in a relatively quick period of time. This type of appraisal differs from an ordinary appraisal, which would indicate a value of the property when time would not be of the essence. The quick sale appraisal approach best suits paper investors. Put yourself in our shoes: If you were forced to foreclose on a property to protect your position, you would probably want to sell the property as quickly as possible to recoup your invested capital to keep it working for you.

The appraisal that you will receive, when purchasing an existing note, is slightly different from an appraisal that is obtained when you are buying or selling a piece of property. With an existing note, the owner of the house is not involved with the Note Investor's purchase of the note (other than making payments to them instead of to the seller after closing). Therefore, as note investors, we generally obtain a "drive-by" appraisal of the property.

GAME HINT: Appraisals can take anywhere from three to fifteen days. Give yourself enough time so that you know it will be feasible, and make a commitment as to when the appraisal will be ordered.

An appraisal report needs to be on the appraiser's letterhead. The appraisal report will generally contain information and photographs on three comparable property sales. The appraiser will most likely use a FNMA (Fannie Mae) form for the documentation. The appraisal will contain a form and a narrative, which will include the following:

1. **Description of property.**
2. **Condition of property.**
3. **Location of property.**
4. **Description of surrounding area.**

The appraisal will also contain a location map showing the location of the subject property and the comparable sales. His/her resume will also be included. Finally, the appraiser will indicate the value of the property and will sign and date the report.

IMPORTANCE OF APPRAISAL

The reason we constantly emphasize the importance of being able to obtain an accurate estimate of the value of the property is that the real estate is our secondary repayment source in the event of default by the person making the payments. The strict adherence to our preset investment-to-value ratios provides the necessary insurance that our secondary repayment source (i.e., the real estate) will allow us to recoup our invested capital in the event of a default.

GAME HINT: When investing in real estate secured notes, you have a tremendous advantage: compared to other investments, it is relatively easy to ascertain the value of the real estate securing the investment.

An appraisal provides the note investor a method to determine the value of the real estate and the safety of his investment. By setting his investment parameters and then strictly adhering to the criteria he has established, the investor should be able to minimize the risk in the investment. The note investor utilizes his preset investment to value criteria to provide a "protective equity" buffer in event of default.

An appraiser will prepare his estimate of value by reviewing the property, the socioeconomic trends occurring in the neighborhood, the conformity of the property to other properties in the neighborhood and determine the highest and best use of that piece of real estate. He generally compares the subject property to several other sales of similar properties in the area (known as "comparables") to determine the value of the real estate. Privat note investors should recognize that appraising is not an exact science and not to depend totally on that value when making a buying decision.

VALUES VARY AROUND THE COUNTRY

Please do not make any negative assumptions about a house that secures a note simply because you feel it is an inexpensive (or cheap) price for a house. This word of caution is particularly applicable for people who live in higher priced areas of the country. Some investors are guilty of saying "*Oh, my gosh! This must be a low-income area*!" when reviewing notes secured by lower priced housing. You should be aware that it is quite possible to purchase homes in some parts of the country, at a mere fraction of the cost of housing in other areas. While sales price is relevant, remember that just because the price does not happen to fit within your own personal parameters for housing, it does not make that house a *bad* deal in its own area of the country.

Our office receives numerous submissions every day and they vary a great deal in the sales prices of the homes. We have purchased many quality notes secured by houses (particularly in rural areas) that are in the $30,000 to $40,000 price range. You should recognize that this $30,000 to $40,000 home in the rural area might be a very good piece of real estate while a $40,000 house in a large metropolitan area may not be a particularly sound investment.

GET AN APPRAISER IN YOUR CORNER

We encourage you to develop an on-going, working relationship with an appraiser in your area, particularly if you plan to purchase most of your paper in your immediate area. There are several benefits to finding an appraiser you can work with in your area. You should be able to negotiate a favorable rate on your appraisals since you will provide the appraiser with ongoing business. The appraisal is one of the few major expenses you will have in this business so it is important that you cut the best deal you can. You will want the appraiser to understand your investment objectives and have him be able to, literally, "see the property through your eyes" so to speak.

By developing a good working relationship with a local appraiser, chances are you can get an appraisal completed in a minimum amount of time, on very short notice, when the occasion dictates. You never want to miss out on a great deal simply because the appraiser you utilize cannot provide the information you require fast enough. Since our company purchases nationwide, we utilize several appraisal firms that can provide us a quick turn around time on our deals. We want to be able to receive an appraisal in the shortest time possible once it is ordered.

The importance of knowing the value of the property securing your mortgage cannot be overemphasized. Determining the value of the property is a necessary and very important part of the note evaluation process. An appraisal or accurate estimate of value must be one of your primary purchase requirements. Should you elect to sell your note to other investors, you will find most of those investors will require an appraisal. Let's face it: procuring an appraisal of the property is a relatively inexpensive method of insuring that your investment is secure.

PHOTOGRAPHS OF THE PROPERTY

A picture is worth a thousand words... or something like that. If you are purchasing a note secured by a property outside of your immediate area, please request that the seller provide you with photos of the property if at all possible. Photographs are invaluable in the verification stage, particularly when you are unable to physically inspect the property yourself. Without the photos, you could be in for a big surprise if you later find out the deal that looks so pretty on paper is a "dog" in person.

Most note investors require you use a national firm when ordering the appraisal. I have listed **four** of these to help you:

U.S. Property and Appraisals
1-800-837-8450

First American Real Estate Service
1-800-972-9127

Lender Services, Incorporated

Nationwide Appraisal

1-800-722-0300 **1-800-920-0050**

BRIEF DESCRIPTION OF IMPROVEMENTS ON THE PROPERTY

Please have the seller give you as much detail as possible about the property. Information you would like to know about the property includes: type of property, number of bedrooms and bathrooms (if residential), size of lot, carport or garage and other improvements. The more you know about the property, the better. The seller should also be queried as to whether he has made any improvements since he has owned the property. Additions or improvements may very well enhance the value.

LOCATION MAP

If the note is outside of your immediate area, a location map depicting the location of the property can prove helpful. It is also extremely helpful for the appraiser when the property is in a rural area.

THE PAYOR

THE PERSON MAKING THE PAYMENTS

You also need to check out the person(s) making the payments on the note you purchase. This portion of the information verification process focuses on the credit worthiness of the mortgagor and his or her payment history on the obligation.

GAME HINT: Keep in mind that your note investor will do this as part of their due diligence. On the other hand, if you are purchasing a note for your own portfolio, you will need to do this yourself.

PAYMENT HISTORY

When you are in the business of buying notes, it is imperative for you to take every precaution available to protect your investment. It is very important to know the payment history of the person making the payments, since your primary repayment source (person making the payments) depends on their credit worthiness.

We are all creatures of habit. The person who has made payments on time in the past will generally continue to do so in the future. Conversely, a person who has exhibited a poor payment history in the past will, as a rule, continue to be a problem. Unless you are very comfortable with the property and would not mind owning the property through a foreclosure proceeding, we recommend you steer clear of any notes with mortgagors who have a spotty payment performance record. This is particularly true if you plan on flipping or selling your note to other private note investors.

While some note investors will purchase problem or trouble payment record type notes, the vast majority will be seeking a sound, safe investment with a good payment history on the note. Purchasing notes with poor payment histories is just asking for trouble unless you are hoping to foreclose on the property. Problem notes can be good opportunities for profit, but should be left to real pros in the business. If you are purchasing a second position note, it is recommended that you check the payment history on the first note as well. The payment history is no guarantee of future payments, nor is it relevant should the property securing the note have been sold and your note assumed by someone else. It is however, an important part of your pre-purchase checklist and provides an additional safeguard to keep you out of trouble.

THE CREDIT REPORT

The credit report on the mortgagor will show if he or she has a large amount of outstanding liabilities (high credit card balances, for example) and other facets of his credit history (payment history, accounts sent to collection or written off by lender). If you are purchasing a lot of notes it could be advantageous to join a credit-reporting agency in your community so you can quickly obtain credit reports on mortgagors of notes you are considering for purchase. Generally, the better the person's credit, the less likely he will default on his payments to you.

Even though you are buying notes and not actually lending money, it is important to take all the steps available to you to protect your investment. In order to "pull" a credit report on a mortgagor, you ***must*** have an authorization to do so. The Right to Financial Privacy act requires it. On the other hand...

> ***GAME HINT:*** A signed purchase agreement for the note provides the written authorization necessary to check the credit on the person making the payments, since you have ostensible ownership of the note and are thereby standing in the note holder's shoes.

OTHER IDEAS

You may also want to check out the mortgagor's employment history, particularly if the mortgagor has little or no credit or even bad credit. You could find out where he is employed, how long he has been working and what his long-term prospects are for continued employment. You might even consider a face-to-face meeting if appropriate so that you can judge the mortgagor for yourself.

***GAME HINT*:** On EXISTING NOTES, you never want to meet or talk to the mortgagor until you have the note purchase agreement signed by the seller. Why? You do not want the seller and the mortgagor to start talking to each other before you have an agreement. They just might cut a deal and leave you out in the rain.

TITLE COMMITMENT / INSURANCE

Now that you have received all the requested information outlined previously and have initiated the appraisal of the property, you will also want to procure a title insurance commitment on the note purchase. It is not advisable to purchase a note without having a mortgagee's policy insuring the title on the note. This title insurance policy, which goes into effect at closing, will protect you against defects in the title that could pose a problem to your investment. The title commitment will outline the status of the title on the property securing the note including any defects in the title, liens or other issues that may represent a problem to you. You can review this information prior to closing. The title commitment will convert to a title insurance policy at closing by payment of the appropriate fee.

Remember: It is very important to conduct a title search prior to closing. Failure to do so could result in purchasing a note that has title problems that may jeopardize your investment.

CONCLUSION

You now have an outline of the basic action steps you or your Note Investor will need to take during the information verification stage. As I emphasized earlier, the more efficient you become at moving your deals along, the more money you will make in the business. These action steps truly require some "action" on your part, but you will find a little effort can generate huge results.

As we head to closing, keep in mind the following: No matter how well prepared we think we are, often there are little "glitches" right before a deal closes. Some of them can be helped; a lot of them cannot. Be aware of this ahead of time, and remember this…

GAME WINNING STRATEGIES

- Don't over-promise your borrowers.
- Let your Note Investors set the closing – they have the money.
- Remember the words, **"A diamond is a chunk of coal that performed well under pressure."**

PART FIFTEEN

WINNING THE GAME

"Show me the money!"

Hey Jayme! How do I get paid?

The closing table is where it all comes together. Here, the Note Investor sends money and documents affecting the assignment and transfer of the note, the note seller brings the original note for surrender, and you? You bring yourself, to stand by in case problems come up, to network with everyone there, and to take any compliments and referrals thrown your way.

You don't get your money at the closing table. Up to this point, the seller has no idea what you are making. No need to start now. The Note Investor will send you your money after they have received the closing documents back in their office. Getting the documents returned usually takes about 48 hours; your check is usually mailed out to you within several days of closing.

The closing department sends the money…

Your Note Investor's closing department orders and prepares the documents, and also wires money to the closing agent. Here are the documents that the seller will sign at closing, which have been prepared by the Note Investor, or its attorney:

1. **The assignment of the trust deed or mortgage.** This document assigns the Mortgage or newly created mortgage to the Note Investor, giving him the right to receive future payments.

2. **Mortgagee affidavit or estoppel letter.** Like the estoppel letter for the buyer or mortgagor, this letter will be the note seller's verification of the terms and remaining balance of the note when he sells it.

3. **Letter to the payor informing him of the assignment.** This document is signed by the note seller at closing and is sent to the payor informing him of the sale of the note. It directs the payor (which may be you!) to now make payments to the Note Investor. It is often called a "good bye" letter.

4. **Notification letter to the insurance company.** This letter is forwarded to the insurance company advising them to issue a "change endorsement" naming the Note Investor as the new mortgagee.

5. **Promissory note endorsement.** The Note Investor's attorney may also prepare a promissory note endorsement. Many note purchasers prefer to have the note endorsed to them directly on the note itself.

During the closing, the seller signs documents regarding the transfer of the note and mortgage to the note investor. The note and mortgage are conveyed to the Note Investor, in exchange for a check from the investor to the seller. The seller relinquishes the original note and the mortgage, in effect exchanging ***cash*** (from the investor) for ***cash flow*** (future payments on the note).

SPECIAL NOTE: Closing generally takes place in an attorney's or title company's office, and should be scheduled by the Note Investor who is buying the note. The Note Investor has the money; only the Note Investor knows when he is ready to fund!

Once all of the documents have been signed (which were provided, in most cases, by the attorney representing the investor), the closing agent notarizes them and faxes them to the Note Investor.

Behind the scenes…

Behind the scenes, the Note Investor has had the documents prepared and has over-nighted them to the closer's office. The Note Investor already wired the money, too, so in most cases, the money is in the closing agent's bank account before closing occurs. After receiving faxed proof of all documents being signed, the Note Investor gives the closer a funding number, authorizing him/her to release the funds to the seller.

Mail Out Closings…

Sometimes, the seller is out of town when the closing occurs. If this is the case, the closing agent does a ***mail out*** closing. In a closing done by mail, the documents are sent out to the seller, who signs them, has them notarized, and returns them to the closing agent ***along with the original note.*** When the closing agent has received properly signed and notarized documents from the seller and funds from the investor, he/she will complete the closing in his/her office, disbursing the documents and funds to the appropriate parties per the instruction letter, and recording the necessary documents at the County Recorder's Office.

Simon says…

Closing a transaction is a lot like the game ***Simon Says***. If Simon doesn't *say*, then the player shouldn't *do*. In our version of the game, Simon is the note investor who, by the way, has all of the money. The title company/closing agent must do what ***Simon Says***, following all of the instructions sent by the note investor.

The instruction letter for the title company and/or escrow agent outlines the Note Investor's procedures for the closing. The funds for the purchase will be transferred to the note seller by the closing agent ***only*** when all documents are completed and executed and in the hands of the closing agent. The Note Investor wants to be sure that they, or the closing agent, send the letter to the person making the payments at closing, informing him of the transfer of the note. The letter of notification to the insurance company must be forwarded at closing as well. The closing agent will have the assignment of the mortgage recorded in public record.

Never be intimidated, particularly if you are new to the business, by the paperwork required to close a transaction. *The Note Investor and the closing agent usually prepare and coordinate all of the closing for you!*

PROPER CLOSING & RECORDATION

Once the Note Investors have purchased the note, they must see that their interest in the note and mortgage is recorded at the County Courthouse where the property is located. This will put their position of ownership of the note into public record, preventing the person who sold them the note from selling to multiple parties. This recordation is formal notice of their interest. The title-company, Note Investor, or closing attorney should immediately record all pertinent documents after closing.

POST CLOSING CONCERNS

After the note purchase is completed, the Note Investor needs to make sure several post-closing documents are received. This includes making sure they receive the actual title insurance ***policy***, the completed closing document package and the certificate of insurance from the insurance company naming them as co-insured. Last, but certainly not least, they need to monitor the deal until they receive the first payment on the note. This first payment will provide proof-positive that the payor knows that he now makes the payments to the Note Investor (and not to the original seller, who sold his interest in the note).

Smile and say, "Thank You!"

After a successful closing, make sure you thank ***everyone*** in sight. Thanking people is almost a forgotten art in today's business climate. You will find that providing thank you notes to all who participated in the closing will be greatly appreciated by the recipients and can prove to be an invaluable marketing technique for future deals. Thank the title-company, the note seller, the mortgagor, your note buyer/investor, the appraiser and anyone else you can think of who was involved in the deal.

GAME HINT: Please recognize that thank-you notes are just another facet of your ongoing marketing campaign. The first paragraph of your letter should thank them for their participation. The second paragraph should be a solicitation, asking them to remember you in the future should they ever come across a deal meeting your parameters.

This often-overlooked marketing effort can provide you tremendous dividends. It is simple, easy and it works! ***Try it***.

In Summary…

There are many facets of closing, and though it may seem difficult to keep them all in order, don't despair! That is why you use seasoned professionals to do all of this for you! And boy, do they have a lot to do…

1. **Information verification (review of all documents)**
2. **Credit check**
3. **Title commitment**
4. **Appraisal**
5. **Letters to underlying lien holder (if applicable)**
6. **Selection of closing Agent**
7. **Preparation of closing documents**
8. **A. Instruction letter to closing agent**
    B. Assignment of mortgage/trust deed
    C. Mortgagee estoppel letter
    D. Payor notification letter
    E. Insurance company notification letter
    F. Promissory note endorsement
9. **Communication to payor (regarding estoppel letter if necessary)**
10. **Communication to seller with copy of closing documents**
11. **Closing**
12. **Funds transferred after all documents executed**
13. **Notice-letters sent out**
14. **Post-closing considerations:**
    A. Change endorsement received from insurance company
    B. Receipt of closing package (executed documents & title policy)

C. **Receipt of first payment**

15. **Thank you letters!**

Private Note Investors...

There may be a time when you sell your note to a private note investor, or when you buy it yourself. Please understand that you will need to go through the same steps an ordinary investor goes through, from due diligence to closing. There are, however, a couple of advantages working with private note investors:

- They usually require less paperwork and less due diligence.
- They are a lot more lenient in their buying parameters, often because they invest in areas with which they are familiar and that they can control.
- They can close more quickly.

To find a private note investor, start developing an investor list. Remember that you are going to tell everyone you know, and some you don't know, what it is that you do. Along the way, you will find note sellers; you will also find potential note buyers. Determine their needs, and only approach them with notes which fit their parameters.

I personally invest in notes. Because I have been in the business for a long time, I am fully aware of the risks and am fairly picky about the paper I buy for my personal portfolio. On the other hand, I can usually get a 14% - 20% yield on my money. Which brings up another subject...

Investing for long term high yields...

When we started these materials, I promised to show you ways to make high yields on your personal money, while at the same time decreasing your risk. Here it is:

Would you agree that investing in a partial (rather than a full) purchase decreases one's risk? If the LTV is 95%, we are looking at a high risk note. On the other hand, we can decrease our risk by only investing a portion of that. In other words, we can lower the 95% LTV risk by investing our money at a 50% ITV. We have less invested, and if we should have to foreclose, we have now given ourselves an equity cushion – we can probably recoup our investment a lot easier at a lower ITV.

OK, then... Suppose we had a situation where the note seller had a $100K note, which, by the way, represented a 100% LTV. Pretty high risk, right? Now, for the sake of the example, suppose that the note seller only needed $50,000 now. Could we structure the deal? Sure, and here are how the numbers play out. Keep in mind that our hypothetical note is for $100K at 10% for 360 months, and that no payments have elapsed.

N	**I/YR**	**PV**	**PMT**	**FV**
360	10	100,000	-877.57	0

Now suppose we use the following negotiation strategy: Mr. Seller, seeing as you only need half of the principal balance now ($50K is ½ of $100K), why don't I just make it simple and buy ½ of the remaining payments? The seller agrees, and now your grid looks like:

N	**I/YR**	**PV**	**PMT**	**FV**
360	10	100,000	-877.57	0
180	?	**50,000**	-877.57	0

Go ahead and do the numbers. You may be surprised: if you buy 180 payments for $50,000, your yield jumps up to 20%. In effect, buying ½ of the remaining payments for ½ of the balance effectively doubles your yield. You can even take this a few steps further. Go ahead and try it; you'll see that a ¼ for a ¼ quadruples your yield and so on. And what makes this really great is that every time your yield goes up, you have lowered your ITV and thus lowered your risk.

GAME HINT: Remember the old adage that states, "The higher the return, the *greater* the risk?" We have just debunked that myth and developed our own saying: "The higher the return, the *lower* the risk."

Let's say, though, that you don't have $50,000 to invest. What if you had locked up the previous deals at the terms shown above (½ for ½), then sold those 180 payments to a Note Investor who required a 13% yield. How would you and the seller fare?

Going back to our grid, we find:

N	**I/YR**	**PV**	**PMT**	**FV**
360	10	100,000	-877.57	0
180	19.98	**50,000**	-877.57	0

If we sold those 180 payments to a Note Investor who required a 13% yield, the Note Investor would pay:

180	**13**	69,359.97	-877.57	0

Solving for **[PV]**, we find the Investor will pay $69,359.97 for those payments. You are paying the seller $50,000. You get the rest…WOW! That's a HUGE profit, and all for a little neat negotiating. But wait! Because we are making so much money, does that mean the seller is getting the proverbial shaft? Absolutely not (!) – see below:

The seller gets $50,000 now, and when the final 180 payments revert back to him, he will have a note whose principal balance is still $81,664.

N	I/YR	PV	PMT	FV
180	**10**	81,664.42	-877.57	0

That means that, cash on cash, the seller will receive a total sum of $131,664 for his $100K note! Granted he has to wait for his money, but he still is receiving more than the principal balance of his note. So let's see…the seller gets more than the face value of his note, the Investor gets a safe investment (50% ITV) and yields 13%, and you make a whopping $19,359 profit. Heck, you can even afford closing costs, or…

You could invest in paper…

One of the key strategies that we used when starting our company was that we invested in notes with some of our profits, giving us tremendous yields. It has also helped us build a strong, debt free company. You can too…

Invest using funds from a self directed IRA. There is a great company called Mid Ohio Securities – look them up on the Internet; they are very familiar with this type of investing.

And remember, you don't need a lot of money to invest in notes. Just a little bit at a high yield over a long period of time will bring you great rewards.

It's safer than the stock market, and you won't have all of your eggs tied up in the company retirement plan basket (like some large Houston company we know!).

PART SIXTEEN

PARTING THOUGHTS

"Destiny is no matter of chance; it is a matter of choice. It is not a thing to be waited for; it is a thing to be achieved."

-William Jennings Bryan-

Regardless of whether you use it for quick cash, long-term wealth building, as a part or full time income flipping technique, or as the basis for creating pretty paper to buy and sell real estate, ***paper*** should be an integral part of your overall investment strategy.

This has been quite an undertaking, you and I: you, because of all the time, energy, and money you have invested in learning these great techniques, and me, because of the same reason. I have devoted (at the time of this writing) the last ten years of my life to the Paper business. It wasn't always easy.

And at the same time, it has been a lot of fun for me, and can be a lot of fun for you, too. The paper game literally changed my life; it can change yours, too, if you let it. There is an old Eastern saying that states, "When the student is ready, the teacher will appear." I thank the good Lord that I had the sense to recognize and learn from the lessons life has had to offer; I pray that you, too, will take these techniques and put them into action. Only through action and application will you succeed.

So, in that vein, I wish you the best in your endeavors. It is difficult to keep up with all of the email directed my way, but I am happy to answer any questions you have about the materials, as long as you put your questions in writing, and direct them to:

askjayme@aol.com

Thank you for your interest, and for your willingness to make a difference in your life. I leave you with a parting thought, one that literally helped me turn my life around; one that demonstrated to me that yes, I have choices in my life, and my life is a product of these choices.

"For things to change, I must change."