PROFITS IN UGLY PAPER

by

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PROFITS WITH UGLY PAPER

Imagine sitting at the closing table at a title company, about to close on a “note” deal. The seller shows up with the original note, the note investor has wired the funds, and the closing agent, in her usual no-nonsense business style, calmly goes over the paperwork with everyone, obtaining signatures in all of the right places.

The seller, upon signing over the note, receives her money. She looks at you, smiling, telling you how much she appreciates all you have done for her. Then, picking up her purse (and her rather substantial check from the title company), she happily leaves.

With one eyebrow raised, the title agent now looks at you, a smile slowly playing across her face.

"Congratulations on a job well done. Is this the first note transaction you have ever been involved in?"

"No ", you answer. *"I've been involved in several. "Why do you ask?"*

"I just wondered," she says, as she hands you your check. *"It seems like a very lucrative business..."*

Thanking her, you smile, and then quietly pocket the check she has just handed you. *"It is! " you think, "Oh, it **really** is!"* And to think, for the first time in your career, instead of making your usual 3-5% as a commission on a note deal, you made some ***real*** money this time.

Real money, you reflect, because you finally learned the true power of Paper. ***Real money***, you think again, because you worked *smarter* rather than *harder*. ***Real money***, you echo, as the reality of the transaction finally hits you. You controlled the transaction without ever owning the real estate, without ever owning the note, and without any of your own money. And speaking of money, there it is again...

The *check*...

$28,000...

WORKING SMARTER, NOT HARDER...

Welcome Back! In this volume, I want to share with you the secrets of Paper that make this industry so exciting! And while the title states ***Profits in Ugly Paper***, the truth is that this course will show you how to make ***real*** money with just about *any* paper, as well as control real estate without owning it. Even better – paper is a marvelous alternative to short sales!

I look at Paper like I look at real estate. You can make money in one of ***two*** ways – you can either make money for someone else by representing *them* in the transaction and flipping the note to a note investor, or, you can choose to make a lot more money by having the courage to control the transaction yourself. In other words, *you* can choose to control both the note, and the real estate that secures it.

The choice is yours – you can take the easy road and merely broker deals, thus earning the normal 3-5% that is standard for that type of transaction. This is the path taken by most people involved in the note business. Or, you can choose a more difficult road; the road *less traveled*; the road that requires you to think outside the box, one that asks you not only to *learn* the techniques, but to *apply* them. The second choice requires more knowledge and courage...

...and it also provides you with greater rewards.

This manual deals with Option Number Two. As a result, we'll be discussing working *smarter* rather than *harder*.

HOW TO TRULY PROFIT IN THE NOTE BUSINESS

I started this chapter with a real-world scenario. When I first got started in the real estate and note investing business, I came across a deal that, at first, seemed like any other deal. As the deal progressed, I found it increasingly more difficult to complete. In fact, it wasn't until I was faced with the prospect of the deal falling out completely that a solution presented itself.

The sad part was that the *solution* had been right there, staring me in the face, all the time... You see, I had learned the mechanics of the note business, but at the time, I wasn't thinking about how I could *apply* them in a creative fashion. Finally, a friend of mine pointed out a possible solution, and to this day, I believe that the reason she was able to see the solution that I hadn't seen, was that she was on the *outside looking in*. In other words, whereas all I could see were the *trees*, she was able, from an outsider's view, to see the entire *forest*. And by the way, it was that very deal that started our partnership, and eventually led us to forming our company.

Now then, I will gladly share more about that particular deal later on in the manual (see the chapter entitled, ***Six Ways to Profit***), and I'll also teach you the technique that allowed me to make so much money on a simple note deal! And here's the exciting part – if you will pay attention, I will teach you:

- How to control real estate without owning it.
- How to avoid short sales by going *around* the loss mitigation department
- How to own and control notes with none of your own money or credit, and finally...
- How to make real profits of up to ten, twenty, or thirty thousand dollars per transaction.

One final note: this course assumes you have a basic knowledge of the Paper business, including the concept of Paper itself, as well as the concepts of *discounting* and *yields*. It is an *intermediate* course – if you are unclear on these concepts, be sure and review ***The Paper Game***. Okay, enough said...

Are you ready to go on?

Great! Then let's get started...

ON THE ROAD TO FORECLOSURE

*When to Buy **Ugly** Paper*

When we talk about *ugly* paper, we're really talking about what the industry refers to as ***non-performing*** paper. In other words, sometimes, the paper we find isn't always so *pretty* (for a closer look at *pretty paper* as well as Paper basics, please refer to my earlier course, ***The Paper Game***). *Pretty* paper is defined as paper where the payments are current, the payor has decent credit, and finally, paper in which all of the prior payments have been received in a timely manner.

Then again, there is ugly paper...

Ugly paper is any mortgage, deed of trust, land contract, or other debt instrument where the payments are not current, or where the payor has shown either a *reluctance* or *inability* to pay the payments on time. There is a tremendous amount of money to be made with ugly paper! The note holder, afraid in many cases that the payor will default, is often willing to sell the note at a substantial discount. And while ugly paper may represent more *risk*, the *discount* represents more *profit*.

Before continuing, however, it is important to talk about the different types of defaulted paper, and in order to do so, we need to go over a *foreclosure timeline*. Granted, for many of you, this will be a review. And for those of you who are concerned about me going over the specific foreclosure laws in all fifty states, don't worry – I won't. I *will*, however, ask you to remember that even though the exact procedure and time it takes to foreclose vary from state to state, the overall process is still the same. I will also ask that you check the laws in your particular state for a more accurate picture of what happens in your local area.

THE DEATH OF A NOTE

Let’s take a moment and discuss the whole process of foreclosure, keeping in mind that the main reason lenders and private note holders don’t like to go through the process is plain and simple: they ultimately lose money!

Wait a minute! you say. *How can they lose money? When they foreclose, don’t they take the house back and then resell it to recoup their costs?* As a mortgage banker and as a note investor, I truly wish that it were that simple. ***Unfortunately, it isn’t***. Let me share with you what *really* happens behind the scenes in a foreclosure:

First of all, most lenders don’t have unlimited funds to keep loaning money to people. Think about it: if they kept loaning out money, they would eventually run out. So, they’ve had to figure out a way to get the money back into their coffers so that they can loan it out all over again. Simply said, they sell the loans to someone else, usually other institutions or Wall Street firms. (NOTE: This is just like when a private seller sells his note). When they do so, they recoup their money plus some profit, then loan it out all over again. Specifically, here’s how it works:

Because most lenders don’t have unlimited funds, they first have to borrow the money that they will eventually loan out. It really makes economic sense: they borrow it at one rate, then loan it out at a higher rate, pocketing the difference, or the *spread*. Most lenders have huge credit lines with *warehouse banks*, and pay interest on the money that they borrow.

When a payor borrows money from the lender, the lender writes a check drawn from their *warehouse line of credit*. Every time they draw down their line of credit, they are responsible to pay interest on the money they borrow. The warehouse bank also wants to hold onto collateral for every draw; in real estate, this collateral is the note itself, or the I.O.U. So, at any given time, the lender’s warehouse line is comprised of two items: money that is still available to loan out, and collateral on money already loaned out.

Now then, let’s say that the payor stops making their house payment to the lender. The lender no longer has any money coming in from that loan, but at the same time, the lender is still obligated to pay interest on that money to his warehouse bank (remember, the lender borrowed it to loan it out in the first place). In other words, he continues to have money going out... with none coming in.

How would you like it if you borrowed money to loan to someone else, only to have them stop paying you? You wouldn't like it one bit, and neither do lenders! In fact, what *really* irritates me **[[Editor's note:** *He's really on a roll!***]]** is when payors develop the attitude, "*Well, you should never have loaned me the money in the first place!*" Aaaaaaggggghhhhh!

The Story Continues...

Okay, I've calmed down – let's continue our foreclosure story. The payor has either started making *sporadic* rather than *regular* payments, or... they have stopped paying all together. The lender, in turn, is trying to sell the note just like they do their other notes, but in this case, to no avail. Because the risk of foreclosure is very high, ***no one*** wants to buy a slow-paying or non-performing note! In fact, statistics show that the rate of foreclosure goes up exponentially once the payor is behind sixty days (two months) on his payment.

Now, the lender has already started collection proceedings, and when they don't work, the lender gets serious and sends a letter to the payor demanding that they immediately bring the loan current, or they will begin the foreclosure process. When the payors *still* don't pay, the lender starts the foreclosure process, which varies from state to state. Finally, when the state-specified period has passed, the lender files a ***Notice of Default (a.k.a. N.O.D.)***, which is a public announcement that the payor has officially defaulted on his note, and that foreclosure is imminent.

The time period between the Notice of Default and the actual foreclosure varies from state to state. In Texas, we can file the notice, and then foreclose on the property a mere 21 days later. In some states, the time period between the two events may be up to a year and a half! ***And yes, during that entire time, the payor is still not paying, yet the lender is still paying on the money they borrowed***. In other words, the lender is making the payor's house payments for him!

Finally, the day comes when the lender actually gets to foreclose. The trustee stands on the courthouse steps to announce the sale. Suddenly, he is notified that the payor has just filed bankruptcy that morning, in order to put off the foreclosure. Now, the lender has to go to court and meet with the bankruptcy trustee, and in most cases, has to agree to let the payor include the unpaid back-payments in the bankruptcy. The bankruptcy trustee, however, tells the payor that from this point forward, he has to start making his house payments again.

The payor continues, however, to *not* make his payments, forcing the lender to go back to court weeks later and petition the trustee to take the house out of the bankruptcy. This is called a *motion to lift stay*. (I think of it as the fact that the executioner was at the door, and the bankruptcy court halted the foreclosure process with a *stay of execution*. This motion merely *lifts* that stay, or makes it go away.) Once that motion is approved, the lender can continue with the foreclosure. ***And of course, during all of this time, the lender still has money going out with nothing coming in***.

Another foreclosure date is set, and, hopefully, this time the sale is completed. Some payors have found a way, however, by manipulating the bankruptcy court, to drag the process on for several years - living in the house*free* during that time. And yes, during all of this time, the original lender is still paying interest on the money it borrowed to do the loan in the first place.

However, let's say that the house finally went to the foreclosure sale, and the lender legally took back the property. Getting the property back at foreclosure, however, isn't enough. The lender still has to get the payor out of the property! So, being as the payor is intent on staying in the property as long as possible for *free*, the lender now has to file an eviction suit (which may take another several weeks), and after winning, still has to send the Sheriff or Marshall out to kick the payors out of the property. ***And yes, during the time it takes to complete these proceedings, the lender still has money going out with nothing coming in***.

At last, the payor is out of the house, and of course... left the house in *pristine* condition!

Not!

The reality is that the payors will probably take everything they can get their hands on, including water heaters, garbage disposals, air conditioning units, water meters, etc.

Then, because they are angry at getting kicked out of their property, where of course, they haven't made a payment in quite some time, they punch holes in the walls on the way out! **[[Side Note:** Quite some time ago, my company bought a note on a property in Syracuse, New York. The payor ***never*** made a payment to us. Finally, after about six months of trying to work with her (*The check is in the mail!*), we initiated foreclosure proceedings. After another six months went by with *still no payment*, we received a letter from her. She started the letter by saying (and this is a direct quote), ***"I can no longer afford this house!"*****]]**

HYPOTHETICAL EXAMPLE

Let's speculate that the foreclosure process in our example only took a year (in some states, the entire process can take up to two years). For the purpose of our example, let's say that this is a $100,000 house where the lender loaned $95,000. I am making some basic assumptions about the cost of funds, so bear with me. Let's also assume a yearly property tax-rate of 2.5%.

Taking these parameters into consideration, we find that during that one year it took to foreclose, the lender has incurred the following costs:

- 12+ months of interest on the money they loaned out ($6000). (Remember, I took some liberties here that come from my experience. The lender *borrows* money in order to loan it out, and therefore, has to pay interest on it)
- Lost profit revenue from not selling the note ($3325). (Normally, the lender sells the note on the secondary market – that's how they make their money. And yes... the amount I listed is very realistic for a note of this amount!)
- Legal fees to foreclose ($2000).
- Accrued property taxes ($2500). (If the payor isn't paying the lender, you can be assured that the tax man isn't receiving his share, either! And, property taxes continue to accrue, as, "T*he tax man waits for no one!*")
- Property damage repair ($5000).
- Force-placed property insurance ($1000). (Most likely, if the payor isn't paying the lender or his property taxes, he won't be paying his property

insurance. So, the lender *force places* insurance on the property, so that their money can be recouped in case it is destroyed by fire, etc.)

You do the math – the lender has now *lost* $14,825, and that doesn't include the $5000 we've allocated to make any repairs! When you look at it this way, they have $95,000 invested in the property, plus an additional $14,825, for a total of $109,825! And even in pristine condition (which you know it isn't), the property is only worth $100,000! (*Aaaah, Houston? I think we have a problem*.)

Now, as you well know, the property never sells for full market value after a foreclosure, but is usually sold at a *discount*. Our subject property needs repairs, and will probably be sold down around $70,000. And yes, even in an "up" market, foreclosures that need repair sell for considerably less than market value.

This means that the lender will lose $25,000 in principal ($95K less $70K), and will incur another $14,825 in additional costs. And yes, if you've been following along, you are absolutely correct in your assumptions: in this case, **the lender lost almost $40,000 on this transaction!**

Now let me ask you something...

"*If you were a lender, would you want to go through all of the time, money, and hassle associated with foreclosure, or would you just prefer to sell the note at a discount, cut your losses, and move on to something else? For that matter, what if you were a private seller who had carried paper and were faced with the same dilemma?*"

A DAY IN THE LIFE OF A DYING NOTE

This may sound morbid, but it is the best description that I could use to describe a note on its way to its death. You may remember in ***The Paper Game*** when I explained the word *amortization*, and how it derives from two Latin words literally meaning, "To the death." In the case of ugly paper, however, that *death* comes a lot sooner. In fact, it is almost as if the note has a disease and is expected to die before its time. "*How?*" you ask? "

"Simple!" Once a payor stops paying, in most cases it is inevitable that the note is headed to its death, or in this case, to foreclosure. As we just discussed in depth, lenders and private note holders hate foreclosure for the simple reason that they lose money!

I've drawn a little timeline for you below, which has been divided into five different time periods. Each segment represents a period of time in the life of a dying note; these are the same segments that I briefly mentioned in the discussion on foreclosure we just had. And while the length of each segment may vary from state to state, keep in mind that the steps are still the same, and happen in the same chronological order no matter where you live. Here's the timeline:

S&D SLOW PAY NON-PERFORMING N.O.D. NOTICE OF SALE

Reading from left to right, you'll see that there are five distinct, *different* time periods that are included, all leading up to the actual foreclosure (which is the next step after "notice of sale"). Each of these time periods represents a different time when you can buy ugly paper, and each time period represents different motivation on the part of the note holder (lender or private note holder), as well as differences in how much you would expect to pay for the note.

[[SPECIAL NOTE: The prices that I mention in the following sections are only ***guidelines***. The ***actual*** price you pay for a note will vary, and will depend on the property's condition and location, the local real estate market and the demand for the property, as well as, ultimately, the lender's motivation.**]]**

FIVE STAGES OF A DYING NOTE

Stage One -*SCRATCH & DENT*

Remember when we mentioned earlier that lenders sell their loans to other institutions? Well, there are some cases in which nobody will buy that loan. Case in point: Let's pick a fictional lender and call them ***Lending Giant***. *Lending Giant* loans Barbara

Buyer money, with the intent of later selling that loan to *Lehman Brothers*, a large Wall Street firm that buys loans. In fact, the only reason that *Lending Giant* loaned Barbara Buyer money in the first place was that they knew her loan was sellable, because it met Lehman Brother's *requirements* for buying that loan.

Now, let's say that Barbara's credit score was 683 when she bought the property, and let's say that Lehman Brother's credit criteria to buy this loan was a credit score above 680. So far, so good. After closing, however, Barbara went out and bought a brand new car to go into her brand new garage, and by incurring more debt, dropped her credit scores to 659. Granted, she is still a good credit risk, and granted, she is still making her payments. The problem, however, is that even though *Lending Giant* has already closed on this loan, *Lehman Brothers* won't buy it, as it no longer meets their buying requirements.

What's a lender to do?

In most cases, this loan is sold to someone else, and usually at a discount. Just like a banged up car commands less money when sold, so does a *scratch and dent* loan sell at a discount. *How do you benefit?*

We already know that we can buy seller-financed notes at a discount. This, however, is a case where an *institutional lender* is also willing to sell their note at a discount! The best part is that this is a *common* practice among lenders (They even have a *name* for it – Scratch & Dent!) and they *expect* to take a loss. **In most instances, they will sell this type of paper for 96-98 cents on the dollar and in today's post-meltdown market, often less.**

In ***The Paper Game***, you learned how you could buy a note at a discount, and literally flip it to an institutional note investor at a higher price, pocketing the difference for your profit. You can do the same thing here as all of the same rules apply. Keep reading, and I'll show you later on in this manual other, more profitable, things that you can do with discounted paper. In the meantime, however, let's move on to ***Stage Two*** in our timeline.

Stage Two –*SLOW PAYING*

When a payor starts to fall behind in his/her payments, we refer to that as a *slow paying* note. As you might imagine, a slow paying note represents a higher degree of risk than one where the payments have all been made on time. *Why?* Because the payor either does not have the money to make his payments as scheduled, or, because he really doesn't care enough about his credit to insure that his payments are on time every month. Either way, we look at *slow paying* as one step closer to foreclosure.

Slow paying notes represent yet another profit opportunity for us, for several different reasons:

1. Lenders expect to sell them at a discount.
2. The discount is usually greater than regular *scratch & dent* loans.
3. We can purchase them from both *lenders* and from *private sellers*.

As in the case of scratch & dent loans, lenders know that the note they are carrying does not represent the cream of the crop! In fact, they know that once a payor falls behind on his payments, the probability of foreclosure goes up exponentially. They are unable to sell this note to their intended Wall Street buyer, because it no longer fits their guidelines. They don't want to keep it, because they want to replenish their coffers with money that they can loan out again. And, in many cases, they cannot keep this note, as the terms of their Warehouse Line of Credit won't allow them to do so.

At this point, the lender has a couple of options. They can either put the note into their *workout division*, which specializes in working with the payor to bring their payments current, or, they can avoid the hassles, and *sell* the note. Usually, they will work with the payor for a period of time, hopefully bringing the payor current. Even if this happens (and the loan is worth a lot more on the secondary market if it is current!), the loan has been *red flagged*, and they will sell it, at a discount, as soon as possible.

If they are unable to bring the loan current, they will most likely sell it at a significant discount. **Most institutional notes that are in *slow pay* status sell for between 88 and 92 cents on the dollar.** (More later on how to find these notes...)

This Works Not Only with Lending Institutions, but with Private Sellers, too!

What's even better is that you may come across this same scenario with a *private seller*! One of the things that I've found over the years in the seller-financed market is that private sellers often sell their notes when they experience problems in collecting the payments. They're pretty easy to spot. "*Why are you selling your note*," I ask. "*Well*," they answer, "*I'm tired of collecting payments, and would rather have the cash*." The between-the-lines interpretation of their response might be, "*It is a real hassle collecting the payments, because the payor either falls behind, or pays sporadically, or jerks me around. And, the prospect of receiving a lump sum of cash rather than putting up with all of the hassle is very enticing*!"

One of the great things that I've also found about private sellers is that they have a tendency to lie to you! Yes, you read that correctly... ***sellers lie***! Even though their payor is behind in his/her payments, they'll look you straight in the face and tell you that they have received all of the payments on time! They feel that they can pass their problems on to someone else, kind of like those kids in that old Life-cereal commercial, "*Hey, let's get Mikey! He'll eat anything!*" They want to sell you the note, and are willing to lie to you in hopes that you will buy it! Here's the fun part:

When you go to buy a note from a private seller, they'll always want you to give them a price *before* they start giving you all of the documentation that you need. Note investors' prices are predicated on the fact that the note is current, a fact that you should pass on to the note seller. In fact, you should put it in writing when you present them the offer. Then, when you ask them for a 12-month pay history on the note, they'll either be able to prove a solid pay history or, they'll be caught right in the middle of their lie. In fact, you'll have them *dead to rights*! **[[Editor's Note:** *He's showing off the fact that he's learned how to speak "Texan."***]]**

When it comes to negotiating an even lower price for the note, who's in the driver's seat now?

Stage Three – *NON-PERFORMING*

Non-performing notes are past the stage of slow paying. When a note is classified as *non-performing*, it simply means that the payor has stopped making payments altogether. The fact is, when a note gets to this point, most lenders consider it to be past the *point of no return*. In other words, foreclosure is imminent.

NOTE: Because there are so many of these notes in the market today, lenders have even developed an acronym for these notes: NPNs (non-performing notes)

As before, the lender has a several options: they can file a Notice of Default (see Step Four) and officially start the foreclosure, they can approve a Short Sale if the homeowners sell the property or, they can sell the *note*. Keeping in mind the time, money, and effort that goes into the foreclosure process, you can easily see why this is a wonderful time to buy notes from both private sellers and from lending institutions. **If you find a note that is non-performing, you can expect to pay between 65 and 80 cents on the dollar for it, *depending on the asset itself as well as the geographic locale***. But wait! It gets better!

Step Four –*NOTICE OF DEFAULT*

Finally, the lender's patience runs out! Keep in mind that most lenders will work with delinquent payors as long as the lines of communication are kept open, and as long as the payor adheres to their promises. However, if the payors continually lie and make empty promises ("*I'll send a check out to you at the end of the week when I get paid…*"), there comes a point where the lender gets fed-up with playing the game. This is when they file a public notice (usually by an ad in a local newspaper) telling both the payor and the rest of the world that the payor is in default on his loan, and that they, the lender, are going to foreclose.

This ***Notice ofDefault*** (N.O.D.) is a required step in most states before a lender can foreclose. It is public record, so it is fairly easy to find (research your local County Records Office – the same place you'd find seller-financed notes), and is, of course, an even better time to buy a note from either a lender or a private seller. Foreclosure and all of its costs and hassles is now a sure thing. *If you were the lender, wouldn't you want to sell your note at this time, rather than go through with the foreclosure?* Sure you would, and you would probably gladly take the discount and move on to more pleasant things (like dealing with notes where people actually pay on time!).

The Power of Short Sales

As of this writing, there is a technique that is literally sweeping the country called ***short sales***. The concept of short sales has been around for quite a long time (the lender is taking less for the note than is owed), but it is recently coming to light as an excellent technique to buy property. In this technique, as it is taught by most instructors, you research County Records to find Notices of Default in your area. Then, working with the seller of the property (who is very motivated because they are facing foreclosure), you prepare a package to present to the lender. In this package, you convince the lender to take less than they are owed. Then, you buy the property from the seller, paying less than is owed on it.

If you are a property investor, you are bound to come across properties that are in pre-foreclosure, properties where, in many cases, the N.O.D. has already been filed. If this doesn't excite you, it should! Because foreclosure is right around the corner, and they really don't want to contend with all of the hassles associated with foreclosure, lenders will usually take less than what is owed on the note *after* the N.O.D. has been filed.

Let's say that you find a house where the sellers currently owe a mortgage of $85,000, plus arrearages of an additional $8,500. Not only will most lenders accept a payoff of $85,000 (meaning that they forego the money owed to them for back payments) but, in many cases, they will accept even less than that! **On many notes where the Notice of Default has been filed, expect to pay 60 to 75 cents on the dollar.**

Now then, this isn't a course on short sales. In fact, there are many good short sale courses available. I would suggest that if you are interested in specializing in this technique, you do an Internet search on ***short sales***. On the other hand, all that you need to remember about this section is that, once the N.O.D. has been filed, both lenders and private note sellers are very motivated to sell their notes at a steep discount. And of course, the greater the discount, the greater your potential profit!

Step Five – NOTICE OF SALE

Notice (no pun intended) that the closer we get to the actual foreclosure sale, the more motivated the note seller becomes! That being the case, they are probably the most motivated after the ***Notice of Sale*** has been filed. In many states, this is the final notice in the foreclosure process that basically states that the lender has completed all of the requirements necessary to go through with the foreclosure, and has set an actual date for the sale.

I don't think that I need to elaborate on the fact that the note seller does not want to go through with the sale if he doesn't have to, and therefore is willing to take a discount. **I would suggest that you negotiate as low as possible for this note, and frankly, I would never go over 65 cents on the dollar.** (Then again, if there is a lot of equity in the property, I may, on occasion, pay more for the note.)

SECOND LIENS

A note about *second* liens: *Second* liens, by their very nature, represent a higher risk than do *first* liens. *That having been said, none of the numbers I have stated above apply to second liens*. Instead, you should adjust your offer downward. For example, on a second lien where the payor has completely stopped paying, I would never offer more than 30 cents on the dollar, and in most cases, I would offer considerably less. I will discuss these more in depth when we get to the chapter on second liens later in this course.

A QUICK REVIEW

In this chapter, I've shown you different times that you can buy ugly paper, with each point in time representing a different motivation on the part of the seller, as well as a different profit margin for you. Before going on to discuss potential pitfalls in buying *ugly* paper, as well as things to look for, let's review what we've covered so far:

1. The foreclosure timeline varies from state to state, but usually follows the same steps and procedures.
2. Those steps, along with your expected pay-price, are:
   a. **Scratch & Dent** **96-98 cents** on the dollar

b. **Slow Paying** **88-92 cents** on the dollar
c. **Non-Performing** **65-80 cents** on the dollar
d. **Notice of Default** **65-75 cents** on the dollar
e. **Notice of Sale** ***Make an Aggressive Offer!***

3. Keep in mind that the prices I have listed are only *suggestions*: lenders and note sellers will ultimately accept a price that is ***optimal for them***, and ***that price may be higher or lower than what I've listed***. The key here is not to be greedy, but to make the transaction worthwhile for you.
4. Second liens represent higher risk; therefore, you should offer less for them.
5. If you buy these notes in bulk, your pricing will be better than if you buy them on a one-off basis (one at a time).

PERILS AND PITFALLS!

*Things to Check **Before** You Buy!*

Just because you find a note that you can buy at a substantial discount, keep in mind that in the case of ugly paper, the payor still represents a greater risk of foreclosure! You should, therefore, take specific steps to insure that you end up with a deal that you can not only live with, but one that is going to make you a nice profit, too!

CRITERIA FOR BUYING UGLY PAPER

While there are numerous items you need to check before ever signing a piece of paper (including an offer to purchase the note), they ultimately fall into *four* categories:

1. Do you want the property?
2. Can you work with the payor?
3. What does a title search tell you about the property?
4. After factoring in all of the costs, does the deal still make sense?

Let’s look at each of these separately, keeping in mind that you, too, will want to go through these steps before making a decision to buy the note.

DO YOU WANT THE PROPERTY?

As I mentioned in the introduction to this chapter, the very fact that you are buying *ugly* paper rather than *pretty* paper means that your chances of having to foreclose and repossess the property are fairly high. In fact, it is almost a certainty that, in most cases, you will end up owning the actual property! So, the question is, *Do you want the property?*

Most people who buy non-performing paper are real estate investors who are doing so only to ultimately control the property. You may be one of them. If this is true, then all of the rules of real estate investing apply to you, the buyer of ugly notes:

1. ***Only buy an ugly note on a property that is within a 25-mile radius of where you live or work***, so that you can easily manage the property, its tenants (if any) and/or its sale. I've seen many beginning investors get into trouble because they've identified and purchased a good deal, only to have it be in another state! It's pretty difficult to keep track of a property so far away.

2. ***Only buy an ugly note on a property that you wouldn't mind owning.*** The bottom line is that you should never buy a defaulted note secured by a property that you don't want. Be sure and check its condition *before* you ever make an offer.

3. ***Only buy an ugly note if you are absolutely certain about the value of the house***, both in its present, *as-is* condition, as well as its *after-repaired value* (A.R.V.). *How do you determine the A.R. V.?* You have to talk with real estate agents familiar with the area and see what comparable houses have sold for in the last 60 days. You should also talk with neighbors and ask them their opinion of value. And, of course, you can always check the tax records, as long as you know how the *tax value* compares with the *market value* for that particular area. And finally, you can use www.eppraisal.com for a rough estimate (and it's free!)

   In other words, how will you know that you are getting a good deal if you don't know what the house is worth? Smart real estate investors and note investors alike know that, as quoted by a famous real estate author, *Until you know value, you know nothing!*

4. ***Only buy an ugly note <u>after</u> you have an exit strategy in place!*** (Will you lease it, sell it, or?)

CAN YOU WORK WITH THE PAYOR?

There is a lot to be said for this topic, and the only way for you to get the information is to, quite simply, go and knock on their door. Tell them that you are in the process of buying the note, and that the *last* thing you want to do is foreclose, preferring, instead, to work together with them and find a way that they can stay in their home.

That having been said, and before we go on to exploring the questions we need to ask the payor, let me emphatically state: ***there will be occasions where you will NOT want to work with the payor!*** Instead, you will want to get them out of the property as quickly as possible, whether through foreclosure, or just getting the deed from them and asking them (maybe even compensating them) to walk away. Why? Because there are certain people who have shown no pride of ownership, their house is a wreck, and most likely, they will continue to abuse the property after you have purchased the note.

Now I am *not* saying that every note that you buy has to be secured by a pristine house. I *am* saying that you need to meet with the payors, and decide for yourself if they will follow through on their obligations to you. You see, you really only have *two* choices:

1. ***OPTION ONE:*** You can choose to work with the payors and leave them in the property, or...
2. ***OPTION TWO:*** You can opt to get them out of the house in whatever way is best for you.

That's it – there are only those two choices. Granted, there are many variations on those two choices, but they all boil down to those two. So, the question is, *What will you do with the property once you control the paper on it?*

Let's look at ***Option One***: you want to really be a good person and help these people in any way that you can to stay in their home, and not lose it to foreclosure. Let's face it – some people have fallen on hard times, and it really makes us feel good if, through the course of our daily business, we can make money while at the same time, help someone. If you can do this, I heartily recommend it! Of course, you need to do some homework to see if this is feasible.

The first thing that you need to find out is whether or not the payor wants to stay in the property, and if so, if he/she can afford to start making payments again. Many times, when faced with foreclosure, payors will simply *bury their head in the sand,* hoping somehow that their problems will magically disappear. While you and I know that this isn't the case, it, nonetheless, happens.

Throughout my years as a mortgage banker, we've had several people default on their mortgages. Each time this happened, the first thing that we would do is contact the payor, either directly if possible, or by sending an intermediary to the property. You'd be surprised how many times we would come across someone who had lost his job, or gotten injured and laid off, yet was afraid to give us a call. What was even sadder is that these people were quite willing and able to resume their payments – they just couldn't catch up on the ones they'd missed.

Now, faced with a similar scenario, most lenders would have started the foreclosure process by this time. You'd be surprised how many times foreclosure decisions are made by employees on the bottom of the totem pole who are merely following the exact procedures as laid out by their boss, rather than by someone who was able to think outside the box and consider the human element. *These bureaucratic personnel will actually reject payments made by the payor, so that they can start the foreclosure process*. As a lender (wearing my lending hat), this doesn't make a lot of sense to me, but then again, that's where we, as real estate and note investors (different hat!) can help.

We can think outside the box and help the payors! ***After we buy the note, we can restructure it and generously put the back-payments onto the other end of the loan***. In other words, we could show the loan as current, and add all of the missed payments onto the back end of the loan. For instance, if the payors were ten payments behind of $800 each, we could report them as current, and simply add $8000 to the loan balance (*more about this in the next chapter*).

When visiting the payors (again, prior to buying the note), create some rapport and let them know that you are considering buying the note. Tell them that if you do, you have several choices, but that your first one is to help them stay in the house. Ask them the following questions:

1. *What happened that made you fall behind in the first place? Is that problem still an issue in your life, or have you resolved it?* (For instance, if they lost their job, do they have a new one?)

2. *If we can come to an agreement, would you like to stay in the house?* (They'll most likely answer yes, but remember, if you get a bad feeling, don't even go down this path!)

3. *Can you afford to start making payments again? Can you afford anything extra per month to cover the payments that you missed?*

4. *If you cannot afford the original payment amount, how much* **can** *you afford per month?* (In this case, you have the ability to re-write the note once you have purchased it. You may decide to lower the monthly payments so that they can afford it. And in many cases, when you restructure the note, you can actually give yourself a better return and help the payor at the same time!)

Then again, there is ***Option Two.*** Remembering back a few pages, this is the option that you choose when you feel that there is no equitable solution presented by keeping the payors in the property. If you choose this option, you have yet another two choices:

1. **Will the payor cooperate and sign the deed to the property over to you in lieu of foreclosure?** (You may urge them along with this by *helping* them with their decision: *"Mr. & Mrs. Owner, either go through the foreclosure process and all of the negativity associated with it, or, accept cash to relinquish the deed and move."* Then, ***offer them $2000***: $1000 upon signing over the deed, and another $1000 on the day they move out and leave the house in good condition.)

2. **What is the likelihood that the payor will file bankruptcy to forestall foreclosure?** If the payor plans on doing this, you either need to be willing to incur extra costs and time, or, you need to be willing to walk away from the deal and move onto the next one.

WHAT DOES THE TITLE SEARCH TELL YOU?

The third step in avoiding the *perils and pitfalls* of getting into a bad deal is researching the title to the property. When you get a ***title search*** (which you should *always* do), here are some questions that you need to ask:

1. Is the note that you are considering a first lien or a second lien?

a. If the note is a *first* lien, you'll want to find out if there are any junior or subordinate liens on the property. If so, <u>you will need to foreclose them out, or buy them at a steep discount</u>.

b. <u>If the note is a *second* lien, you'll want to make sure that there is plenty of equity in the property.</u> It is only on rare occasions that it makes sense to buy a non-performing second lien (more about 2nd liens in a later chapter). For instance, if you were looking at a \$100,000 house with a \$60,000 first lien and a non-performing \$40,000 second lien that you could pick up for \$10,000, it would make sense to do so, because you'd end up controlling the \$100,000 property for \$70,000 (\$60,000 + \$10,000). Then again, if the *first* was for \$90,000 and the *second* for \$10,000, it makes no sense at all!

2. ***What other liens are there on the property? Can they be foreclosed out*?**

a. With ugly paper, you'll often find that there are other judgments and liens against the payors that may have attached to the property. Realize that you can usually get these released, so that the judgment holder retains his judgment against the payor, but releases it against the house (it's amazing what a little cash will do!). For example: "*Mr. Judgmentholder, I'll give you a \$1000 now to release your \$30,000 lien, and you can keep your judgment against the payor. Or, I can just let it go to foreclosure, in which case you will not get anything.*"

b. You can foreclose on most liens and judgments and make them go away, with the *exception* of property taxes, which you will need to pay. Speaking of property taxes...

Let's look at our final question prior to entering into an agreement to buy the note.

AFTER FACTORING IN ALL COSTS, DOES THE DEAL STILL MAKE SENSE?

It's the little things that are the pitfalls in life: little things with *large* consequences. There are a lot of hidden costs associated with ugly paper, and only the uneducated novice (with a self-destruct button) would fail to take these into consideration. In other words, even if you are buying the note at a discount, you may still run into additional costs, and only by considering all of them will you be able to determine if this deal still makes financial sense. Before looking at them, however, we need to establish some parameters for this example:

A.R.V. (after-repair value of house):	$100,000
Outstanding Note Balance:	$ 75,000
Junior Liens:	NONE

Let's say that the $75,000 is in default, and that you are able to purchase the note for $40,000. "*Wow*," you say. "*What a great deal! I can pick up a $100,000 house for $40K!* Well... *maybe*, and then again... *maybe not*! Here are some potential costs that you need to consider:

FORECLOSURE COSTS: After meeting with the payors, you'll need to determine whether you can work with them, or whether you will have to go through the foreclosure process. Keep in mind that the legal fees associated with the process will run you around $2000. And, if you borrowed the money to buy the note, you also will need to take into account that your holding costs (cost of the money you borrowed) will go up, because of the extra time involved. Speaking of which, you'll also need to consider...

COST OF FUNDS: I have devoted an entire chapter to assist you in getting the money to complete these transactions. Bear in mind that most money, however, isn't free, which is okay, because you just factor its cost as an expense for doing the deal. Let's say that in our example, you want to borrow $50,000 ($40K to buy the note and another $10K for fix up). If you borrow it from a private lender, you'll need to factor in at least 3 points in fees ($1500) and at least another $1500 in holding costs (3 month's payments of $500), for a total of $3000.

POTENTIAL REPAIRS: Once again, you may be unable to work with the payors, and they may be reticent in giving you the deed to the property. If this is the case, be prepared for some extra damage that will happen to the property on their way out the door! The other thing that you want to take into account is that the property will need some *sprucing up* to draw top dollar when you put it back on the market. It is imperative that you give yourself plenty of *cushion* when estimating these potential repairs. In our example, I've gone to the high side and estimated $10,000.

FUDGE FACTOR: Finally, let me suggest that there are negative factors that affect even the best-laid plans. Weather may delay the fix-up on the property. The payors may decide to fight you in your attempt to evict them. Your lawyer may be running a special on foreclosures that month (by charging double...). So, always factor in a little *extra* to hedge your bets, just in case something goes awry. In this case, I've allowed another $5000.

DOES THIS DEAL STILL MAKE SENSE?

Let's recap all of our costs, and see how much we could conceivably invest in this deal. Then, let's add them up, and divide by the value of the property to give us an accurate picture of our overall exposure:

Note Cost:	**$40,000**
Foreclosure Costs	**$ 2,000**
Cost of Funds	**$ 3,000**
Potential Repairs	**$10,000**

Fudge factor	**$ 5,000**
Total Costs:	**$60,000**

If we take the total projected cost of $60,000 and divide it by the *After Repaired Value* of the property (*A.R. V.*) of $100,000, you'll see that we are into the property for a grand total of 60%, which, if I say so myself, is a pretty good deal! Then, you could option the note, or... refinance it and pull out tax-free money, or... sell it, or... lease option it... and... *Oh, wait! Im sorry! Thats covered in the **next** chapter!*

SIX WAYS TO PROFIT

Making Money with Defaulted Paper

Warning, Will Robinson! Warning! You may have to read this chapter several times to get the full gist of things. After I wrote it, I realized just how much information I've packed into it, with each progressive technique getting a little more difficult. So... the way to read this is the same way you would eat an elephant: ***Slowly, and One Bite at a Time!*** **[[Editor's Note:** *Dont let him scare you…like me, I think that the more* ***you*** *get into this chapter, the more excited you'll get! Especially when you come to the last technique!* **]]**

Hopefully, I haven't scared you off, because my intention was to do just the opposite! This chapter, in my belief, is where this material really starts to get fun! I know, you're probably thinking that I should be walking around with a calculator and a pocket-protector (no offense intended to my readers whose daily uniform consists of these items!), but the reality is that when it comes to making substantial *profits in paper*, I just plain get excited. You can't deny a guy his fun, can you?!

Seriously, in the chapter we'll be discussing several different ways of making money using defaulted paper as our vehicle. You'll note from our brief discussion in the introduction that we can look at paper from two different angles: we can either represent someone else in the transaction and make the standard 3-5% for our fee, or...we can courageously take the risk and control the paper for ourselves, resulting in profits that are 20% or greater!

I'm pretty sure that you are one of the latter, and that's why you purchased this course. With that in mind, let's discuss six specific ways that you can make money with defaulted paper. Before, however, we go on, we need to make sure (as we say here in Texas), that we are all "*singin off the same page in the hymnal*." In other words, let's set some parameters:

NEW MASTER DEAL

It will be a lot easier for us if we take a *master deal*, and use its numbers throughout the six different methods, so that you can easily compare them. Keep these numbers in mind:

$150,000	Value of the Property – no repairs needed (A.R.V.)
$120,000	Present Value (PV) or Current Balance of the Defaulted Note
$ 84,000	Price you pay for the note (you paid 70 cents on the dollar)...
$ 7,200	Amount that the payors are in arrears ($1200 X 6 months)

Are you ready? Then let's get started!

Six Money Making Strategies

There are quite a few ways to make money with defaulted paper. Some of them are basic, as you'll find in this chapter, and others are more advanced, which you'll find in a later chapter entitled, ***Generating Cash Flow with Paper***. To start with, however, you need to learn the basics, and learn them well. Remember, as a musician friend of mine likes to say, *The better you know the melody, the easier it is to harmonize.* In other words, a thorough knowledge of the basics makes it a lot easier to be creative.

Take a minute and review the previous chapter, if necessary. You'll find that we talked about *two distinct options* when it comes to dealing with payors on defaulted notes: either **a)** they merit you working with them or, **b)** they're like a bowl of granola: if they're not fruits or nuts, they're *flakes* and need to get out of the property. Ultimately, those are your only two choices, and the reason that I ask you to review them is that the following six options depend on which choice you make.

In short, in this chapter we'll be discussing the following six profit-making possibilities after you have purchased the note. Let's first look at them in outline form, and then go into each method in depth. To summarize, you can buy the note with the intent to:

Option the Note

Get the Deed, in which case you could:

- Refinance in your name, then lease
- Sell the Property

Foreclose, in which case you could:

- Refinance in your name, then lease
- Sell the Property

Work w/ Payor to bring note current, and then **Refinance**
Work w/ Payor to bring note current, and then **Sell Note**
Work w/ Payor to bring note current, then **Use It For Trade**

Now then, let's look at each one of these techniques in detail...

PROFIT STRATEGY #1 – OPTION THE NOTE

As you learned in ***The Paper Game***, a very common technique in the buying and selling of paper is to tie a note up under an option to buy it at one price, and then have a back-end note investor buy it from you at a higher price. In other words, if we were discussing Pretty Paper (performing notes), you would be able to get a price from your note investor, then sign an Option to Purchase Agreement to buy the note from the note-seller at a lower price (discussed at length in ***The Paper Game***).

While the technique is the same, in this instance we are *not* talking about *pretty* paper. Instead, we're talking about *ugly* paper. Note investors don't buy ugly paper, but real estate investors do! In other words, why not tie the note up under an ***option*** (telling the seller that you reserve the right to buy the note at a certain price at some point in the future, depending on your due diligence), then *wholesale* it to a rehabber?

Think about it: the note is non-performing (*ugly*), so you probably won't find anyone to buy it from you at its full retail value. On the other hand, real estate investors who fix up properties for resale (*rehabbers*) would be very interested in picking up a note at pennies on the dollar. Why? Because it allows them to control the real estate for pennies on the dollar!

Obviously, you'll want to sell it to them at a *wholesale* price, meaning, not that much more than you've agreed to pay for it. Leave room in the deal for them to make a profit, because they'll be doing a majority of the work! In other words, all you are doing is finding the note and tying it up under an option – you're not taking any of the foreclosure, fix-up, or marketing risk. The rehabber is, and because of that, he deserves the lion's share of the profit.

In the case of ***optioning a note***, then ***wholesaling it to a rehabber***, keep in mind a few things:

1. By optioning the note and then reselling it, you can actually use the rehabber's money to close the transaction! In other words, you'll exercise your option to buy the note using the rehabber's money.
2. You are not taking any risk, so your return will be substantially lower than if you chose this deal for yourself. When you option, then wholesale a note, expect to make approximately 3-5% of the note amount as your profit.

Finally, feel free to think *outside the box* when it comes to optioning, then reselling a note. After optioning the note, you could, if you so chose:

1. Sell the note to a rehabber for cash (which he would provide to close the transaction), and also take an equity position in the deal. In other words, you could split the potential profit when the property eventually sells.
2. Sell the note to a rehabber for some cash now (which he would provide to close the transaction), and some more cash (a predetermined amount) when he resells the property. This differs from Option One in that you are agreeing to accept a set amount of cash, rather than take an equity-participation. For instance, you might agree to have the rehabber fund the note acquisition, and

then pay you an additional $5000 when he eventually resells the property.

PROFIT STRATEGY #2 – GET THE DEED

This profit strategy assumes that you have chosen not to work in keeping the payor *in* the property, but rather, have decided that the best thing is to have them *leave*. Then again, maybe the payors have come to that decision on their own (they can no longer afford the property, etc.). Whatever the case, there is a way of getting the payor out of the property that is preferable to foreclosure.

Remember our earlier discussion covering the things that could happen on the way to foreclosure, including the payor filing bankruptcy to postpone it, destroying the property on the way out, etc? One surefire way to avoid all of that is to give them an *incentive* to leave and, at the same time, give them an *incentive* to deed the property over to you. As we said in a previous chapter:

> **Will the payor cooperate and sign the deed to the property over to you in lieu of foreclosure?** (You may urge them along with this by *helping* them with their decision: *Either go through the foreclosure process and all of the negativity associated with it, or, accept cash to relinquish the deed and move.* Then, ***offer them $2000***: $1000 upon signing over the deed, and another $1000 on the day they move out and leave the house in good condition.)

Having the payors deed you the property rather than going through the hassles of foreclosure benefits both you and the payor: the payor avoids having a foreclosure on his/her record, and you get a property back in decent (though probably not pristine) condition. Now consider this: Not only do you own the note on the property, you now own the property itself, giving you two choices:

Choice #1 - Get the Deed and... REFINANCE:

First of all, you could refinance the property for what you paid for the note. Now then... *why do you want to refinance*? For a couple of reasons: A) Maybe you used personal money (or private financing) to buy the defaulted note – in this case, you're refinancing to pay off that high-cost financing with a lower-cost loan. B) Maybe you didn't buy the note at all, but just got the deed to the property from the owner. In this case, you'll still need to negotiate with the lender to pay them off at a lesser price than what's owed to them.

Going back to our original example, you could refinance your $150,000 property (remember, by getting the deed, you now own the property!) for $90,000, giving you $84K to pay for the note, and another $6K in closing costs. This is called a "rate & term" refinance, because your new loan is only enough to cover existing liens and closing costs. If you do so, here's what happens: *You've now paid $90, 000 for a $150, 000 property, giving you* ***$60,000*** *in equity - certainly not a bad profit for one deal.* Then you could hang on to the property, rent it out, lease it out with an option to buy, etc.

Better yet, why not refinance for 80% of the $150,000 value at $120,000? This gives you $84,000 to pay for the note, $6K in closing costs, and another $30K to put in your pocket! Wait – this gets better! The $30,000 that you put in your pocket is tax-free, because it is borrowed money! And, you've left $30,000 of equity in your property!

Of course, you'll need to cover the payment on that refinance (be it the $90K or the $120K), but *couldnt you lease the property out and have someone else make the payment for you?* Even better, if your monthly income exceeded the loan payment, you'd have given yourself yet ***another*** profit center!

Choice #2 - Get the Deed and... RE-SELL:

Then again, you could get the deed, and if you're not into holding on to the property for tax benefits and appreciation, you could always *re-sell* the property to someone else. If you chose to do this, you'd realize the following:

1. You could re-sell for less than market value (to facilitate a quick sale) and still realize a substantial profit. Even if you sold for $140,000 ($ 10K under market),

by the time you paid off your original note and closing costs ($90K), you'd still realize a $50,000 profit. Of course, you'd have to pay taxes on that income...

2. You could develop both short term and long term income without the hassles of property ownership. For example, let's say that you received 80% of the sales price from the buyer at closing ($120,000), and agreed to carry a 2nd lien for the $30,000 balance still owed to you. If you did this, you'd profit $30,000 up front ($120K less $90K in note costs – see above), and you could create monthly income for yourself by carrying the 2nd lien of $30,000 of approximately $300 per month (based on carrying a $30K lien at approximately 10% interest).

[[Editor's Note: You could also make the 2nd lien that you are carrying an ***interest-only*** note, wherein you only collect *interest* on the principal during the note term, and collect the original principal in one lump sum at the end of the term. In this case, at 12% interest-only, you could collect $300 per month over the term of the note, and the $30,000 principal at the end! Money ***now***, money ***over time***, and money ***later***!**]]**

3. You could opt for a quick sale, and use a simultaneous closing to sell this house. By offering to carry paper, you open the property up to a wider range of buyers. Then, all you'd have to do is offer seller-financing on both a 1st and a 2nd lien, sell off the 1st at closing for *cash*, and keep the 2nd lien for monthly *cash flow*.

One final note on this technique: if you decide that you would like to re-sell the property, it is imperative that you have potential buyers already lined up, even *before* you buy the note. This is relatively easy to do by developing a *Buyers List* – a list of potential property buyers that you have gathered as a response to ads that you have placed in the newspaper, offering properties for sale. Every time someone responds to an ad, be sure and get their name, telephone number, what type of house they're looking for and in what area, and how much they feel they can afford per month.

The longer the property sits without a renter or a buyer, the more it will cost you, and the less profit you will make. That's why a Buyers' List is so important!

PROFIT STRATEGY #3 – FORECLOSE

Sometimes, no matter how hard we try to work with the buyers, they just won't cooperate. Believe me, this can be very frustrating, especially considering that they are turning down real cash and the opportunity to keep a foreclosure off of their record (See *Getting the Deed* above). Then again, if this is the case, you need to be ready to begin, or continue, the foreclosure process.

Of course, a lot of this will depend on what state you live in. If you live in a state like Texas, where the sale can occur as soon as 21 days after the Notice of Default, then filing for foreclosure is a fairly easy and speedy process. On the other hand, if you live in a state where this process takes quite a while, you should be prepared to incur holding costs for the time that it takes you to foreclose. Then again, there is a saving grace:

When you purchase a note, you also purchase all of the rights associated with the ownership of that note. In other words, if the lender has already initiated the foreclosure process, you will *not* need to go back to square one, but rather, be able to pick up where they left off.

Even if this is the case, you still need to be prepared for costs (in most states, you can get a lawyer to perform a foreclosure for $1500-$2000) and possible delays. And remember, during the time that it takes you to foreclose, you are still responsible for making payments on the money you used to buy the note (unless you used an equity partner – more about that in the next chapter).

Once you have foreclosed and gotten the people out of the property, you'll need to allocate some money and time for repairs. After they are complete, you'll, once again, have the same two choices as when you got the deed to the property:

1. You can REFINANCE the property and lease it out, or...
2. You can RE-SELL the property.

Both of these techniques were covered in detail in the previous section. To re-cap, you have the same options whether you foreclose or get the deed. Getting the deed, however, is certainly preferable, because it will save you both *time* and *money* (which I guess is the same, isn't it?).

PROFIT STRATEGY #4 – WORK WITH PAYOR TO REFINANCE

Let's assume that you have interviewed the payors, and have determined that they would not only like to stay in the property if possible, but they can, once again, afford the payments. Whatever it was that caused them to fall behind in their payments is now behind them, and they are ready, willing, and able to resume making payments.

First of all, we should know that they probably cannot afford to make up the back payments that are due. Heck, it they could, they would have brought their note current with the original lender! However, this is a wonderful chance for you to be the hero, and create solutions that work for everyone!

When you purchase a note, you now have the right to modify the note, as long as the payor agrees. That's right – YOU CAN DO YOUR OWN LOAN MODIFICATION!

What if you were to offer to take those back payments and put them on the other end of the loan? In other words, whenever they paid off the loan, the payoff would increase by the amount of those payments. (In our example, the payors are six months, or $7200, behind in payments.)

Now put yourself in the payor's shoes: you can either cough up the $7200 or face foreclosure, or you could agree to have the back payments put on the other end of the loan.

Which one would you choose?

Of course, you would choose the latter. In fact, you would probably jump at the chance to have those back payments put on the other end of the loan. They won't affect you now, but they will affect your payoff at some point in the future. You agree, however, that doing things this way gives you a chance to stay in, and keep, your property.

Working with the Payor

Okay – put your investor's hat back on. You've met with the payors, given them another chance by putting all of their back-payments on the end of the loan, and have decided to continue to work with them for at least six to twelve months. *Why so long?* Because you need time to build an *acceptable payment history* to facilitate their eventual refinance.

The concept of this technique is to have the payors make their payments on-time for at least six to twelve months, then refinance (refinancing is getting a new loan), which will pay you off. Remember, they don't *have* to refinance after a year, but you could, with their permission, stipulate that in your note modification (the one where you put their un-paid payments on the back end of the loan). Even if you don't force them to refinance after a year, you could offer them some great incentives, such as paying the closing costs associated with their refinance, giving them a reduced payoff amount, etc.

The key to this is that they make their monthly payments to you on time every month in the intervening year. And yes, it is VERY important, especially in today's lending arena, that they make their payments on the 1st of every month. ***In other words, the refinance lender who is looking at their most recent 12 month housing pay-history will consider January's payment on time only if it is made within5-10 day of the due date.*** While this is a great thing, you will still want to work very closely with the payors to make sure that they pay on time every month.

Even more important is that you keep accurate and written records! Make a photo-copy of their checks every month, and if they pay you in cash, insist on money-orders. Keep a copy of those, too! The key here is to show the refinancing lender ***proof*** that they have made their payments as agreed.

Why is this so important? You want them to refinance, so that you can pay off the money you borrowed to purchase the note in the first place (that tantalizing next chapter again!), and realize your profit. You see, in this case, because you own the note, you will give the payoff as the principal balance owed at that time, *plus the back payments*! Let's go back to our original example:

You purchased a $120K note for $84K, and we've established in the previous section that your cost of funds and closing costs came to an additional $6K. In other words, you have invested $90K to control a $150K property. The borrowers, in turn, after six-to-twelve months, secure new financing by refinancing with a different lender. When that lender asks the payoff amount of the existing loan, you, as the note owner, give them a figure of $127,200.

Where did you get this figure?

Let's assume that the payors touch little, if any, of their principal in those 12 months. In other words, even with 12 month's seasoning, the original $120K principal balance of the note will have decreased very little in those twelve months. Start with that number ($ 120K), then add the $7,200 that they owe in back payments, which will give you a total of $127,200. (Your actual number will reflect the real, not estimated, payoff of their existing note.)

You have $90,000 and one year into the note.
They refinance for $127,200 to pay you off.
You profit $37,200!

[[SPECIAL NOTE: You may be wondering about the payments during the twelve months that you hold the note. While I'll once again dangle the next chapter in front of you for a more detailed answer (it's the ***Seven Sources of Money Chapter***!), let me say this in the meantime: the income from a $120K note at prevailing market interest rates (paid to you by the payors) will exceed the cost of the $84K you borrowed to buy the note at a discount. In other words, during those twelve months, the *worst* case scenario is that your monthly income will be *equal* to your monthly outgo. The best case scenario says that your monthly income will *exceed* your monthly outgo, and you will make a monthly *profit*.**]]**

DENISE AND HER NOTE

I started out this volume by telling you a true story, one in which I asked you to imagine profiting a mere $28,000 on a note deal. It was that particular deal that brought my partner and me together to start our note-buying company, and because it uses a variation of the technique we just covered, I thought it worth mentioning here.

At the time in my note business, I was only buying *existing* notes, which are notes that have been in existence for some period of time. I was going to the courthouse, and was also researching public records to find names of note holders, who I would then contact via mail with an offer to purchase their note. Just starting out in my business, I was like many of you, and was literally brokering notes to back-end investors. In other words, I would gather the information from the note holder, pass it on to my investor who would quote me a purchase price, then pass a reduced price on to the seller. After the seller agreed to the price, I used my investor's money to close the deal.

And as I mentioned at the beginning of this chapter, I optioned the note, reserving the right to buy it at a future date at a predetermined price, subject to my due diligence. In simple English, my back-end note investors funded the deal after they had thoroughly researched it. The note-investor funded the price that they quoted, the seller was happy with the price that I had quoted her, and I pocketed the difference. Not a bad deal, considering I was making approximately $3000 per deal with absolutely none of my own money, nor any risk on my part!

One day, I came across a 2nd lien note that was secured by a house outside of town that was being used as an assisted-living facility. I knew that it was, technically, a 2nd lien on commercial property, which is a very high risk note. However, I reasoned that if I picked the note up at a good enough price, I would be able to find an investor who was interested.

Boy was I wrong!

Even though I had optioned to buy a $60,000 note for $30,000 (fifty cents on the dollar), I was unable to find an investor who wanted the note! Their reasoning was that, considering the fact that it was a 2nd lien on a commercial piece of property, the risk simply outweighed the benefits of doing the deal. On the other hand, I had in my possession a signed agreement from the seller (Option to Purchase Agreement) wherein they had agreed to sell me a $60,000 note (albeit a 2nd lien) for only $30,000.

There simply had to be a way to make this work...

Now is probably a good time to give you the particulars of the deal to see if you can come up with your own solution. Seriously, I want you to try it, because you already have the technique at your fingertips:

Denise (the payor who lived in the property) had purchased the single-family home in rural Central Texas, whereupon she had converted the garage to house four patients in an assisted living facility. She lived in the main part of the house; her patients lived in the converted garage. Denise had originally paid $110,000 for the home. She financed it by giving the original seller $10,000 down, assuming an existing 1st lien of $40,000 written at 12% interest (this was back in the days of FHA non-qualifying assumable loans), and having the seller carry a 2nd lien of $60,000, also at 12% interest.

By the time I found the 2nd lien note, Denise had been making payments to the seller on it for six years, and the property had increased in value to $130,000. Keep in mind that the note-holder (the original seller who had carried the note) had agreed to sell her $60,000 2nd lien for a mere $30,000, probably because of three reasons:

1. She had received a substantial amount of cash over the six years that she had carried the note (approximately $600 per month for 72 months = $43,200), which more that made up for selling the note at a discounted price.
2. She was fighting with Denise for some reason.
3. She needed the cash to invest in another project.

Now, *you* have the parameters, and *you* have also learned the techniques (we've actually combined two of them here). Here's a hint: In one technique, we locked a note up under an option at a predetermined, discounted price; in the other technique, we bought the note at a discount, then had the payor refinance for the full amount owed on the note. Before going on – take time to think this one through, and see what you can do...

...THINKING TIME... THINKING TIME... THINKING TIME... THINKING TIME...

Have you thought it through? Were you able to come up with an answer? I really hope that you tried, because only in *trying* and *applying* will you actually *learn* these techniques. I'll gladly share a solution that we created, but remember, if you read the answer without actually attempting to come up with it on your own, you are only cheating yourself...

A POSSIBLE ANSWER

At the time, I knew an individual who was an experienced mortgage broker, specializing in financing those "hard to finance" cases. She and I discussed this deal at length, and she offered a solution that had been staring me in the face all of the time:

What about refinancing Denise?

If we could find a way to put new financing on the property, it would pay off both the 1st and the 2nd liens. And because I had the option on the 2nd lien, I could give the payoff at the full amount owed ($60,000), and then exercise my option to buy it for $30,000, pocketing the difference. Heck, we could even sweeten the pot a bit by offering to pay for Denise's refinance. And if we could save her money by lowering her payments, she'd be even happier!

Well, that's exactly what happened. Logistically (though this has no bearing on the finance portion of this story), we had to have an appraiser designate the property's *highest and best use* as a residential, single family home. He was able to do that because it really *was* a single family home in a rural setting, albeit with a converted garage. Then, we figured that if Denise refinanced with a conventional lender at the going rate of 8% interest (the prevailing interest rate at that time), her new payment would be about $300 less per month than what she was paying.

When we approached Denise with this option, she was ecstatic! We could save her $300 per month on her mortgage, and we were even willing to pay for her closing costs of approximately $2000. Specifically, it looked like this:

Denise refinanced her home for $100,000, which was what she owed on it. The loans she paid off were written at a 12% interest rate; her new loan was at 8% interest, which saved her around $300 per month in payments. Additionally, her refinance cost her nothing, as we paid her closing costs.

The proceeds from the new loan paid off the FHA loan of $40,000, and the seller financed 2nd lien of $60,000 (which I had optioned at $30,000). When the new lender funded $100,000 to the closing table, the first $40,000 paid off the FHA loan, the original seller received $30,000 (which was the option price), and I received $28,000, which reflected my $30,000 profit less the $2,000 in closing costs.

$28,000 profit! Not bad for a note deal, especially one that I was initially unable to do! Granted, I opted to split the proceeds with my new partner, but just think, if she hadn't contributed, I would not have made *any* money! It just goes to show you that when you look at something from *outside the box*, you often create or recognize solutions where none existed before! And it also goes to that Texas saying relating to the power of bouncing ideas off of others, ***"Ain't none of us as good as all of us."***

[[EDITOR'S NOTE: *It would appear from the previous section that one of your best bets is to team up with a good mortgage broker, who can facilitate the refinance. He makes the refinance fees, and you make the profit on the note. For that matter, if you re paying the fees (like we did with Denise), you might strike a deal with him that if you send him several files a year, he gives you a discount (or at least, tickets to go see your favorite team…).* **]]**

PROFIT STRATEGY #5 – WORK WITH PAYOR, THEN SELL NOTE

Strategies #4, 5, and 6 all assume that you want to work with the payor to keep him/her in the property. Granted, you'll probably make more money if you opt to have them leave the property (either voluntarily or through foreclosure), but let's face it – there is a lot of money to be made by helping people, and our business, while generating profit, also exists to help people. That having been said...

There are a lot of conventional paper-buying sources in the United States, though there are only a few of them that have their own money and actually write the checks. What I mean by this is that even though there are a lot of note-buying companies, most of them merely re-package the note and sell it "up the food chain" if you will. In other words, many of them are only "note brokers" in the true sense of the word.

Selling a note is like anything else – you should prefer to work directly with the *principals* who have the money, rather than *brokers* who are attempting to make decisions for someone else.

With that in mind, you may be asking, *How do I know which note buyer has the money, and which one is only a broker?* That's a great question, considering that the true note buyer will give you better pricing, and will close quicker, because there isn't any middleman. And... here's the answer:

There's a great publication in the note industry that is called, ***The Paper Source***. The ***Paper Source*** is published and edited by Bill and Alison Mencarow, who have been involved with the note business for more than 15 years. Each year, the ***Paper Source*** publishes a directory of note buyers. The criterion for being in the directory is that you are a direct funder, and *not* a broker. You may contact the Paper Source through their Website at www.papersourceonline.com. And remember (refer back to ***The Paper Game***), when you sell a note to a note buyer, be they private or institutional, it really is as simple as filling in some information on a form, sending it to the note buyer, and seeing what they will pay for it.

That having been said, this technique is similar to the last technique I gave you. It is built around working with the payor to bring the note current and *keep* it current by making all of his payments on time. Let's say, however, that for some reason, at the end of 12 months they don't *want* to refinance (if it wasn't in the original terms of the note, nor in your modification, you ***cannot*** force them to do so!) or, for some reason, they are unable to do so. That's okay – you can still realize your profit by selling the note to a private or institutional note buyer!

Now then, let me make something painfully clear: if you choose this route, rather than having the payor refinance, you'll make less money! *Why*? Because when the payor refinances, you'll get paid off at the full unpaid principal balance (**UPB**) of the note. On the other hand, if you sell the note to a note buyer, remember that note buyers buy notes at a *discount* (refer back to the ***Paper Game***).

[[Editor's Note: As a property investor, one of the things that I do with my lease-option tenants and my delinquent borrowers is this: I simply have them work with a credit repair service (notice that I said "*repair*" and ***not*** something like Consumer Credit Counseling) in cleaning up their credit, and offer to pay for it when they exercise their option to buy the property. I do this for an obvious reason – the cleaner their credit, the more likely they'll be able to obtain financing to buy the property. *Why not use this technique when you are working with buyers to cure their notes, so that it s more likely that they can refinance?**]]***

As in the previous technique (*Technique #4*), it is imperative that you *track* the payment history if you want to sell the note to an investor. The best indication for a note buyer of how a note will perform in the future is how it has performed in the past. And, just like lenders, note buyers will want to evaluate the most recent twelve month's pay- history.

This concept of pay-history is so important that I'd like you to turn back to Technique #4 (which is only a few pages back...) and *re-read* the part entitled, ***Working with the Payor***.

PROFIT STRATEGY #6 – WORK WITH PAYOR, THEN TRADE THE NOTE

Okay, my illustrious reader, here's where the ride starts to get fun! I simply love this technique, mainly because it takes you where few note buyers and real estate investors dare to tread. In fact, to me, this is one of the reasons that I am crazy about the note business – because if you know the basics well enough, you can be really creative.

The concept surrounding this strategy starts out the same as in previous techniques. You'll begin by working with the payor and making the note a *performing* note. You want it to be *performing* rather than *non*-performing, because you want to increase its value to you and to others. Then, once the note is performing, you can do several things with it to increase its value:

- You can restructure the note.
- Use it as down payment on another property, car, etc.

- Trade the now-performing note to a lender in exchange for one of their REO properties (properties they now own because they've foreclosed on them).
- Trade it to a private note holder for one that is non-performing.

Let's explore each one of these options:

OPTION ONE: RESTRUCTURE THE NOTE

When we talk about restructuring the note, remember that you can do anything that the payor will agree to. As the note holder, you are obligated to abide by the original terms of the note, so you ***must*** give the payor some type of incentive to want to restructure. Let's look at some examples:

For the purpose of this exercise, let's look at a new master deal. The terms of the delinquent note are as follows:

Original Balance:	**$75,000**
Interest Rate:	**8%**
Term:	**360 months**
Payment Amount:	**$550.32**
Payments Made:	**18**
Delinquent Pmts:	**4**
Unpaid Principal Balance:	**$74,040.98**

The payors are 4 payments behind, so in addition to the unpaid balance of the note, they also owe **$2,201.29** in back payments, plus late fees of **$39.50** for each month that they were late (a total of **$158.00**)

And, also for the purposes of this exercise, let's also assume that the original note holder is a bank ready to file the notice of default. The bank has stopped accepting payments from the payor (which, in my opinion, is crazy) and will only accept the full delinquency to reinstate the payor. At this point the bank has significant incentive to sell this note. For them, the costs are just getting started...

[[Editor's Note: Watch out! I see one of those word problems coming on! Let's see, *"If a train was traveling 50 mph going west, and another train was traveling 70mph going east…´* **]]**

Where Do I Go From Here?

Knowing that you have to do your homework *before* you buy, you first determine the **property value** to be **$115,000**. You also know that with the back payments and late fees added to the balance, the payor is not able to refinance, even with what is called a *foreclosure bailout loan*. (Typically, a lender will only loan 65% of the value of the property on a foreclosure bailout.) At 65% loan-to-value, the new loan would not pay off the old loan, let alone cover the fees. And, if the payors are already behind in their payments, a new loan would be extremely risky.

Besides, foreclosure bailout loans are *very* expensive - not only is the interest rate exorbitant, but the fees a mortgage broker would charge would be the maximum the broker *could* charge. If they *could* get the loan, the delinquent homeowner would also incur the costs of a new title policy, as well as an appraisal and closing costs! Faced with these parameters, the payor's only option is to file bankruptcy to forestall the foreclosure – something that they really don't want to do.

Taking It Step by Step...

Before negotiating the note purchase with the bank, the ***first step*** is to talk to the payor. Find out why they got behind on their payments and what has changed for them (so that they won't get behind again). Perhaps the primary breadwinner lost his or her job, but they have a new one now. They can't come up with the entire back payments but they *can* afford to make the payments in the future. Maybe the new job pays more and they can afford to pay a little more per month.

The ***next step*** is to talk to the bank and find out the best price they'll take for the note. Combining the back-payments (**$2201.29**) and late fees (**$158.00**) with the unpaid principal balance (**$74,040.98**), the bank is asking for a payoff of **$76,400**. You're probably thinking that with the house valued at $115,000, there is still close to $40,000 in equity, and that's even paying full price for the note!

Of course, you've learned that you should never offer full price for anything, and so, offer 70 cents on the dollar. They laugh, and you laugh back. In turn, they counter at 75 cents, and you *reluctantly* agree to pay **$57,300** for that delinquent note. Of course, you also reluctantly *laugh*, as you realize that you are into the property at only 50% of its value!

Finally, you take assignment to the note from the bank in exchange for giving them $57,300. They are completely out of the deal and now, the payor owes *you* the $76,400.

How to Restructure the Note

If the homeowners were current on their mortgage, they would be making a monthly payment of **$550** based on an 8% interest rate, and would have 342 payments remaining on their mortgage (remember, they've already paid 18 out of 360 payments). Remember, though, that their new job allows them to pay a little more each month. *Why not make the note worth more?* Here's one way to do it:

You could offer to put the back payments and fees on the end of the loan if they agree to restructure the note at 300 payments (which shortens the time they have to pay), and raise the interest rate to 9%. This raises their payment to $641.15. *However*, it brings their loan current *and* cuts ***31/2 years*** off their mortgage! (*That's their incentive!)* Now, you have a newly restructured note whose principal balance is **$76,400** at **9%** interest, amortized over **300** months with a payment of **$641.15.**

How Can I Profit Off of the Restructured Note?

Let's look at three different ways. After 12 months of good pay history, you could:

1) Sell the note to an institutional note buyer for around $70,000 (which represents a 10% yield on their part). You paid $57,300 for the note and collected 12 payments of $641.15. Your cost of funds was 12%, or $573.00 per month (*see next chapter for a detailed explanation of where to get the money*).

Your profit looks like this:

Sale of Note:	$70,000.00
12 payments of $641.15:	$ 7,693.80

Total Received:	**$77,693.80**
Less Amount Paid for Note:	$57,300.00
Less Cost of Funds (12X$573.00):	$ 6,876.00
Total Costs:	**$64,176.00**
Total profit:	**$13,517.80**

Of course, if you had used your own funds to purchase this note, then you would have profited $12,700 on the sale of the note, plus you would have made an additional $641.15 per month for 12 months ($7693.80) for a total of **$20,393.80**!

2) If you were feeling generous, you could forgive the back payments ($2201.29) and fees ($158.00), so that their balance owed is only $74,040.98. Then, you could raise the interest rate to 9% (just like in the last example) in exchange for shortening the time they have to pay (from 342 months down to 300 months) and knocking 31/2 years off of their mortgage.

Then, you could put in a 5-year balloon to make the note worth more (see ***The Paper Game***) and sell the note to a discounted note buyer after 12 months payments have been made. In this example, the monthly payment goes up to **$621.35** ($74,040.98 loan at 9%, amortized over 300 months). And, the pay-price from the note investor is a little higher, reflecting the 60-balloon.

Here is how you would profit:

Sale of Note:	$72,000.00
12 payments of $621.35:	$ 7,456.20
Total received:	**$79,456.20**

Less Amount Paid for Note:	$57,300.00
Less Cost of Funds (12X$573.00):	$ 6,876.00
Total Costs:	**$64,176.00**
Total profit	**$15,280.20**

As in the last example, if you had used your own funds to purchase this note, then you would have profited $14,700 on the sale of the note, plus you would have made an additional $621.35 per month for 12 months ($7456.20) for a total of **$22,156.20**!

3) Finally, you could still restructure the note at 9% for 300 months, and leave the back payments in (a principal balance of $76,400). Then, after twelve months, you could induce the payors to refinance and possibly lower their interest rate and monthly payment. After 12 months, their payoff (the unpaid principal balance of the note) would be **$75,547.66**.

Your profit looks like this:

Proceeds from Refinance:	$75,547.66
12 payments of $641.15:	$ 7,693.80
Total Received:	**$83,241.46**
Less Amount Paid for Note:	$57,300.00
Less Cost of Funds (12X$573.00):	$ 6,876.00
Total Costs:	**$64,176.00**
Total profit:	**$19,065.46**

And, just like before, there is a possibility that you've used your own funds. If this is the case, you'll make an **$18,247.66** profit on the note itself, and will have received an additional 12 months of $641.15 payments (**$7,693.80**), for a grand total of **$25,941.46**.

In short, there are literally hundreds of ways to restructure a note. You can do whatever makes sense, as long as the payor agrees.

OPTION TWO: USE THE NOTE AS A DOWN PAYMENT ON ANOTHER ASSET

Here's a fun one! Going back to our original example (you remember, the $150K house where you bought the $120K note for $84K), you'll notice that we purchased a $120,000 note for only $84,000. Now then, that doesn't mean that the note is only worth $84,000 – it just means that we purchased it on sale.

In other words, imagine that a friend of yours has an $80,000 Mercedes that he has to sell. Because he's motivated, he's willing to take $60,000 for it. He might be willing to sell it for $60,000, but it really is worth $80,000! *Are you beginning to get the picture?* The note that you purchased on sale can be traded for its ***full value*** to the right individual!

Let's say, for example, that you find another house that is worth $120,000 that you want to buy. The only asset that you have is the note that you paid $84,000 for. But wait! You remember that the note has a face value (the amount owed by the borrower) of $120,000. Could you use it to trade? You bet! Now, you trade the $120,000 note for the $120,000 house. Ahhhh...but you really bought your new $120,000 house for only $84,000!

Hmm...let's think about this for a minute...

You bought the note, hung on to it for awhile, then traded it to someone based on its ***full value***, and *not* the price you paid for it! The borrowers didn't have to refinance, and you didn't have to sell the note at a discount. In fact, everyone makes out very well:

The ***borrower*** cleans up his credit by making his payment on time, and when the note is traded, isn't affected in any way except to make his payments to the new note-holder.

The house ***seller*** doesn't get $120,000 in cash for his house, but he does get a note in trade that is worth $120,000. Besides, his new asset is already earning interest (the note you traded), and he only pays taxes on the money as he receives it, rather than being taxed on the entire lump sum.

Finally, let's say that you used private money (see next chapter) to acquire the note. After trading the note for a house, you can refinance the house, pay off the hard money lender, rent it out, make monthly cash flow, have significant equity, etc. In fact, you'll reap all of the benefits as if the payors had refinanced their house (see this Chapter – ***Profit Strategy #4***).

OPTION THREE: TRADE THE NOTE TO A LENDER FOR AN REO PROPERTY

This whole program is based on the fact that lenders and private note holders are willing to sell their non-performing notes at a discount. What if we could give them the option of receiving a performing note of similar value in exchange for their REO properties?

Remember, an REO property (REO = Real Estate Owned) is one that the lender has taken back in foreclosure. Remember, too, that lenders don't want to have non-performing assets on their books. Instead, they are looking for performing assets that generate cash flow! *Can you see where Im headed?*

Let's say that a lender has a $160,000 REO that they are willing to sell for 75 cents on the dollar. (Now don't take that number literally! I've seen REO's go for less than 75 cents on the dollar, and I've seen some go for more! This is just an example!) And, let us remember that you have a note that has a $120,000 value; a note that is both ***performing*** and *generating* ***interest income***. *Will the lender take the note in trade?* In many cases – you betcha'!

And how do you come out in this? **[[Editor's Note:** *Okay, so Im editorializing here, but youre gonna love this...***]]**

You now own a $160,000 house, but you only paid $84,000 for it! How? You bought a non-performing $120,000 for $84,000 for it, worked with the borrowers and brought it current, then leveraged it into a $160,000 house.

Your gross profit? **[[Editor's Note:** *Here he goes…***]]**

Seventy-six Thousand Dollars ($76,000)

And you know the amazing part? I've taught workshops where so-called "savvy" real estate investors say that there is no money in the note business! Oh well, they just don't realize that he who makes the money is he who controls the paper!

OPTION FOUR: TRADE THE NOTE TO A PRIVATE NOTE HOLDER

The outcome of this option is even better! It's the same line of thought as the previous option with roughly the same application, only this time, it has a little "twist."

Okay, you've made your $120K note into a performing note by working with the buyers. Now, let's use its full $120K value in trade, but this time, to a private seller, and trade it for his/her ***non-performing*** note. Stay with me here, and remember that non-performing notes are always bought at a steep discount.

Let's say that you go out and find a seller with a $200,000 non-performing note on a $250,000 house. If you were paying cash for that note, would you pay the full $200,000? Of course you wouldn't! You'd probably pay 60-70% ($120,000-$140,000) or even less, depending on the property (collateral), location, condition, etc. Now then, you don't have to actually give him/her $120,000 in ***cash***! Instead, couldn't you give him something that is ***worth*** $120,000, *like that now-performing note of yours*?

Assuming that he took the deal (and why wouldn't he?), here's what you've done: You've effectively leveraged your $84,000 that you used to buy a $120,000 note, into controlling a $250,000 property. Let's see – that means that you're in for 34 cents on the dollar! And, it means that you're picking up $166,000 in equity!

Now do you see why I like the paper business so much? I certainly hope so, and as that you remember that these six ways to profit are just the beginning! Oops! Did I say just

six ways to profit? Just for fun, let's recap. With the methods presented in this chapter, you can:

Option Note:	Wholesale it for ***Cash***
	Wholesale it – take an ***Equity Position***
	Wholesale it – ***Money Now, Money Later***
Get the Deed:	Get the Deed, then ***Refinance*** for better terms (then lease)
	Get the Deed, then ***Refinance*** to pull Cash Out (then Lease)
	Get the Deed, then ***Re-Sell*** for less than market value.
	Get the Deed, then ***Re-Sell*** by carrying 2nd lien w/ balloon
	Get the Deed, then ***Re-Sell*** with Simultaneous Closing
Foreclose:	Foreclose, then ***Refinance*** for better terms (then lease)
	Foreclose, then ***Refinance*** to pull Cash Out (then lease)
	Foreclose, then ***Re-Sell*** for less than market value.
	Foreclose, then ***Re-sell*** by carrying 2nd lien w/ balloon.
	Foreclose, then ***Re-Sell*** with Simultaneous Closing
Work with Payor:	Cure the note, then have Payor ***Refinance*** for full amount owed.
Work with Payor:	Cure the note, then ***Sell*** the performing Note
Work with Payor:	Cure the note, then Restructure it for sale, trade, etc.
	Cure the note, then use as Down Payment on property, car, etc.
	Cure the note, then trade it to Lender for REO
	Cure the note, then trade it to Private Note Holder for non-performing note.

Okay, so our six ways to make money morphed into *nineteen* ways. I'm sure that there are a lot more ways to make money with defaulted paper, but I just wanted to get your creative juices flowing.

[[Special Note: *Heres a special offer from me: If you'll use a method that is* ***different*** *than one of the 19 that I have given you, and you use it to successfully close a transaction involving defaulted paper, I'll comp you in to my next seminar, and let you tell your story to the class. In other words, if you creatively apply what yo u've learned in these materials, I'd like to reward you*.**]]**

Before you go out and try to use them however, I want you to read this chapter, understand it, and then read it again. *Why*? Because I want you to understand the *basics* so well that they become second nature to you. ***Fair enough?*** Great! Now let's go ***find the money*** to buy Ugly Paper!

SEVEN SOURCES OF MONEY

Leveraging Your Resources for ***Profit***

All of these techniques really don't mean a whole lot if you don't have the financial wherewithal to buy the note in the first place. In fact, I can easily say that one of the main questions I have received at my workshops over the past ten years is, *Where do I get the money to put this deal together?* Don't despair, because as I promised you in the course summary, here are ***seven*** financial resources that will allow you to put your deals together.

SOURCE #1 - OPTION THE NOTE

This technique is really quite easy, and is one that you are probably already using, though you may not know it! For instance, if you are currently active in the Paper business, you know that your first step is to find the note and gather the information, then ask your backend note investor to tell you what they will pay for it, then pass a reduced price on to the seller. To lock up this agreement, you are using a *Standard Option to Purchase Agreement*, which outlines the deal between you and the seller, and gives you permission to buy the note based on the results of your due diligence.

In other words, you have the *option* to purchase this note if you want to. You don't *have* to purchase it, but you *may* if everything checks out. You put together an agreement with the note seller to sell *to* you at one price, then you lock up an agreement with someone to buy it *from* you at a higher price. ***You keep the difference***. So...

One of the things that you can do when you find ugly paper is to use this same technique: lock up an agreement to buy it at one price (using the Option to Purchase), then contract with someone else to buy it from you at a higher price. Now then, who can you get to buy this ugly paper from you?

First of all, you should realize that very few, if any, traditional institutional note investors will buy ugly paper. Their business model is built around cash flow, rather than on owning the property. That having been said, here are two great resources who would be interested in buying ugly paper:

1. **Another Investor Just Like You!** Yes, there are other people just like you who want to invest in ugly paper. They are your competition, but they are also a tremendous resource. Why not act as a "*bird-dog* and help them find paper that suits their needs? First of all, you need to ***network***, ***network***, ***and network*** to find these people! When you meet them, you'll be surprised at how much you can help your competition, and how much your competition can help you! Look at it this way – if you lock the deal up at one price and sell to your *competition* at a higher price, ***you may only make 3-5% of the note amount, but that's for doing nothing more than some legwork and a little bit of negotiating!***

2. **Real Estate Investors!** The second great resource is someone who fixes, or *rehabs* properties. Think about it for a minute: Here is a real estate investor whose business model is based on acquiring houses at a discount, fixing them up, and then reselling them at full market value. You come along with a great deal, having found a note that you can acquire at a significant discount, giving you control of the property at even a greater discount. *What real estate investor in their right mind wouldn t jump at the chance to work with someone like you who can bring them deals on a regular basis?* And the nice part is that they usually have their own money sources to pay cash for the deal! Again, ***you'll make roughly 3-5% of the note amount, and you'll never have to come up with any cash, qualify for financing, or even take ownership of the note or the property!***

[[SPECIAL NOTE: there are several places to find other real estate investors in your area:

A. *First*, go to foreclosure sales, which occur periodically (check the laws of your state) in a public place, usually the courthouse steps. Foreclosure sales are attended by real estate investors who are attempting to buy properties at a discount.

B. *Second*, get involved with a real estate investors club in your area. These are easily found through the yellow-pages, title companies, and the Internet. Go to www.creonline.com to find real estate investment clubs in your state. Contact them, go to their meetings, and ***get involved***!

C. Check you local newspaper. Note that in the "Real Estate for Sale" section you'll find several ads for "newly remodeled" homes. Chances are, there is a real estate investor involved. You can also advertise for investors in the same newspaper.**]]**

SOURCE #2 - YOUR OWN FUNDS

Some of you already see the benefits of owning just the Paper, others, who are real estate investors, see the potential of owning the paper with the intent to control the real estate. Whatever your motives, you can always use your own cash, and pay yourself handsome dividends to do so!

Obviously, you can use any cash that you may have readily available to you. The yields on most defaulted paper (because you are buying at such substantial discounts) are usually quite substantial, often exceeding 15%, which *certainly* beats the paltry 1-2% you would receive if you were to invest those same funds in an interest-bearing account or Certificate of Deposit at your local bank. And, because the paper is backed by real estate (which you may eventually own), you know that its value won't fluctuate, unlike a stock in today's volatile market!

What if I don't have a lot of cash on hand, but have some equity in my home?

Now you're thinking! **Let's say that you find an $80K, 10% note that is secured by a $100K property (we'll use this example throughout the rest of the chapter).** Let's also say, for purposes of this example, that you can pick up that *ugly paper* for $48K (sixty cents on the dollar), but you don't have the cash on hand. You are, however, able to pull that much money out of the equity in your home, and get a Home Equity Line of Credit (HELOC) at today's prevailing rate of 7%. (*Prevailing market rates may have changed by the time you are reading this.*)

Based on our previous chapter, you can either keep the payors and the property, or get rid of both. If you choose the latter, foreclose on the non-payors, and sell the property, you'll have paid 7% on the money during the process. When you sell the house, you'll be able to pay off your line of credit, and pocket $52K ($100K-$48K=$52K) less holding and closing costs.

On the other hand, you may choose to hang on to the note and work with the payors. If you do this, they'll be paying you based on what they currently owe ($80,000 at 10% - see above), yet you'll be paying your $48,000 line of credit at 7%. In other words, by borrowing money at one rate, then investing it at a significantly higher rate, you'll have a lot more coming *in* every month than you have going *out*. And eventually, when you either sell the note, or when they refinance, you'll be able to pay off that line of credit and make *additional* profit! Congratulations! You're putting the equity in your home to work for you!

SOURCE #3 – SELF DIRECTED IRA

Many of you reading this have, right now, a retirement plan or IRA that is earning a whopping 1%-3% return! Yes, I am being facetious here, but you need to realize that inflation is, in many cases, rising faster than your rate of return. If inflation goes up at 4% per year, yet you only earn 3% on your money, you can see how your earnings are not keeping up with the normal increase in the cost of living. In other words, if the rate of inflation exceeds your rate of return, you are actually *losing* money every year!

Why not take that same money, and invest it in high-yielding Paper? You can choose to buy pretty paper or ugly paper, but in either case, you will still receive a return that is *significantly* higher than what you are receiving now! The key, here, is to turn your IRA, where someone else makes all of the investment decisions for you, into a *Self-Directed* IRA, where ***you*** have control over how your money is invested.

Now, I *used* to be a licensed CPA, and there *was* a time when I was paid to give accounting advice. ***That time is no longer*** – my suggestion to you is that you seek advice from a competent professional who is familiar with your personal financial situation, and that you act accordingly. However, just to show you that I am not trying to skirt the issue, let me offer you this resource:

Mid-Ohio Securities recently sold their Self-Directed IRA portfolio to ***Equity Trust Company***. To learn more about them (and no, I do not receive *any* kind of referral commission!), visit them at their Website, www.trustetc.com. Equity Trust can help you put both mortgages and real estate into your 401K accounts, as well as your IRA's. They are very familiar with using real estate and mortgage as investment tools, and they are definitely a tax-planning resource worth using!

SOURCE #4 - CREDIT CARDS

There are a lot of charlatans who profess to teach you *creative* real estate financing, only to say that you should put your home purchases on your credit cards! Ha! And while I laugh at that (because there is so much more to real estate financing than that!), I know that it can be done: my partner and I actually bought a house that was owned by the school district for back taxes by taking a cash-advance on one of my credit cards! That having been said...

Taking a cash-advance on your credit card can be an excellent way of generating cash to purchase ugly paper. In the example I mentioned in the previous paragraph, I only paid (are you sitting down?) $3500 for this house, in a neighborhood where the rest of the houses were selling for $42,000! Now, this brings up another possibility for you – when looking for ugly paper, why not check out school districts? Yes, you read it correctly – *school districts!*

When a homeowner defaults on his property taxes, the school districts (who are the major recipients of property taxes) have the ability to foreclose. Here's the fun part: when they foreclose, they take precedence over all other liens on the property, including those of the lender! This means that when we bought this particular property, the school district had already foreclosed out the original lender, so we got clear title to the property by just paying the back taxes!

Now, I could go into this technique at length, but that really isn't what this course is all about. Let's just say this: find out from your local school district the name of the law firm that handles their foreclosures. Get on their mailing list. Then, if you are short of cash, don't hesitate to take an advance on your credit cards, provided that:

1. The investment is short term (let’s face it – 18% is a hefty price to pay for money!)
2. Your yield exceeds your cost of funds!

SOURCE #5 – BRING IN A PARTNER

You may have heard the phrase, “O.P.M.” which stands for *other people's money*. I am a firm proponent of the wisdom that a*piece* of pie is better than no pie at all, and I don’t hesitate to bring a partner into the deal if it means the difference between sharing the profits, vs. not getting any at all! And, you’d be surprised at how many people want to get in on the deals you have available to you.

Just this last week (at the time of this writing), my partner approached his cousin on a deal where he would receive a 12% return on a $36,000 investment. He literally jumped at the opportunity – you see, he’d been getting a measly 1-2% return on that money, and was excited at the prospect of investing in a low LTV first lien, secured by real estate, which yielded him such a high return.

Do you know of anyone in your family who might enjoy the same benefits?

You see, the beauty of this is that you are not *taking* from anyone, but rather, you are *giving* him (or her) a high rate of return – certainly a higher one than they would have received on the open market!

Let’s say that you find the same note we used in our previous example (we’ll continue to use that same example for ease of explanation). The property is worth $ 100K, and you are able to pick up the existing $80K note for $48K. Could you bring in a financial partner to provide the $48K to acquire the note? Sure you could! And, there are several ways that you could compensate this partner:

1. ***You could pay them a return on their money based on a percentage.*** (*"I'll pay you an annual interest rate of 14% on your money."*)

2. ***You could pay them a flat fee to use their money.*** (*When I sell the house (for $100K), I will pay you your $48,000 back plus an additional $10,000 for the use of that money.*). In this case, you would give up $10K of your profit – you would ***still*** make $42K!

3. ***You could split the profits with them, based on a pre-determined percentage.*** For instance, you could split the potential $52K profit 50-50%, or, maybe even 60-40% in your favor. After all, you *are* the one who put the deal together. And if you did this (60-40 split), you would still make a little over $31,000, which is very respectable!

You can take this same scenario a bit further, and apply it to other real estate investors! Why not partner with them? I'll tell you, as a real estate investor myself, I would gladly provide the money if I knew that I could make that rate of return on it, especially if I had a modicum of control over the deal!

Finally, why not consider your *Butcher*, your *Baker*, or even your *Candlestick Maker*? In other words, there are a lot of people that you know, and even a lot that you don't yet know, who would invest with you to make these types of returns.

Just the other night, I was out having dinner at a Supper Club (fancy word for a restaurant that has a live band and dancing), and, responding to the maitre d' and his questions regarding what I did for a living, got to talking about real estate. **[[Editor's Note:** *Go figure*...**]]** We ended the evening by him giving me his card, saying, *I have been trying to get involved with real estate, and just dont know where to start! If you come across any deals like the one you just mentioned, please, keep me in mind. I'd love to be involved!* And this was from a guy who ***barely*** knew me! Think about the folks you ***do*** know...

SOURCE #6 – BORROW THE MONEY

When I talk about borrowing money, I am specifically referring to one of three different sources:

Private Investor
Your Pension Fund or Retirement Plan

Your Bank.

The first two are pretty self-explanatory. In fact, it should be fairly easy to borrow money at one rate from either a private investor or your pension fund, then reinvesting it at a higher rate of return and pocketing the difference. Just make sure that the yield that you receive is significantly higher than what you are paying for the money, so that the transaction is worth your while.

Now then, many of my students are so well-tuned to the idea of *creative* financing and finding new ways to do something, that they forget that one of their greatest resources is an old standby: their own bank! *Why not talk to them?* Let's look at how everyone benefits, starting with your banker, because he's the one you're going to have to convince!

First of all, **your bank benefits in several ways:**

1. They know the borrower (you)! And while this may be a bad thing in some instances, this technique is predicated on the fact that it is a good thing!
2. Chances are they are already familiar with the collateral. If you are buying a note secured by property in your area (and remember, with *defaulted* paper, it's imperative that the property be in your area!), the bank can now see and touch it, which always makes bankers more comfortable!
3. Their loan is secured, because you will secure it with the note and deed of trust, and if you foreclose, they will have the deed as security.
4. Their exposure is minimal – in our ongoing example, they would be into a $ 100K property for $48K, which represents only a 48% LTV.
5. If you, heaven forbid, should default on the loan, their minimal exposure pretty much ensures them getting all of their money back!

Of course, you benefit, too, by having a ready supply of cash available to you at decent interest rates, and the note seller benefits because you can move quickly (not *too* quickly, however, as you'll see in the *Due Diligence* chapter coming up!). Let me give you an example:

I have a real estate investor friend who used to work in my office. *Michael* (yes, that's his real name!) has lined up several banks that have extended credit lines to him to acquire paper and real estate. His rate is prime, plus 1%, and his banks will lend up to 80% of the *After Repaired Value* (ARV) of the property! Whenever he sees a property (or note) that makes sense, he puts together a package for the bank showing them all of the particulars. His package includes:

Preliminary Title Report.
Appraisal, or Web-based evaluation of the property in its *as-is* condition.
Comparable sales in the area.

What the house will be worth *after* it is fixed up (ARV).
How much money it will take to fix it up.
What he plans to do with the property (resell it, keep it, etc.)

[[SPECIAL NOTE: This is the type of package that you should put together for *anyone* that you are considering to be a part of your deal: private investors, bankers, other real estate investors, private lenders (see below), and family money sources (especially them!)**]]**

Now then, there are steps you need to take in order to secure this type of financing. ***First***, go down to the bank and visit with your banker *before* you need the money! Point out the benefits to him, and let him know that you really don't need it, but that you are offering him a great way to make a higher and safer return than many of his investments. Be willing to walk away and take this opportunity down the street to another bank, because you, in this case, are in the driver's seat. If you appear to be desperate, you won't get the money! **[[Editor's Note:** *The famous humorist Will Rogers once stated that A banker is the type of person who will loan you an umbrella when the sun is shining, and want it back when it starts to rain.*.**]]**

Second, you need to identify some sample properties and take them with you, showing him that you have, indeed, done your homework. You may even want to go into that meeting with a sample package, so that he/she sees not only how you handle your business, but also what they can expect from you.

Finally, make sure that your cost of funds (which will usually be less expensive if you go this route) doesn't exceed what this deal will generate, both on a monthly basis and overall. Don't be afraid to show him that you are making a profit; profit-making is the sign of a good businesswoman! **[[Editor's note:** I think she's taking this *politically correct* thing a little far!**]]**

SOURCE #7 - PRIVATE LENDERS (a.k.a. EQUITY LENDERS)

A lot of you are familiar with the concept of *private* or *equity* lending, but in case you aren't, let me immediately dispel a common myth: Just because you are borrowing money from a private source, doesn't mean that you have to deal with *Uncle Guido*! You've heard of him; he's that guy who's *connected* and wouldn't hesitate to take a baseball bat to your knees if you fall behind on payments! And, if you default, he's offering a special on cement shoes...

Yes, unfortunately, a lot of people have that ***mis***conception! However, my job is to teach you ***reality***, and so, with that in mind, here is the *truth* about this tremendous resource, *private lenders*. And, if you want to know how to get money where the primary requirement is that you have the ability to *fog a mirror*, then read on!

We're going to cover this topic in *three* different sections. ***First,*** I'll tell you what a private-money lender really is. ***Second***, we'll discuss his/her lending parameters, and ***third***, we'll finish not only with how they benefit you, the paper/real estate investor, but where you can find them.

OPPORTUNITY KNOCKS

Imagine that you are a professional, or maybe even an average, every-day kind of person, who has some money that you would like to invest. You know that the stock market is volatile, and investing in Uncle Joe's latest offshore oil-well scheme just isn't for you. One day, an acquaintance comes up to you with the following investment offer:

> Your investment will be short-term – between 12 and 18 months, and may return your money even sooner.
>
> You will receive a 12%-14% return on your money, interest-only. That means that you'll receive monthly interest payments, and at the end of 12-18 months, you'll receive your initial investment back in one lump sum.
>
> Your investment will be secured by a 1^{st} lien on real estate, and your exposure in the property will not exceed 70% of the property's value, so that if you should ever have to foreclose, you are virtually assured of getting all of your money back.
>
> You don't need to invest a lot of money – in many cases, you can do this for as little as $20,000, which is probably less than you have in a retirement account or 401K plan.

Now then, if you're like most people (and I pose this scenario to students in my workshops), your response will be, ***"Where do I sign up?"***

Private lenders are just that – people like you and me who want to invest their money for a safe, high yielding return. In most instances, they know an individual who acts as a *broker*, helping them place their money. This broker makes money every time he facilitates a loan, and *only* when the loan closes! (**Side Note:** If you ever come across a private lender who wants to charge you for an application, run, don't walk, to someone else!)

THE GUIDELINES

In a roundabout way, I have already mentioned the guidelines of most private, or *equity*, lenders. They base their lending on the strength of the *property*, rather than that of the borrower. They *dont* check credit, they *dont* make the borrower prove employment or income, but they *do* look very carefully at the property. Let's face it: they're taking a risk, so they want to make sure that if things go wrong, they can get their money back!

Here is a list of parameters that you can expect on a *typical* private loan (NOT *hard money*):

- Interest Only (compared to an *amortized* loan)
- 12-36 Month Term, with possible extension at the end of that time.
- Interest below 10% (most private investors actually prefer this)
- Non-Owner Occupied (don't borrow private money on your homestead)
- 65-75% of ARV (After Repaired Value)
- 100% of Acquisition Price (provided it falls in the 65-75% of ARV range)
- No fees (a *hard money* lender would charge fees; a private lender usually doesn't)
- No Appraisal (In Most Cases)
- No Pre-Payment Penalty (which means that you could resell the property as quickly as possible to realize your profit!)

Now, you may also want to consider a hard-money lender. My suggestion is that you don't use one, because in the last several years they've become pretty conservative.

HOWEVER, just in case you *are* thinking about using hard money instead of private money (there's a place for both) and feel that 12-14% interest and 3-4 points are a high price to pay (and I *know* that you are thinking that!), let me point out something to you: Let's say that you were to go to a *traditional* mortgage lender. First of all, the chances of you getting a 100% loan on an investment property are slim to none, and when you add in the restrictions of not checking credit or income, your chances are even less! Then, even if you *could* convince a lender to loan under those circumstances, they would probably charge you about 9-10% interest, as well as lender, mortgage broker, escrow, warehousing, discount, origination, and other fees that in many cases add up to 3-5%, or *more*, of the loan amount.

Yes, even though it seems high, in reality, it will probably cost you more in fees to get a *traditional* loan than it will to get a *private* one. Granted, the interest rate is still higher, but the difference in rates between a traditional loan and a private loan translates to around $75 per month per interest percentage point per $100,000. In other words, on a $100,000 loan where a traditional lender might charge 10% interest and a private lender 14% interest, the private money will cost you approximately $300 more per month (4 X $75).

Let's look at our ongoing example. If we were to borrow $48K from a private lender, we could expect to pay approximately $1500 in fees, and our monthly payments would be approximately $585 per month ($50,000 at 14% per year, interest-only). If, on the other hand, we sought conventional lending, we would probably pay more than $1500 in fees (just the mortgage broker would want to make $1500, and that's before any of the *other* fees are included!), and our payments would be $438.79 per month (based on $50K @ 10% interest).

To put it very clearly, if you kept the property for only three months, it would ***only cost you $423.00 more*** (3 months at approximately $141 per month, which is the difference between the $580 you would pay to the private lender, and the $438.79 you would pay to the conventional lender) ***to go with the advantages of a private lender!*** Now I don't know about you, but to me, that is a small price to pay to get the deal done, especially when the potential profit (see Chapter 3) is $40,000!

BENEFITS

By now, the benefits of using *private money* or *hard money* should be apparent – no qualifying, 100% of acquisition price, quick and painless funding, and no *jumping through the hoops of conventional financing.* Use it for ugly paper, with the ultimate intention of acquiring the property. The best part is, it is relatively easy to find!

FINDING PRIVATE MONEY

If you think about it for a minute and reflect back to an earlier portion of this chapter, people who broker *private* money don't make any money themselves unless they are facilitating a loan! It is their job to find people like yourself who need money, and, in turn, place their client's money with you. Their client (the person with the money) makes the actual interest-related return (8-14%), while the broker makes the fees for putting the deal together (3-4 points).

Hard money brokers, therefore, only make money when they are lending money. In other words, they have to "reach out" to people like you and me, and advertise the fact that they have money to loan. Keep in mind that they prefer to work with ***real estate investors,*** because homestead laws in most states favor the owner-occupant homeowner, and may, in some cases, affect the lender's ability to foreclose.

If the private lender (notice that I have used the terms ***hard money***, ***equity lending***, and ***private lending*** interchangeably) wants to only work with real estate investors, he must, first, find them.

Yes, I said that correctly: ***private-money lenders are looking for you!***

And how does a private-money lender find you?

They will do the following:

1. They will advertise in the newspaper, often in the *money to lend* section, or in the *income property* section,
2. They will sponsor real estate investment club meetings. *Why?* Because real estate investment clubs represent a whole roomful of potential customers!
3. They will advertise on a great Website, www.creonline.com, which is sponsored by Terry Vaughan and his wife, and is geared toward the real estate investor who is looking for alternate ways to purchase property. (C.R.E. stands for Creative Real Estate).
4. They will post their name on the Internet (do a search for Equity Lender, Private Lender, or Hard Money Lender, and of course, be sure and include the City Name in the search.)
5. You should also check out a program that I personally developed and use with my customers: www.PrivateMoneyCashMachine.com.

SUMMARY

You should be able to see by now that there are quite a few places to get money to invest in ***ugly*** (defaulted) paper. As much as I hate cliché's, I have to repeat one here:

"If the deal is good enough, the money will follow."

I know, I know... you've heard it before, but I can't emphasize enough how true it is. Show someone how they can make an incredible return with minimal risk, and they willjump at the opportunity to work with you! Besides, your idea is a LOT better than that risky off-shore oil well they were considering investing in with Uncle Joe...

So, now that you know where you are going to get the money to buy your ugly paper, let's discuss the best ways to ***negotiate the purchase*** and ***make the offer***!

NEGOTIATING & PRESENTING YOUR OFFER

The Proportionate Use of Your Ears and Mouth!

There's an old saying that applies to life, and especially to negotiating: *God gave us two ears and one mouth use them in proportion!* In other words, the key to a successful negotiator is ***listening*** rather than talking. With that in mind, when you talk to a seller that has a non-performing note (be it a bank or a private individual), be sure and obey the following rules (we'll go over each one individually):

- Establish Rapport, and then Stick to Questions.
- Be sure and Listen to the Answers, and try to Fully Understand the situation.
- Don't think about potential solutions until you are certain both *you* and *they* understand their problem.
- Remember, talk about ***your*** benefits to them in terms of ***their*** needs.
- Finally, here are a couple of great questions that will lock in the deal for you:

  What's the least you would accept for all cash and a quick close?

  Is that the best you can do?

Approaching the Note Holder

Before going on, let's take a moment and talk about ways that you should approach the note holder. Obviously (*and if you've been following along, then yes this should be obvious*), there are two types of note holders: **Private Note Holders**, and **Traditional Lenders**.

If you are working with a **Private Note Holder**, bear in mind that you are dealing with an individual, and not some large faceless corporation. As such, you'll want to be empathic to the seller's needs, and realize that there will probably be some emotion involved. Let's face it: how would *you* feel if you were losing thousands of dollars? Take the time to establish rapport, commiserate a little, and guide the seller into the realization that his best option is working with you. Realize ahead of time that he won't be ecstatic (Who would when they're losing money?), but he will feel like a burden has been lifted from his shoulders when you complete the transaction.

On the other hand, if you are working with a Traditional Lender, or a Government Agency (like FHA, VA, HUD, etc.), you ***are*** dealing with a large, faceless organization. The person on the other end of the phone gets paid regardless of whether or not you buy the note, and they are *certainly not* emotionally involved. Your approach with them is going to be completely different than with a private seller. In this case, you should present yourself *not* as a compassionate businessperson (an excellent approach with the private seller), but rather, as a savvy note buyer who invests in paper all the time. To you, this is just another day spent trying to find good paper in which to invest. Adopt the corporate mentality – this transaction is all about dollars and cents. [[More about how to find these lenders in the Marketing Chapter]]

Establish Rapport, then Stick to Questions

I wish that I could tell take a whole volume and tell you just how important it is to take the time and establish rapport. The bottom-line is that ***people*** do business with ***people***, and they *prefer* to do business with people that they *like*! My lawyer constantly tells me that most people will take bad advice from a lawyer that they like vs. good advice from a lawyer they don't like. *What does this tell you?*

It tells me that the concept of rapport is invaluable because it lowers fences (and defenses!), and makes people feel more comfortable about being honest with you in expressing their needs. My business partner is one of the best rapport builders I have ever met. I overheard him on the phone one Friday afternoon calling someone who was, obviously, very terse on the other end of the line. *Are you ready for this week to be over?* he quipped even *before* he introduced himself. *I could tell it in your voice. I dont know about you, but I sure am!*

Now what did this do? It totally disarmed the lady on the other end of the phone, and let her know that he both sensed she was tired and grouchy, and he was just another poor working slob like her who had a job to get done before the weekend! Bingo! They bonded! Then, and only then, did he go on to get the information that he needed. And here's the point: take some time and establish rapport before you jump into business. In other words, you have to dance with your partner before you can lead him the way you want. It's the same in negotiation.

I'll also tell you, before leaving this subject (I'm feeling like I'm beating the proverbial dead horse, but it really is that important and bears repeating...), that if there was one thing that I could have imparted to my entire staff when I owned a large mortgage bank, it was the importance of personal contact and rapport building. People who feel that they are your "best friends" as a result of rapport building will bend over backwards to help you. I can't count the times that they were unable to achieve certain results, only to have a person more skilled in rapport building come in behind them and succeed.

The second part of this technique is: ***Stick to Questions***. In other words, whoever is asking the questions is in control of the interaction. Remember that, and if they ask you a question, answer it, then move immediately to another question. Not only will you continue to control the conversation, but you'll also gain valuable knowledge that will help you determine whether or not this is a deal that you'd like to pursue.

You should be asking questions like:

- How far are the payors in arrears?
- Is this a first or a second lien?
- Do you know if there are any other liens against the property?
- What can you tell me about the property? (size, condition, location, value, etc.)
- What are the terms of the note?
- What is the unpaid principal balance?

(NOTE: These last three questions are on the **Existing Note Worksheet**, and reflect information that you would get on ***all*** notes that you are considering for purchase. For a more detailed explanation, refer back to ***The Paper Game*****.)**

Listen to the Answers to Fully Understand the Situation

One of my pet peeves is people who ask a question, then ignore your answer because they already have one of their own in mind! DON'T make the same mistake! In other words, be friendly, but *really* listen, and try to determine what the problem really is! Often, you'll learn more by what the seller *doesnt* say than by what the seller *says*! Be empathic to their needs, then try to meet those needs, often using them as a negotiating technique. For example:

Let's say that you are dealing with a lender on a non-performing note. You're working with someone in the ***secondary marketing*** department, and in the process of finding out the note particulars, you discover (through rapport building) that the person on the other end (lender's employee) really wants to get this resolved before the end of the month (or quarter, or year).*Why*? Probably because their monthly statistics will be reviewed, making them eligible either for bonuses, or possible demerits (if the note doesn't sell).

Here's the technique: Play to those needs! *Mr. Lender, if I can get this non-performing asset off of your books by the end of the month, what is the least you would accept?* In other words, what you are saying is, *Mr. Lender, if I do this for you* (get the loan off of your books), *what will you do for me* (in terms of price)

This is a great time to get answers to the following two questions:

Why are they selling their paper?

How much, and how soon, do they need the money?

Potential Solutions

The tendency of the novice negotiator is to immediately start offering potential solutions, especially when dealing with private note sellers. Don't even ***think*** about doing so until you are certain that both *you* and *they* understand their problem. Here's what I mean:

Suppose you are dealing with a note seller that is carrying a non-performing 2^{nd} lien. Frankly, the value of a non-performing 2^{nd} is very little; in order to protect that position, the 2_{nd} lien holder has to keep the 1^{st} lien current! Anyway, back to our example: it is up to *you*, the note buyer, to tell the note seller that his note isn't worth much on the open market. Make sure that he fully understands the problem, and don't be afraid to paint a dim picture (there's no need to lie, because in many cases, the truth is bad enough). In other words, make sure that the seller fully understands his problem, and make sure that he knows exactly what his options are, whether he hangs on to the note or sells it to you. For example:

Mr. Seller, based on what you've told me, I see that you have a non-performing $30,000 2nd lien behind a non-performing $70,000 1st lien, and that the house is supposedly worth $100,000. And, as you are in 2nd position, if the house goes to foreclosure, you get paid only after the 1st lien is paid off.

As I see it, here's the problem: If the 1st lien-holder forecloses and the house goes to auction, they'll be lucky to sell it for enough to cover their lien because houses usually go at auction for around 70 cents on the dollar. If that happens, then you won't get anything, because there won't be any money left over to pay you.

Now then, if I buy the note from you, I am opening myself up to the same risk. So, here's what I propose: I can pay you $5000 for that lien, or, you can take your chances at the foreclosure sale. Keep in mind, though, that once the first lien forecloses, then you lose your position entirely.

Then again, you can also foreclose on the 2nd lien if you wish, but bear in mind that if you do, you'll incur the costs of foreclosure, eviction, fixing up the property for resale, and…you'll also have to bring the 1st lien current and continue making payments on it until you sell or refinance the property.

What did I do? I painted a dim picture of the options, and gave the seller a way out. However, along with the solution, I made sure that the seller fully understood the ups and (mostly) downs of his situation.

Meet Their Needs with Your Benefits

This concept ties in with the previous thought about asking questions and fully understanding the answers. Truly understanding the answers will help you determine the seller's needs, and once you can show him that you can *meet* those needs, he'll agree to do the deal.

[[Editor's Note: I once had an instructor who used to call this technique, ***Ethical Persuasion***. Using a diagram, he would show that the best way to negotiate was to **A)** establish rapport; **B)** have ***them*** point out ***their*** needs (*these people aren't paying, and its* *costing me a lot of money*); **C)** show them how ***you*** could ***meet*** those needs (*I can get this burden off of your shoulders and put cash in your hands*), and **D)** lock in the benefits of doing so (*If I can do so by next Friday, what will that do for you?*).**]]**

The great sales trainer, Zig Ziglar, said it best: *If you give another other people what **they** need, youll get what **you** need.*

Closing Questions

Finally, here are a couple of great questions that will lock in the deal for you. Don't back away from them – remember that you are *helping* the note seller, and have a right to ask:

- What's the least you would accept if I paid you all cash and closed quickly? When they answer you... p. ..a.. .u... s.. .e..., then ask...
- Is that the best you can do?

Then, SHUT UP! Don't let the silence frighten you or make you uncomfortable. At this point, he who talks first loses!

Putting the Offer Together

Now that you're ready to actually make an offer, I want you to keep several things in mind:

First of all, as with any real estate offer, it should be in writing. You can use the *Standard Option to Purchase* form that we went over in ***The Paper Game*** (you can also get one from my company, SMI Funding – simply email our Broker Help Desk at smifunding@aol.com). **You should also make your offer contingent on your due diligence** (see next chapter). In other words, if something doesn't make sense, or if your results are different than the seller's representations (or in this case, *mis*representations), then you don't have to go through with the deal.

Second, be sure you understand the note seller's motivation. Remember, in the case of a lender selling the note, you'll want to create a relationship that allows you to purchase notes well into the future. So, don't cut your nose off to spite your face. In other words, don't sacrifice repeat, long-term business just because you're trying to score a home run on the first deal.

Lastly, here are a few guidelines that will help you structure your offer, but remember, THERE IS NO SET FORMULA! These are just GUIDELINES!

Pretty House	Expect to Pay **More**
Ugly House	Expect to Pay **Less**
Mortgage	Expect to Pay **More**
Contract for Deed	Expect to Pay **Less**
Clear Title	Expect to Pay **More**
Liens/Judgments	Expect to Pay **Less**
1st Position Note	Expect to Pay **More**
Junior Lien	Expect to Pay **Less**
Newly Defaulted	Expect to Pay **More**
Aged REO	Expect to Pay **Less**

And keep in mind – ***if there is plenty of equity in the property, sometimes it is perfectly okay to pay full value for a lien!***

THREE STEPS TO DUE DILIGENCE

Putting Your Ducks in a Row...

This is the **C.Y.A.** section. You know... Cover Your Assets! Referring back to the basic volume, ***The Paper Game***, you'll remember that after the note has been negotiated, there is still some homework left to do before anyone writes a check. In other words, you want to make sure that you know exactly what it is that you are buying. You also want to be able to communicate that information to your funding source.

That having been said, let's divide this section up into *three* parts:

1. Information you Need to Get From the Note Seller
2. Information you Need to Gather on Your Own
3. Items you Need to Present to Your Funding Source

Information You Need to Get From the Note Seller

When talking with the note seller, the onus is on him/her to provide you with accurate information regarding the note you are purchasing. Let's first look at a list of the things that they'll need to provide you, and then let's discuss what you need to look for in each document, and why:

Name & Address of person selling the Note
Borrower Contact Information (Name, Address, SS#, Phone)
Address of Property

Copy of the Note, Mortgage, D.O.T. or land Contract

Copy of Previous Closing Statement

Pay History Statement – Showing how far Borrower is behind in payments.

Copy of Old Appraisal (if lender) or Property Photos (if private seller)

Copy of Title Insurance Policy

Copy of Hazard Insurance

Any leases on the property (if being held for rental).

If buying a 2nd, get info on the first.

NAME & ADDRESS OF PERSON SELLING THE NOTE

No secrets here – the reason you want this is obvious. Be sure and get all of their information – there may come a time when they have other notes to sell. Remember, this is a relationship-based game. In fact, this business is all about *building* relationships. You never know when someone will refer someone else, etc.

BORROWER CONTACT INFORMATION (NAME, ADDRESS, SS#, PHONE)

This shouldn't be any great mystery, either. First of all, you need to get in touch with the borrower to see if you can work with them, or if you'd rather have them get out of the property. You'll want to know several ways of getting hold of them (home phone, work phone, address, etc.), so that you can easily contact them. And finally, you'll want their Social Security Number so that you can pull credit on them. *Why would you want to do that?* A credit report reveals a lot about the individual. Perhaps they recently declared bankruptcy; perhaps they are late on all of their bills and are overextended (in which case, they probably cannot afford to stay in the house); or perhaps they just got behind and are now playing catch up. Whatever the case, the credit report is an excellent indicator of their current financial condition.

[[SPECIAL NOTE: Be Prepared! Sometimes, if you purchase a note where the N.O.D. has already been filed, you'll find that the borrowers have already moved out of the property! If you don't want to deal with them, this could be a good thing for you. On the other hand... you really should track them down. *Why*? It's simple: You can offer them the opportunity to deed you the property, and therefore avoid foreclosure. You avoid the costs and the hassle – they avoid the negative entry on their credit report.**]]**

ADDRESS OF PROPERTY

Okay, okay...this one really isn't as stupid as it sounds. I've seen many cases where you, the novice note buyer, have assumed that the property address and the borrower's address are the same. Unfortunately, that's not always the case. Rental properties go bad, too. In fact, you'd be surprised how many real estate investors don't learn how to do things the correct way, get overextended, continue to collect rents, and don't pay the underlying mortgage.

COPY OF THE NOTE, MORTGAGE, D.O.T. OR LAND CONTRACT

Any time you buy a note, you need to kick the tires and make sure that what the seller represents is true. *What better way than to ask to see copies of the original documents?* Remember, too, that at closing, you'll actually receive the *original* note (after all, that's what you are buying). In the meantime, however, check both the note and the collateral document (mortgage, deed of trust, etc.). You'll need to ascertain the answers to the following questions:

1. ***What position is the note? Is it a 1st lien? A 2nd lien?***
2. ***What is the note amount? The interest rate? The payment? The terms?***
3. ***Is there a balloon in the note, and if so, for how much, and when is it due?***
4. ***Is the collateral document a mortgage or trust deed, or is it a land contract?*** (Be aware that in the case of a Contract for Deed, you'll need to also get the Warranty Deed from the seller.)

COPY OF PREVIOUS CLOSING STATEMENT

The current loan was obviously originated at the time of the last sale of the property. In some cases, a Lender funded the loan, in which case, the Lender is selling the note. In other instances, the Seller of the property carried back a mortgage, in which case, the Seller is selling his note. In either case, it is very likely that the closing (where the buyer purchased the property) occurred at either an attorney's office or at a title/escrow company.

When a third-party (such as an attorney or a closing agent) closes the transaction, they are required to prepare a *HUD*- 1, or *settlement statement*. These are just fancy names for a form that is approved by Fannie Mae (FNMA – Federal National Mortgage Association) that shows the details of the transaction, and how they affect both the buyer and the seller. The good news is that they reveal several things, including:

- The original sales price of the property (helps to determine property value)
- The original selling date (when used in conjunction with the original sales price, it also helps to determine value)
- The mortgage liens on the property and their amounts (you'll compare these figures to the actual note and mortgage – they'd better match!)

PAY HISTORY STATEMENT

Whether you are buying the note from an Institutional Lender or a Private Seller, chances are that they kept track of the payments made (or not made) by the borrowers. This is very important, as you want to know how much is currently owed on the note. In banking, we refer to this as the UPB, or Unpaid Principal Balance, which reflects the amount of principal still owed on the note. **[[SPECIAL NOTE:** Lenders use this figure when figuring a payoff when people refinance their home.**]]**

Not only do you want to know the *present value* of the note, but you'll also want to know how many back payments are owed by the borrowers, as well as any late fees. This will help you in your negotiations with them, and in determining whether you should restructure the note, put the payments on the back end, etc. (review Chapter 4 if necessary)

There may also be times when the Seller doesn't have a pay history. You'll probably never run into this situation with an institutional seller, but you *will* run into it frequently with private sellers. And the last thing that you want to happen is for you to buy the note, then have the payor protest the amount that he owes (it could get messy...). So, in order to protect yourself, as part of your due diligence, you need to send out a ***Payor's Estoppel Letter***.

A *Payor s Estoppel Letter* (vs. the *Sellers* Estoppel – which I'll cover in the next chapter) is simply a letter that you send to the payors *before* you buy the note. In this letter (and there's an example in the forms section), you'll notify the payors that you're buying the note, and confirm the balance that they owe as of a certain date. You'll give them 10 days to respond, and let them know that if they don't respond within that timeframe, you'll assume that the numbers stated in the letter are correct.

COPY OF OLD APPRAISAL (IF LENDER) OR PROPERTY PHOTOS (IF PRIVATE SELLER)

If you are dealing with an institutional lender, the chances are very high that they have an appraisal in their file. Granted, it may be an older one, but you can use it to at least see what the property looks like, and what it was worth when it last sold. On the other hand, if you are dealing with a private seller, the chances are just as high that there will not be an existing appraisal. In this case, you'll need to order one (*see next section*), but in the meantime, ask for photos of the property. Most likely, the seller will still live near the property, and can drive by and send you photos. You'd be surprised at what a photo shows...or maybe you wouldn't! Don't expect anything really pretty; when people fall behind in their payments, they usually also fall behind in their property maintenance.

COPY OF TITLE INSURANCE POLICY

In review, you'll remember that a title policy is nothing more than an insurance company's issuance of insurance, warranting that the subject property is free and clear of all encumbrances that could affect title. Traditionally, the seller pays for it when he sells the property, and the buyer pays for a *rider* to insure a third-party lender. To that end, all lenders require a title policy. Unfortunately, however, in the case where a private seller carried a mortgage, there *may*...or *may not* be a title policy in place.

If you are buying the note from an *institutional lender*, there will definitely be a title policy in the file – you're going to want to see a copy for a couple of reasons. First of all, you want to make sure that the lien (the one that you're buying) was filed correctly. Second, you want to see if there is anything that would prevent you from wanting the property (certain easements, liens, etc.).

Again, if you are buying the note from a *private seller*, there may or may not be a title policy already in place. If there is one, great! If not, you need to order one and deduct the cost from the seller's proceeds. *Why make the seller pay for it?* When the property was originally sold, it was the seller's responsibility to warrant to the buyer that the property was free and clear of all encumbrances that would affect title. The only way to do that is through a title insurance policy.

COPY OF HAZARD INSURANCE POLICY

First of all, you want to make sure the property is currently insured, and for how much. At closing, the note seller will assign his beneficial interest in the policy to you, but... more about that in the next chapter.

ANY LEASES ON THE PROPERTY (IF BEING HELD FOR RENTAL)

Sometimes, the property is being held for rental purposes. In the industry, we refer to this as a Non Owner-Occupied property (N/O/O). As I mentioned earlier, we see a lot of cases where the property owner (landlord) continues to collect the rent payments, but fails to pay the mortgage on the property. In other words, the landlord is living off the payments.

When taking over an N/O/O property, the first thing you'll want to do is notify both the current owner and the tenants that from now on, you are to receive all rent payments. Don't worry, if you decide to work with the seller and let him maintain ownership of the property, tell him that you'll apply the rental income first to his monthly mortgage payment, and then send him a check for the balance. Also, he needs to know that you'll give him a full accounting every month.

You'll also want a copy of their leases to determine **A)** what the tenants are paying every month, **B)** whether or not those payments reflect the true market value of the rents in the area, **C)** if they are in violation of any of the lease-stipulations (old cars in the yard, etc.) in case you need to evict them, and **D)** what the terms are (month-to-month, etc.). Again, you'll need all of this information to help you determine what you will do with the property once you control it.

IF BUYING A 2ND, GET INFO ON THE FIRST

Finally, there will be some cases where you buy a lien that is in 2nd position. You'll need to gather all of the information we just discussed; you'll also want to get all of the information regarding the 1st lien – again, just to make sure you know where you stand.

Information That You *Need to Generate*

Granted, you can get a lot of information from the note seller, but you'll also need to generate some on your own. Again, this is all just to make sure that you really get what you think you are purchasing! Looking at the list below, you'll find that there are some things that are really based on what the seller can or cannot provide – things such as the appraisal, title, etc. And, like before, let's first look at the list, and then let's discuss the importance of each of the items.

Option to Purchase Agreement between You and the Note Seller (private or institutional)

Preliminary Title Report or Nothing Further Certificate

Appraisal or Web-based evaluation of the property in its *as-is* condition.

OPTION TO PURCHASE AGREEMENT BETWEEN YOU AND THE SELLER

This agreement, also called a Purchase & Sale Agreement (PSA) is the one between you and the note seller wherein you agree to buy the note pending the results of your due-diligence. If you have read ***The Paper Game,*** (the primer for this course), you should be familiar with this form. Feel free to use a copy of the form that I have provided for you, or again, you may contact me via email (callbobfirst@aol.com) and we'll gladly provide you with one. Of course, you'll want to change it to meet your own specifications, and like anything else, you should also have an attorney review it.

There are a couple of points made on this form that I would like to emphasize. ***First*** of all, this agreement is the written offer you will use to lock-up the deal. It is comparable to a real estate contract; in this case, you're not buying the real estate, but rather, the paper that controls it. ***Second***, it gives you time to complete your homework, and gives you an *out* if your due diligence doesn't produce the desired results. ***Third***, it prevents the seller from simultaneously selling the note to another interested party.

PRELIMINARY TITLE REPORT OR NOTHING FURTHER CERTIFICATE

As we discussed in the previous section, clear title is imperative when you are purchasing defaulted paper. If you are dealing with a lender and there is already a title policy in place, you'll definitely want to order from the issuing title company, a *Nothing Further Certificate*. In other words, the title company will research anything that has affected title since the original policy was issued, and will issue a certificate verifying that nothing else has happened to encumber the property. If there was *not* a title policy issued when the property originally sold, you'll need to order one at the seller's expense.

As part of your title search, you also need to check into the property taxes to make sure that they are current. As people fall behind in their payments, they also have a tendency to let their taxes lapse. ***Because they'll need to be paid off, back-property taxes must be included in your overall costs when figuring out whether or not this is a good deal.***

APPRAISAL OR WEB-BASED EVALUATION OF THE PROPERTY IN ITS AS-IS CONDITION.

Even though you may be able to get an appraisal from the current note holder, chances are that it will be outdated. In any case, you want to determine *beyond a shadow of a doubt*, the value of the property in today's market (Refer back to Chapter 3 for determining value). There are several ways you can do this:

1. Check with real estate agents for recent (within 60 days) comparable sales in the area. Do not ask for properties that are for sale – we're only interested in properties that have ***sold***.
2. Talk with the neighbors. What do they think their house is worth? Chances are, they'll have some pretty definite opinions about the subject property, too!
3. Go Online. Try www.eppraisal.com for an estimate of value. Granted, you'll usually get three different values on this one site – one from Eppraisal, one from Cyberhomes, and one from Zillow and yes, all three will be different. Use this site only as a rough indicator of what the home is worth.
4. Research the local tax records. You should know how the tax value compares with the market value in the subject neighborhood, then adjust the figures accordingly.
5. Of course, you can also order an appraisal. Then again, why incur the expense (usually about $400 on a residential property) if you are convinced of the value of the property? A special note here, however: some times, your funding source

will require an appraisal. It's their money, and the Golden Rule applies, *They have the gold; they make the rules.*

You'll specifically want to know what the property is worth once it is fixed-up, and brought to a condition that is at least *average* for the area. We refer to this as the **A.R.V.** orAfter-Repaired Value. The ARV reflects the true market value of a property once it has been *rehabbed*. And of course, you'll need to determine how much money it will take to fix it up – be sure to give yourself a little *cushion* on this figure, as I've yet to see a rehab project come in at or under budget.

Items That You Need to Present to Your Funding Sou rce

Okay, you've done your homework, and things look good to you. Now the key is communicating that effectively to your funding source. Actually, there are two stages in doing this:

1. ***The Initial-Interest Stage***
2. ***The Due Diligence Stage***

THE INITIAL-INTEREST STAGE

If you are using a third-party funding source, the key here is to convey your *excitement* about the property while leaving no stone unturned. Don't ever hide anything from your lender – they'll probably find out, anyway, and all you will have done is violated a trust. Let's face it: this is all about building relationships **[[Editor's Note:** *Have I read that somewhere before?***]]**, and you don't want to bite the hand that feeds you. Better yet, you want to develop future business, and the only way to do that is to thoroughly do your homework and accurately communicate those results.

When you initially pinpoint a property, let your funding source know. Put together a nice package, and include:

Property Address, Description, Condition
Photos of the Property (if available)
Terms of the Note
What you think you can pay for the note
Accurate Property Value Information

What you plan to do with the property (evict, work with payor, etc.)

This communicates to him/her that you know what you're talking about, and that you have done your preliminary homework before coming to him/her. They'll appreciate the fact that you are not wasting their time, and they'll also appreciate the fact that you've given them enough information to make an initial decision.

THE DUE DILIGENCE STAGE

As the project progresses, you'll want to give your funding source a copy of everything that you collect, so that they, too, can review it prior to purchase. *C'mon, doesn't it make sense that if they are writing the check, they should have all of the facts at their fingertips?* In fact, I'm surprised with the amount of people who come to me for private money who haven't done their homework! And if they have, they don't show it in their presentation. Here are my thoughts:

If they don't pay attention to the details in their presentation, how do I know that they'll pay attention to the details of the transaction?

Again, be professional and present it in a nice package. Don't scrimp – you are asking your funding source to write you a very large check, and they deserve to be treated professionally. You'll be surprised and pleased with the results.

KEYS TO CLOSING

They Get the Money, and I Get the Note!

In reviewing the previous chapter, I must admit: it's a little *dry*, and to be frank, this one may be too! Sorry about that, but it's just that there's not a whole lot really exciting about ***Due Diligence*** and ***Closing the Transaction***. Granted, it's not too exciting. Then again, exciting or not, it is *very* important that you dot all of your "I's" and cross all of your "T' s". You know that old saying, *The jobs not over until the paperworks done!*

Having said that, let's proceed on to the closing of this transaction. By "closing", I mean the point in time where the actual note is exchanged for money! And, if you've read ***The Paper Game*** **[[Editor's Note:** *Are you getting the not-too-subliminal message that it is important that you learn the* ***basics*** *before moving on to the advanced level?* **]]**, you'll find that this chapter is somewhat of a review, although it has a few significant differences.

I recommend that you always use a bonded third-party, such as an attorney or title/escrow company to handle your closing. They'll get the original note from the lender/note seller, and exchange it for the cash that you or your funding source bring to the closing table. Everyone trusts them, so there's no *You send the note, then Ill send the money* or visa versa.

At the closing, remember that you are buying the Note itself. You'll walk away with the *original* note. Ownership of the note gives you the same rights as the bank or of the original note holder. The note seller is *assigning* his interest to you. Therefore, you are going to get an *assignment* of lien, and not a *satisfaction* of lien. One assigns interest; the other says that the note is paid off, which certainly is not the case! You are *buying* the lien; you *are not* paying it off!!

Second, at the actual closing, you'll sign several documents that will not only transfer the note to you, but all of the rights that go along with it. For your convenience, I've included sample copies of these documents at the back of this manual. You'll want to make sure that you receive:

1. **<u>The Original Note</u>** – along with a document assigning it to you, such as an Allonge, or Promissory Note Assignment.
2. **<u>Assignment of the Mortgage or Deed of Trust</u>**.
3. **<u>Assignment of the Hazard Insurance Policy</u>**
4. **<u>Seller's Estoppel Letter</u>** (this is a letter that says that the Seller's interest in the note stops at a certain time, and lists the terms of the note at that time).
5. **<u>Goodbye Letter</u>** (this is a letter from the current note holder telling the payors that they have just sold the note, and directing them to make future payments to you).
6. Make sure that if the wording, "...and/or assigns" doesn't appear on the original title policy, that you have it endorsed over to you.
7. If buying a land contract or a contract for deed, make sure that you get the actual deed to the property. **A BRIEF ASIDE:** A ***Contract-for-Deed*** means that the warranty deed to the property transfers only *after* the Contract has been fulfilled. In other words, when you buy the note, you are also buying the property itself, because the payor doesn't own it yet! So – you'll be on chain-of-title. **[[Editor's Note:** *Recently, we bought a contract-for-deed in Michigan. Little did we realize that we had to pay transfer taxes when the deed transferred in to our name. Boy was that ever an expensive seminar! Use our mistake and make sure that you dont make the same. Determine all the costs* ***before*** *you buy!***]]**

Finally, if you are buying a 2^{nd} lien, make sure that you get all of the contact information for the 1^{st} lien holder!

HOW TO FIND UGLY PAPER

One Mans Trash is Another Mans Treasure

Okay... take a deep breath. No, really, I'm not kidding! Take a deep breath right now! Go ahead... I'll wait...

You see, the reason I asked you to do so is that I am switching topics, and taking a deep breath helps clear away the old and make way for the new. We've gone through all of the steps to buying paper, from your initial research all the way to closing. In our journey, we have covered Ugly Paper in its many forms, and we've also discussed what you are going to do with it, how to fund it, what homework you need to do, and even how to complete the closing. We have, however, up to this point, omitted one very important topic: *How do you* ***find*** *ugly paper?*

As in the previous volume, I've saved the *marketing* for paper, and the *finding* of paper, for last. There's a specific reason I've done this, especially considering that in the past, I've included marketing toward the *beginning* of a course, rather than at the *end*. Here's the reason: Over the years, I've learned that it is best to learn marketing only when you know what you're talking about. In other words, it's best to learn how to find notes only *after* you know what you're looking for! **[[Editor's Note:** *Nice dangling participle, wasnt it?***]]**

Okay, enough of the *chit chat* – let's jump right into the many ways that you can find Ugly Paper. In fact, the number of ways to find paper is only limited by your imagination. So, I've tried to make it easier for you by grouping them into categories. Below, you'll find sources to help you generate:

Lender Held (Institutional) Ugly Paper
Privately Held (Seller Financed) Ugly Paper
Sources that Generate Both

LENDER HELD (INSTITUTIONAL) UGLY PAPER

The key to finding Lender Held, or Institutional paper, is to align yourself with institutions that deal with conventional lending. Specifically, you'll contact insurance companies, mortgage companies, credit unions and banks; especially those with mortgages on ugly houses or seconds behind firsts which are in foreclosure. You'll also be contacting Lenders who have purchased loans from the now-defunct B&C Lenders, as well as servicing companies that deal in sub-prime paper.

Again, one of the things that you want to remember when dealing with institutions is that you want to come across as being corporate. Don't waste their time, don't call ten times to see if your fax went through, and don't call sixteen times each day. **[[Editor's Note:** *Does he sound a little jaded? Its only because folks at his company experience that every day from novice, though well-meaning, brokers*.**]]** Instead, be professional in all of your dealings. Then again, that doesn't mean make it so stiff that you don't establish rapport.

One of the things that I mentioned in the negotiation section of this manual is the importance of establishing rapport. You can be fun and friendly, and still be professional! Remember, people do business with people, and if you are dealing with an institution, the chances are very high that you can buy more ugly paper from the same source in the future. So, if the person likes you and looks forward to your calls, imagine how much more likely they are to work with you in giving you a good price!

There's another point that I'd like to make before moving on. I thought a lot about giving you sample letters to send to institutions like the ones listed below. However, I opted not to do so for two very important reasons:

1. When you send a letter to a large corporation, it often gets lost, or doesn't get to the right person. Besides, if you have a desk full of things to do, one of the last things that you'll do is respond to a solicitation letter from someone you don't even know!

2. The second point is that personal contact leaves a much better and long lasting impression. There is no substitute for personal interaction. Period. Don't hide behind the fax machine, emails, or the U.S. Postal Service. Get out there, make the personal contact, establish rapport, and ask for the business!

That doesn't mean, however, that you shouldn't send follow-up notes reiterating your conversation, and setting the stage for future business. And no offense, but if I have to tell you how to write a thank-you note, you probably shouldn't be reading this manual.

Okay, ready to move on? Let's take a look at the following:

Insurance Companies
Mortgage Companies
Credit Unions and Banks
Lenders
Sub-prime Servicing Companies

Insurance Companies

This is a somewhat esoteric way to find *ugly* paper, but remember that ***"the successful people are willing to do that which the unsuccessful people are unwilling to do."*** In other words, it is always worth it to go the *extra mile*, and move away from the rest of the proverbial *pack*.

When people start to fall behind on paying their bills, they invariably stop paying other bills, too; among them – their property insurance bill. So, why not make friends with insurance agents in your area, work with them on their cancellation lists, and contact the homeowners with a nice postcard or letter? You might mention something like, "*Behind on your house payments? Local businessperson may be able to help! Please call…*" Notice that I emphasized the word "local." People feel a lot more comfortable with someone who is, relatively, a *neighbor*.

Of course, the insurance company will also notify the mortgagee (be it a lender or a private seller who carried financing) when the homeowner lets his insurance lapse, giving you the perfect opportunity to approach the lien holder about selling the possibly-delinquent note.

Mortgage Companies

I've differentiated between the neighborhood mortgage company, and the lenders that actually fund the loans. In this case, I'm talking specifically about a mortgage company – you know, the place where people go when they're behind on their payments and seeking to refinance. In many cases, a good mortgage broker/loan officer can refinance a mortgagor who has fallen behind on his payments. Then again, if the payor is more than 120 days delinquent, there is usually little, if anything, that the mortgage company can do.

This is where you come in.

Contact the mortgage brokers in your area, and offer to pay them a referral fee (only when the deal actually closes) for delinquent payors that they can't help and are willing to send to you. This puts you directly in touch with a borrower who is in trouble, and through them, connects you with the lending institution (or private seller) that holds the *ugly* paper.

[[Side Note: I'll relent here a bit and tell you that with both insurance and retail mortgage companies, you can send an initial letter introducing your services. It is imperative, however, that you follow up with a phone call and visit! If you don't, you are just wasting your time, money and postage.**]]**

B& C Lenders (or what USED to be B&C Lenders! LOL!)

A brief review is in order (based on your reading of Volume One of Paper Magic, "Profits in Creating Paper"). ***First*** of all, a Lender is one who actually loans the money. Mortgage Brokers work with a variety of Lenders to fund their loans. Imagine it just like you would with your local insurance agent: he doesn't actually insure your car, but instead, brokers your policy to one of the big boys, like Geico, or Farmer's, or... You get the picture: both the insurance agent and the mortgage broker play the part of the retailer; the companies that actually provide the coverage/money play the role of the wholesaler.

More specifically, a ***B&C*** lender was one that specialized in people with less than perfect credit. They got their name from grading someone's credit like you would a report card – A, B, or C. and were also referred to as ***Sub-prime Lenders***. Mortgage Brokers (see previous paragraph) sent loans for people who were credit challenged to B&C lenders. Unfortunately, B&C lenders got greedy and took unseemly lending risks only because Wall Street would buy the product. Before you knew it, default rates were up, Wall Street stopped buying this type of high-risk mortgage, and the B&C lenders were out of business!

The loans were eventually sold-off to other, more solvent, lenders who, in turn, inherited a veritable mess, with the result being that you can now find defaulted paper with almost ANY lender. And the BEST part is that we can focus on the B&C paper, because that type of paper was/is the most likely to default!

The mere fact that they sub-prime lenders specialized in high risk borrowers would indicate that their foreclosure rate is higher than other lenders. In fact, while the rate of foreclosure in the "A" paper market is 3/1 0ths of 1%, the incidence of foreclosure in the B&C market ranges between 5% and 10%. So, it stands to reason that whoever inherited the paper would end up with a lot of *ugly* paper.

Actually getting to a decision maker in this type of organization, however, takes some work and finesse. The first thing you'll want to do is bypass the people at the bottom of the food chain, and go to the top. Talk with a manager either in the "*workout*" department, or in "*secondary marketing*." Remember the chapter on negotiation? Here's your chance to utilize those skills! Remember, too, that this person may be able to sell you several ugly notes over a period of time, so it pays to develop a good rapport. **[[Helpful Hint:** *Dont try to buy a whole portfolio of defaulted paper until you have successfully completed a few transactions involving just one property. Youll be dealing with professionals - if you dont know what you are talking about, they will detect it right away*.**]]**

Credit Unions and Banks

Credit Unions and Banks are kind of a crossover between the previous two institutions: As with Mortgage Brokers, people in need of refinancing (due to delinquency and pending foreclosure) may seek them out. Then again, the bank, itself, may be carrying ugly paper on its books. In either case, it is definitely worth your time and effort to create relationships with ones in your area. And yes, the best way to do so is to actually go into the institution and introduce yourself to the branch manager. They're people just like you are, and you'll be surprised how great it feels to include them in the list of people who refer business to you!

Sub-prime Servicing Companies

When lenders sell their loans on the secondary market, they often refer the *servicing*, or the process of collecting monthly payments, to a third-party company. Ocwen, a large company based in Florida is one of these. In fact, in addition to servicing a tremendous amount of sub-prime loans, they also service a lot of the delinquent VA loans in the country.

Now, I don't want you rushing to your phone to call Ocwen. I've just used them as an example, and will tell you that there are quite a few sub-prime servicing companies throughout the company. One of the easiest ways to find them is to research the public records at your County Courthouse, and develop a list of mortgagees which you'll find on the mortgages and trust deeds filed there. Call them, and find out what they specialize in. Yes, it will be a lot of work, but then again, if you're making several thousand dollars on one transaction, what is a few hours at the courthouse? Besides, if you're smart, you find an online service, like WWW.NETRONLINE.COM, who can provide them for you!

And just as you would do with B&C lenders, a phone call, in this case, will get you a lot farther than a letter!

PRIVATELY HELD (OWNER FINANCED) UGLY PAPER

Of course, not all ugly paper is deemed *institutional*. In fact, there is a lot of seller-financed paper out there, and a tremendous amount of it could be termed *ugly. Why*? Think about it: the large companies have full-time personnel devoted to working with customers to make sure they don't go into default. The private seller, on the other hand, usually has no experience in working with buyers to keep a loan current, nor does he have any experience in the foreclosure arena. Frankly, I love privately held defaulted paper, because the profits are greater than pretty paper, and I know that I am providing a service for the *little guy*.

There are a lot of sources for privately held ugly paper. You can talk with hard money lenders (equity lenders) and see if they would like to unload some of their problem loans (be sure you can fix the problem before you decide to buy). You can run ads in the newspaper to reach private sellers, or you can send out a general mailer to note holders you found while researching county records. Let's review and take an in-depth look at each of the following:

- Newspaper Advertising
- Direct Mail to Private Sellers
- Hard Money Lenders

Newspaper Advertising

There is so much that has already been said by others regarding newspaper advertising that this section won't even begin to attempt to cover it all. On the other hand, I will share with you some specifics that will help you find defaulted paper. First, however, a few rules governing newspaper advertising:

1. Make sure that your ad is an eye-catching headline backed up with text. Keep it simple. Be sure and stress the fact that you are local. In short, you might try something like, ***STOPPED RECEIVING PAYMENTS?*** *Local investor can help. We buy seller-financed mortgages and trust deeds. Call* Or you might try, ***TROUBLE COLLECTING PAYMENTS?*** *Let me help! Local investor buys seller-financed mortgages and trust deeds. Call*
2. Use all caps (capital letters) in your headline, and make it **bold;** instead of paying for a border around the ad, you might try paying for a couple of blank lines – one at the top and one at the bottom of your ad. When the reader scans the page, the spaces will make your ad automatically stand out.
3. Advertising in small, local papers will give you a lot more bang for your buck. Not only is the cost less expensive, but people have a tendency to read the entire paper from cover to cover. Chances are a lot greater that your ad will be read than if you advertised in large papers.

Direct Mail to Private Sellers

Private note holders frequently receive letters and postcards from people around the country who want to buy their notes. They don't, however (and I know this because I hold several notes and constantly receive those letters), receive letters offering to buy their notes if they are slow-paying or non-performing. Imagine the service you would provide to them by giving them an outlet to sell their *ugly* paper! Here's how to go about it:

First of all, you'll need to find people who are holding notes in your area. The easiest way to do this is to research public records in your county, looking for private mortgagees. I've gone over this extensively in The Paper Game, so please refer back to that manual for different ways to find paper (including online services, mailing-list brokers, etc.). Then, I would send them a post card, letter, or even a ***letter/post card*** (*intrigued?*). Each has its strengths and weaknesses:

Post Cards: Post cards are inexpensive, and virtually guarantee that the mortgagee will read them because they don't have to actually open an envelope. They limit you, however, to what you can say, and, depending on how you design them, they can also look cheap.

Letters: The hardest part about sending letters is getting the mortgagee to open them. You can often entice them to do so by hand-addressing the letter, or by putting something bulky in the envelope (that whole curiosity thing...). If you do send a letter, and this is contrary to popular belief, the longer the letter, the more effective it is. Crazy, huh? Seriously, statistics show that 2-page letters get a better response than 1-page letters, and that 4-page letters get better response than 2-page ones. That having been said, what will you say about defaulted paper that will take up several pages? Well, you could tell a gloom and doom story about the hassles of foreclosure, and for that matter, even use some of the text from this manual.

Letter/Postcards: This is my newest way to find paper, and I've been very pleased with the results. It combines the previous two methods – I use an oversized postcard (the largest that the Postal Service will allow) and put a lot of text on it. This intrigues the reader, who ends up reading the entire thing.

Hard Money Lenders

We visited hard money lenders in an earlier chapter. In addition to getting money from them to fund you deals, why don't you create a relationship where you can help them by taking bad paper off their hands? Granted, they'll need to sell it at a discount, but remember, even if you pay full price for the note, you'll still be into the property at a 75% LTV or less! (You may want to review Chapter 5.) You're getting a great deal, and they don't have to go through the hassles of foreclosure. Better yet, their investors get paid off, which keeps their relationship with them on a high note!

SOURCES THAT GENERATE BOTH

In addition to the resources specific to Institutional and Privately Held paper, there are relationships and sources that you can develop that will generate *both* kinds of paper. These include:

Title Companies
Bankruptcy Attorneys
Realtors
Mortgages & liens on house you are trying to buy
Mortgage Brokers
Foreclosure Filing Services and Publications

As usual, let's look in-depth at each one!

Title Companies

This is one of those sources where it is best to develop personal relationships. Yes, you need to get out of your chair and actually go by their offices, but be sure and do so in the middle-two weeks of the month. Title companies are very busy on both the first and the last week of the month, and won't have time to visit with you then. On the other hand...

Establishing a rapport with a closing agent can be *invaluable*. They may not be able to directly generate defaulted paper for you, but they're always looking for new business. As such, they are willing to do things for you, provided that you bring them the deals when it comes time to close (or refinance, or...). For instance:

In some cases, they will actually do your mailing for you! Their abstractors come across the names of private note-holders every day. They could do a mailing for you to their list, and pick up some business for themselves in the process.

They can also tell you who the hard money lenders are in your area. How? They see where the money is coming from, and they also review all of the notes before closing. It would be pretty simple to pinpoint a one-year note that is funded by an individual, family trust, or whatever.

Finally, the hook for getting title companies to work with you is that you are bringing them business. You'll order *nothing-further* certificates from them (see Due Diligence), perhaps new title policies, and when the borrowers refinance, you'll use them again. See? It's a win-win-win for everyone!

Bankruptcy Attorneys

When people face foreclosure, they often retain an attorney and contemplate filing bankruptcy as a last resort. Most people, however, wouldn't do so if they didn't have to. And, with the new bankruptcy laws going into effect in late 2005, it will become harder to do so. Why not create a relationship with bankruptcy attorneys wherein they can refer clients to you, and visa versa. They win, because they can offer your service to their clients, and you can even pay them a referral fee. You win because you are now in touch with payors in trouble, and their motivated mortgagees.

Realtors

If you are a real estate agent reading this, please excuse my somewhat caustic humor. I deal a lot with agents, both in my real estate investing and in my note business. In all of my dealings, I can honestly say that I've only met a handful that actually knows what they are doing. Then again, those that do are worth their weight in gold! You need to put one on your team, especially to help you find properties, because they have the inside track. Not only can they help you find good properties, but they can also help you find notes. Here's how:

Mortgages & liens on house you are trying to buy

If you have a friendly real estate broker, you can look through all of the available properties offered for sale to see if there are any mortgages that will be paid off upon sale. This may mean some leg work at the registry of deeds, however, you can then get an option to purchase the paper from the note holder.

Let's say that you're looking for a house, and your agent finds you one where the people are selling only because they want to avoid foreclosure. They want you to close as quickly as possible, because they are behind in their payments. Actually, they'd love to stay in the house, but the lender is fed-up and won't work with them.

What are their options? Well, they could sell the house, or...the lender could sell you the note (and avoid the hassles of foreclosing), and you could work things out with the homeowners, provided, of course, that they are willing. Now, you're either getting a great deal on a house, or on a note!

Mortgage Brokers

We went over Mortgage Brokers in a previous section, but I wanted to reiterate that you can use them to find both Institutional and Private note holders. You may want to review the previous section.

Foreclosure Filing Services and Publications

In every major township, there are publications that file the Notices of Default on a regular basis. How often this is depends on the foreclosure laws in your state. Some states, as I mentioned at the beginning of this manual, foreclose every day (like Utah). Others, like Texas, only foreclose once a month. Either way, however, the mortgagee or trustee needs to publicly announce the pending foreclosure by publishing a Notice of Default.

Sure, you can go to the courthouse and research them, but doesn't it make more sense to subscribe to some sort of service or publication that does the research for you? You can find them Online, or through an Internet search. Simply put in "Notice of Default and Your

City" (eg. Notice of Default Austin Texas). Then, you'll need to contact the lien holders directly.

You can also contact the homeowners, but keep in mind that once an N.O.D. hits the paper, the homeowner will start receiving lots of letters from companies who want to buy their house at a steep discount, etc. The unfortunate part is that many of them simply stick their head in the sand, and hope that by not dealing with the situation, it will magically go away. Therefore, there is a good chance that they won't open a letter from you. You can, however, go knock on their door. It may be scary for you, but it is the most effective way to deal with a pre-foreclosure seller.

THE BOTTOM LINE

When it comes to finding paper, both pretty and ugly, the bottom line is to get the word out to everyone in your area that you buy real estate secured paper. Over time, you will get two or three calls a week from people needing to sell their mortgages and/or deeds of trusts.

PUTTING IT ALL TOGETHER

Five Steps to Success

Congratulations! You made it! We've walked through the entire process of acquiring *ugly* paper from beginning to end. The only thing left is to put it all into perspective, and re-cap the step-by-step process you'll need to take in order to make this work for you. Follow these simple ***5 Steps to Success***:

STEP ONE – LOCATE PROSPECTS

Obviously, the first thing that you need to do is *find* ugly paper. The best way to do this is to have a lot of lines in the water at the same time. Don't limit your efforts to using just one technique at a time. Look in the previous chapter and pick a couple to try simultaneously. Start making phone calls to lenders, while at the same time starting to visit real estate agents, title companies, and mortgage brokers in your area. If you want to invest some money initially, invest it in direct mail or ads in your small local newspaper. On the other hand, you may want to initially emphasize the first two techniques, and only spend more money once you've closed a deal or two.

During this phase, you should also be lining-up your money source, and having initial conversations.

STEP TWO – PRESCREEN PROSPECTS

In the Prescreening Process, you'll be evaluating both the *subject property* (for profitability) and the *homeowner* (for agreeability). With an eye out for pitfalls, you'll be asking yourself the following questions (be sure and write down your answers):

Regarding the **PROPERTY**:

1. *What is it worth?*
2. *What can I get it for?*
3. *What is the AR V?*

4. *Does it need repair, and if so, how much will repairs cost me?*
5. *Taking into consideration all costs, is the ITV acceptable?*
6. *What liens are on the property, and can they be foreclosed?*

Regarding the **HOMEOWNER**:

1. *Does he want to stay in the house?*
2. *If so, what can he afford to pay monthly?*
3. *Will the payor file bankruptcy?*
4. *Should the person stay in the property, or is it better that they don t?*

Make sure that you do all of your homework ahead of time, and determine if this really is a property in which you want to invest time, effort, and money.

STEP THREE – CONSTRUCT & PRESENT OFFER

Once you've determined that you want to go ahead with the project, now you need to present your offer. Just a note to remember all of the negotiating tips that I mentioned, and don't be afraid to pick up the phone and talk to people! We're in the unique business of helping people; you are offering to get them out of a bad situation, be they a lending institution or private individual.

Remember several key guidelines:

1. Make sure that you always put your offer in writing. It will give you, and your offer, more validity. Besides, it gives the note seller something concrete in front of them, rather than a verbal offer.
2. Determine their needs, and try to meet them!
3. God gave us two ears and one mouth – use them in proportion.
4. He who speaks first... loses. Don't be afraid of some awkward silence when negotiating. You'll find others agreeing to things just to break the silence!

STEP FOUR – FOLLOW UP

Following up on your deals is half the battle: in my office, I have had several people in the position of buying notes for my firm; people we refer to as Contract Buyers. Some of them have made some great money – some haven't. Unequivocally, I can tell you that those who make money are the ones who return phone calls, keep appointments, are on-time with their customers and their peers, and *who do what they say they are going to do*! In other words, they are the ones that are diligent about their follow-up. And I guess the point here is that the whole business is really about creating rapport and following-up on things: things like finding, negotiation, due diligence, closing, etc. You get the picture, don't you?

When it comes to ***Ugly Paper***, you'll need to follow-up on several fronts.

Work with the Note Seller: I wish that everyone worked at a faster pace, but the bottom line is that they seldom do. Then again, it must have something to do with salaried employees getting paid whether or not they address the situation. Anyway, you'll really need to "stay in their face" because I have seen some bank negotiations go on for 2 months!

Get an Agreement: Creating rapport is okay, but the bottom line is that you are there to get an agreement, and as I said before, get it in writing! Once the note closes, you'll also want to put your agreement with the homeowner in writing (if you choose to work with them).

Check Title: You never know what is lurking on the title report, and let's face it: you really don't want to buy a property with hidden costs that will jump up and surprise you at the last minute. Title will show you everything from the accepted use of the property to homeowner association dues, outstanding judgments and liens, easements, etc. In other words, as they say in real estate circles, "Buyer Beware!"

Due Diligence: Sometimes, the note seller will have the items you're looking for, and sometimes, they won't. In that case, you can try working with the title company to see if they can supply the relevant answers, or... you're welcome to call my office and one of us can probably steer you in the right direction (I'll give you my contact information in the next and final chapter).

Purchase: I know that this may sound like I'm over-simplifying, but I really need to remind you that the bottom of all your efforts is for you to purchase a defaulted note. All other things lead up to that. Period. So be sure to begin…with the end in mind. In other words, never, ever, take your mind off of your goal. In all things (negotiation, due diligence, etc.) you should be asking yourself, "H*ave I gotten one step closer to buying a note?*" If the answer is *"no"*, then I would suggest that you reevaluate your strategy and refocus your energy.

STEP FIVE – IMPLEMENT EXIT STRATEGY

It ain't over til the fat lady sings! In other words, buying the note is just the beginning. Without talking and *following-up* with the homeowner, all of your efforts are for naught. *So, what will you do?* **IF IT WERE ME, I WOULDN'T WAIT TO TALK WITH THE HOMEOWNER – I WOULD HAVE DONE IT DURING MY DUE DILIGENCE PERIOD, SO THAT WHEN I ACTUALLY CLOSED THE NOTE, I COULD, LITERALLY, HIT THE GROUND RUNNING.**

You can, and should, do the same. Either get a deed in lieu of foreclosure, or. . start the foreclosure proceedings (or *continue* them, as the case may be). If you've decided to work with the homeowner and allow them to stay in the property, you should immediately get them into some sort of credit repair program. You should also be restructuring the note as soon as possible.

And finally, if they will be refinancing, you should meet with them once a month to make sure that they get on and stay on the right track!

IN CONCLUSION

Some Final Thoughts...

CONGRATULATIONS! YOU MADE IT! (And if you just skipped the middle and went right to the end, **SHAME ON YOU!** *Youre only cheating yourself*...)

When I come to the end of one of my books, I always have to put extra thought in how to end it. And then of course, the questions arise: *Is it clear? Did I leave anything out? Could I have said something different?* You know... those nagging doubts that most of us have; doubts that keep us from getting to where we deserve to go.

I'm hoping that you don't let your doubts control your life, but rather, that you focus on the possibilities! I have a screen saver on my computer that says (okay, so it doesn't really *say* anything... you have to *read* it!), ***"Doubt your doubts... not your beliefs."*** The ***loser*** focuses on the fact that he/she cannot have or achieve something, "*We cant afford to go to Europe*". The ***winner***, on the other hand, focuses on ***how*** he/she ***can*** achieve something! "*What can I do so that we **can** afford to go to Europe?*" In other words, a good mental attitude does not guarantee success; however... I don't know any successful people who didn't first develop a good mental outlook, focusing on the possibilities rather than the negatives. Look, we're all faced with negatives on a day-to-day basis. Some of us just choose to deal with them in a positive manner, and consistently achieve better results!

Now then, in case I haven't told you already, you are not alone out there! As an instructor, I realize that your education doesn't end with this portion of the course.

Far from it!

Instead, ***now*** is the time when your learning really begins! **Now**, you should review all of the materials. **Now**, you should implement your marketing plan. **Now**, you should start building your network of real estate agents, title companies, hard money lenders, etc. **Now**... ***you should take action!***

In that light, let me give you some resources that I truly hope that you will use. ***First*** of all, you are always free to contact me directly. The best way is by emailing me at callbobfirst@aol.com.

Second, you can contact the office at **512-351-8142**, and the Broker Help Desk will be happy to answer any deal-related questions. You may also contact the office via email at CustomerService@CapitalGainPublishing.com, or fax us at **512-374-4948**.

Utilize these resources – my staff and I are there to help you in any way that we can. And having said that...

It's time that you and I said "goodbye" for now, and it's time that you got to work. I wish you well, and leave you with these words from Oliver Wendell Holmes, Jr. that you will hopefully incorporate into your life:

"The greatest tragedy of mankind is that most of us go to our graves with our songs yet unsung."

Get out there and sing your song...