Part One: Day One

CreativeFinancing

Making Money with this course

License to Print Money Legally

Using Paper to Work Smarter, Not Harder

What You Can Expect From this Course

As an active real estate investor, I know how much money there is to be made by investing in property. At the same time, I've also been a mortgage broker and have been on both the lending and borrowing side of Private and Hard Money transactions; so in other words, I understand the finance and paper game from all sides. I know how paper is created, how it is bought and sold, its advantages and pitfalls, and... how the application of that knowledge to real estate can help you reap tremendous rewards.

The purpose of this course is to share that knowledge with you. I won't make you a finance "expert" in eight hours over a two-day span. I will, however, give you the tools to identify and complete good deals in both the residential and commercial arenas. I'll also show you how to make money by *controlling* real estate rather than *owning* it.

You'll be presented with a lot of options that you may, or may not, decide to use. Regardless of your direction, what you're about to learn is not common knowledge. Get ready, because you're about to join an elite, select few in an untapped market! Buying discounted paper and notes is a specialized technique and used only by a small percentage of real estate entrepreneurs.

By focusing on defaulted paper and alternative financing methods, you'll learn how to handle any situation that arises, and you'll learn how much easier it will be for you to profit. Of course, the more you profit, the more your peers will think you're a genius. Which, of course YOU ARE!

How to Make Money With Paper

Representation

You can make money for someone else by representing them in a transaction and flipping the note to another investor. This is also called brokering.

Ownership / Control

You can also make a good deal of money by controlling the transaction yourself. In other words, you can choose to control both the note and the real estate that secures it!

Notes:

It's Your Choice: Massive Action = Massive Reward

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 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.

Notes:

Basic Terms

Paper

The term *paper* refers to the specific documents that represent a debt and the collateral that secures it. When I discuss *paper,* I'm referring to a mortgage or trust deed on a house or other real estate. Banks buy and sell *paper* all the time, as do private investors. During this workshop, we will be discussing using *paper* to facilitate real estate transactions.

Note

A note is nothing more than an I.O.U. The *note* is the evidence of the debt. In lending, a buyer (also called the *payor, mortgagor,* or *trustor)* acknowledges his debt to the lender (known also as the **payee, mortgagee, or beneficiary**) by signing an I.O.U., which is called the *note* or, in some states, the *mortgage note.*

The simplest form of a *note* is a dollar bill, which is the U.S. Government's *promise to pay* upon demand. A personal check is another common form of a promise to pay, or a note. If the seller offers *owner financing,* he or she is creating *paper.* The buyer signs the *note* at the closing table. If you will be acting as the buyer, *you* will be signing this I.O.U. at closing.

Mortgage / Deed of Trust

The mortgage, or deed of trust (trust deed) is *legal evidence* of the *collateral* for the debt. The *actual collateral* is the property supporting the mortgage or trust deed. This document gives the lender the right to take back their collateral (the property) if the payor stops paying.

As soon as it is created (which is at closing during the sale of the property), the mortgage (or trust deed) is filed at the County Recorder's office, and becomes part of public record. It you want to find notes for sale, the County Recorder's office is a great place to start, because all real estate notes have mortgages or trust deeds attached to them (or should, if the lender wants any leverage against the borrower).

The mortgage is the document that gives the lender (or the seller, if he or she is carrying *paper)* the right to *foreclose.*

Special Note

All mortgages and trust deeds *should* be recorded. Not all *are.* You can count on banks, S & L's, finance companies and private lenders, etc., to record their mortgages and trust deeds--they know how important it is to do so. Exceptions can occur when notes are created between family members or two private individuals who don't know their own best interests. One of many reasons for doing a careful title search is to seek out unrecorded liens against a property. A good title agent will be quite diligent about this--but be sure that the right checks are made.

Basic Terms Cont.

The Players

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

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

In a state where the Deed of Trust is the main security instrument *(vs.* a mortgage), the players are the person making the payment (the *Trustor),* the one receiving the payment (the *Beneficiary),* and the guardian of the trust, the person with the power to foreclose, the *Trustee.*

Foreclosure

A foreclosure is the lender's act of taking back the property because of non-payment. Each state has its own foreclosure laws. In some states, if the payor stops making payments, the lender can take the house back in as little as twenty-one days. In other states, this procedure may take up to two years.

I bring up foreclosure because this is the mortgage or trust deed owner's or note investor's only remedy should the payor stop paying. If you plan to invest in real estate or in mortgages, you should also be aware of the foreclosure laws in your state, and how they are affected by your state's homestead and bankruptcy laws. My company has had to foreclose on very few notes in the last eight years. We credit this to the effectiveness of our up front homework--our *due diligence.*

Lien Position

The position of the lien affects the ability of the lien holder to foreclose. Let me repeat that in simple English: When a lender (or seller) accepts an IOU, he or she (if they know what they're doing!), immediately secures it by filing the *security instrument* (mortgage or deed of trust) as a matter of public record. When this happens, that action puts a *lien* against the title of the property. The borrower cannot give clear title to someone else before paying off the note, or, *satisfying the lien.*

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

Basic Terms Cont.

Loan To Value (LTV)

Also known as ***LTV,*** this concept analyzes the amount borrowed by the payor in relation to the value of the property. LTV is a great indicator of risk. Let's say that you want to buy a $100,000 house, but have only $5,000 in cash for a down payment. You borrow the rest from a lender. In this instance, you would be borrowing $95,000, which would represent 95% of the value of the property, or a **95% LTV.**

Note that LTV will change as the mortgage or trust deed is paid off, and as time passes and the value of the property goes up, as is normal, or goes down, as can happen when markets take a dive. When buying a property and creating a note, the ***current value*** at that time is all that matters. Note that after one year, the remaining balance will not have changed much, since most of the first payments are interest-only, but the current value may have gone up considerably, in appreciating markets, or dropped, in markets where values are falling.

The note investor's risk (and the property investor's risk) is directly proportionate to the LTV on the property. The higher the LTV, the less the borrower has invested, and therefore the greater the risk of default.

If things go bad the buyer has a lot less to lose than if he or she had put down a larger sum of money.

Equity

Equity goes hand in hand with Loan to Value, because it is the amount of value present in a property above the remaining balance(s) of all liens. Equity is the difference between the current value of the property and what is owed on the property. If a seller has a $100,000 house with a first lien (to any lender) of $80,000; his or her LTV is 80%, his ***equity*** is 20%, or $20,000--if that's the only lien. If there are additional liens, the equity drops. If $80,000 is the total of all liens, then the 80% LTV figure is valid. As noted above, equity increases as the loan(s) are paid down and as property values increase. Equity can ***decrease*** if property values in an area drop faster than the loan is paid off.

Example of Lien Position

If you were to sell your house today, you might find buyers who qualify for a mortgage with a traditional lender, but who may ask you to carry a small balance as a second mortgage (lien). The lender's first lien mortgage takes precedence over your second lien mortgage. If the payor falls behind on their payments to you, you would, in order to foreclose, need to keep the first lien's payments current. If, on the other hand, the first lien holder foreclosed, they could totally wipe out your position, unless: 1) you had the cash to pay them off, 2) the property sold for enough to pay you both, or 3) you made an arrangement with the first lien holder to take over paying the first lien.

Basic Terms Cont.

Assignment

Let's say that the lender is running out of money. With the latest developments in the banking market, this is much more conceivable than it used to be. When you think about it, you'll realize that even though lenders have very deep pockets, those pockets aren't infinitely deep. At some point, their money will start running out.

Assignment is how lenders generate more cash: When a lender loans money, he or she is exchanging *cash* for the right to receive *cashflow.* Running low on cash means that the lender has accumulated a lot of *receivables* (cashflow) in the form of mortgage notes. Now he or she (or the company) is mortgage rich and cash poor. In order to reverse that situation, the lender sells those notes to someone else, this time exchanging the right to receive payments (the cashflow) for cash.

Even the big boys play this game.

Assignments happen all the time on the secondary market. As an example, lets use a hypothetical situation involving one of the nation's largest lenders, Countrywide Lending. Now let's say that Countrywide, a major national mortgage bank, makes $100 million in loans, then turns around and sells those loans to Wall Street for $100 million, plus some profit. Unlike private investors, Wall Street will accept a *lower* yield, and thus will buy at a premium (pay more for the note than what is owed on it), vs. a private investor who wants a *higher* yield and thus buys at a discount (pays less for the note than what is owed on it).

Now they have their $100 million back in their pocket to loan all over again. (See *ITV.)* Private sellers who have carried financing may also exchange their cashflow (right to receive payments) for cash.

When Countrywide (or our example private seller/owner financer) sells their notes, they assign the right to receive payments to the entity buying the note. It's like endorsing a check to someone else: When someone writes you a check, you have the right to receive that payment. When you endorse that check to someone else, you are *assigning* to him or her the right to receive that payment. The same holds true for mortgage or trust deed notes. Thus our current economic state.

Basic Terms Cont.

Investment to Value

Unlike LTV (reflecting what the borrower pays *vs.* the current value of the property), the *ITV* reflects what the investor *invests* in relation to the value of the property, *i.e.,* what the investor pays relative to the current value of the property. Let's say that the $100 million in loans that Countrywide is carrying is backed by $120 million of real estate. Their *ITV* on their loan portfolio is 83% (100/120 = 83%). If Wall Street pays more for those notes, their *ITV* will be higher than 83%. If Wall Street buys those notes at a discount, their *ITV* will be less than 83%.

Discount

Why in the world would a private seller offer to sell his or her note at a discount? If a seller were owed a principal balance on the note of $96,000, why would he or she take less than that in cash?

The answer is quite simple. When a seller carries back financing, he is agreeing through the terms of the note to receive periodic (usually monthly) payments over a long period of time-up to thirty years. In many (but not all) cases, the seller would rather have the cash now. They would rather have less cash in hand now than wait for more cash spread out over thirty years. Whether this is a desirable and good deal for the seller depends on the seller's needs, and on whether the seller understands *the time value* of *money.* See box to the right.

Yield

This term applies only to the note investor. When a person borrows money, his cost of renting that money is known as interest. *Interest* is what a person pays, *yield* is what an investor receives. The best way to illustrate this is with an example:

EXAMPLE:

You decide to loan Frank, your neighbor, $500 dollars. He agrees to pay you only the interest (you charged him 12%) every month for the next five years, at which time he still owes you the principal balance of $500. Meanwhile, you have profited by a whopping $5 per month, or $60 for the entire year. He is *paying* an interest of 12%; you are *receiving* a yield of 12%.

Time Value of Money

Time Value of Money: Think about it: If I offered you a dollar a year for the next ten years, or eight dollars today, what would you choose? My guess is you would choose the latter, because of the time value of money. Because of inflation, among many other factors, money is worth more today than it is in the future.

Basic Terms Cont.

In the twelfth month you get tired of collecting only $5 per month, and you want all of your money back now. Frank can't afford to pay you $500 now, nor (you secretly suspect) will he be able to do so in a few months as agreed. Along comes Nora Note Buyer-someone who is willing to give you cash in exchange for your cashflow. She offers you $460 for your note. You accept...

You took a small discount, selling the $500 note for $460, yet you had already recaptured $60 in payments, which makes it come out twenty bucks better than even. Remember, you wanted all of your money back, now!

Nora now has the right to receive $60 per year, but instead of having $500 invested, she only has $460 invested. By investing less and still receiving the same monthly payment, her yield is now higher than 12%. She gets $60 per year on her $460 investment. Frank is still *paying* 12% interest, but because she has less than $500 invested, Nora Note Buyer is now *receiving* a 13.07% *yield* on her money.

Notes:

Five Parts of a Note

N

I/Yr

PV

PMT

FV

Commonly Misunderstood Concepts

LTV Vs. ITV

Higher Payment Note is Worth More

Less Money Now = More Money Overall

More Money Now = Less Money Overall

Note Has 3 Players

Loan Has Only 2 Players

Banking Secrets

Acquisition Financing vs. Long Term Financing

Acquisition Financing

- *Easy to Get*
- *Higher Rate* & *Fees*
- *Short Term*
- *Liability may still reside with seller*
- *No Personal Liability*

Long Term Financing

- *More Difficult to Get*
- *Lower Rate* & *Fees*
- *Long Term*
- *Seller relieved* of *Liability*
- *Personal Liability*

Notes:

Banking Secrets

Traditional Bank Terms and What They Really Mean

Chain of Title

Occupancy

# of Properties Owned

Seasoned Down Payment

D.T.I. Ratios

Income: *Provable*

Stated

Credit Scores

Non-Traditional Conventional Mortgage Programs

- 15/30 Year Fixed Loan
- 2/28 or 3/27 ARMS
- Pay Option Arms
- Interest Only
- Rate is Risk Driven
- NINA v. SISA

Notes:

Banking Secrets

Pulling Cash Out After Closing

Pulling cash out after closing involves 3 concepts (this is VERY IMPORTANT):

1 When the real estate changes hands, you, the buyer, give the seller an IOU, or a promise to pay. This *note* (IOU) has value to the seller.

2 The seller sells the note immediately after it is created, for a pre-determined, discounted price to a note investor. The proceeds from the sale payoff any liens that the seller had against the property (such as the current loan, etc.).

3 You, the buyer, can make money from the sale of the note. The money you make will be the difference in the price you paid for the note, and the price paid to you by the Note Investor. You can use this money to reimburse you for your down payment, closing costs, or repair costs, depending on the size of your commission and the merits of the individual transaction.

Notes:

Banking Secrets

Steps to Avoid Chain of Title Issues

1. Pull a full fledged title report.
2. Pay for and get title insurance.
3. Avoid A to B to C transactions.
4. Learn how to read and track reconveyances.
5. Convey title to a new buyer with a quit claim deed.
6. When you purchase a property always get a warranty deed.

Notes:

5 Stages of Notes

1. Scratch and Dent

2. Slow Paying

3. Non-Performing

4. Notice of Default

5. Notice of Sale

What is 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. 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. 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. 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 of Wall Street firms. (NOTE: This is just like when a private seller sells his note.) When they do so, the 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 off of 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 off of 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.

5 Stages of a Note

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. No one wants to buy a slow-paying or non-performing note, because the risk of foreclosure is very high! 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 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.* 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 will be 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 dedicated to 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! But the house is worse off for it. 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!

Now let me ask you something ...

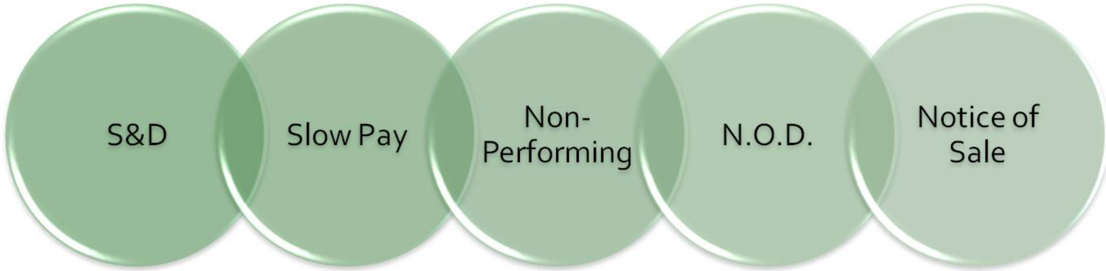
"If you were a lender, would you want to go through all of the time, money, and hassle associated with foreclosure, or would you just prefer to sell the note at a discount, cut your losses, and move on to something else? For that matter, what if you were a private seller who had carried paper and were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

A DAY IN THE LIFE OF A DYING NOTE

This may sound morbid, but it is the best description to describe a note on its way to its death. 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!

Here’s a timeline for you, which has been segmented into different parts. 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:

5 Stages of a Note



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, and would appear off the paper as the line continues to the right). Each of these 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).

Important Note: Prices for these notes vary from state to state.

Notes:

Stage One: Scratch and 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 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 the Wall Street Firm's *requirements* for buying that loan.

5 Stages of a Note

Now, let's say that Barbara's credit score was 683 when she bought the property, and let's say that the Wall Street Firm's credit criteria to buy this loans 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, the Wall Street Firm 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!) and they *expect* to take a loss. In most instances, they will sell this type of paper for 96-98 cents on the dollar.

You can 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.

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 as 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.*

5 Stages of a Note

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 their 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, the 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 92 and 94 cents on the dollar.

Notes:

5 Stages of a Note

Private Seller Are Gold Mines

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 eye 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. 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.

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.

As before, the lender has a couple of options: they can file a Notice of Default (see Step Four) and officially start the foreclosure, 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 80 and 84 cents on the dollar for it.

5 Stages of a Note

Stage Four: Notice of Default (N.O.D.)

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 make empty promises, 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 of Default* (N.O.D.) is a required step 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? You can expect to pay between 65 and 75 cents on the dollar for it.

Stage Five: Notice of Sale

Notice 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.

A Note on 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 50 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.

5 Stages of a Note

Notes:

Rules for Ugly Paper

1. Only buy an ugly note on a property that is within a 25-mile radius of where you live or work.

2. Only buy an ugly note on a property that you wouldn't mind owning.

3. Only buy an ugly note if you are absolutely certain about the value of the house.

4. Only buy an ugly note after you have an exit strategy in place!

Notes:

Calculator Success

Let's Begin with A Simple Math Problem

• Amount Borrowed	$100,000
• 4 Points (1 % of loan per point)	$4,000
• Total	$104,000
• Term	12 months
• Monthly Interest Charge	$1,300
• Total Annual Interest Charge	$15,600
• Total Annual Points	$4,000
• Total Annual Income	$19,500
• Annualized Yield	19.5%

To Increase Yield, Decrease Length of Loan
How Many Times in a Year Does 60 Days Happen

	Term	Annual (x6)
Amount Borrowed	$100,000	
4 Points (1% if loan per point)	4,000	$24,000
Total	$104,000	
Term	60 days	
Monthly Interest Charge	1.25%	15%
Total Term Interest	2.5%	15%
Total Term Points	4	$24,000
Total Term Income	$6,600	$39,600
Total Term Yield	6.6%	39.6%

Calculator Success

If You Know Any 3, You Can Figure Out the Fourth

Principle	Term	Payments	Interest Rate

Figure Out Payments

Principle Amount	Term	Payments	Interest Rate
$100,000	30 years		8 %

Calculator Success

Figure Out Principle Amount

Principle Amount	Term	Payments	Interest Rate
$100,000	30 years	$733.76	8 %
	30 years	$1,200	10 %

Figure Out Term

Principle Amount	Term	Payments	Interest Rate
$100,000	30 years	$733.76	8 %
$136,740.98	30 years	1,200	10 %
$150,000		$2,000	15 %

Figure Out Interest Rate

Principle Amount	Term	Payments	Interest Rate
$100,000	30 years	$733.76	8 %
$136,740.98	30 years	1,200	10 %
$150,000	18.6 years	$2,000	15 %
$200,000	30 years	$3,000	

Calculator Success

The Jim and Sally Example... Getting to 14%.... (Show Your Work Here)

Notes:

Notes:

Notes:

Notes:

Who is Lee Arnold and Private Money Bank.com

After Lee developed his highly acclaimed Foreclosure and Short Sale Courses, he began to speak all over the country on these two profitable strategies. In all of his travels he was constantly bombarded by the same question, "Where do I get the money"? Tired of seeing dreams dashed over something so simple, Lee immediately set out to create the most comprehensive curriculum on the subject of Private Money ever complied in one place. With the help of his long term friend and Legal Council, William C. Halls, and several law students at the local university, Lee was able to accomplish this great feat.

Recently featured in Forbes, the Boston Globe, Market Watch, Reuters, and Business Week as a leading investment strategy expert and as a consultant to Donald Trump's, "Trump University", Lee Arnold has built a personal fortune with private and hard money transactions. As a Real Estate Broker and Lender of both Private and Hard Money, Lee Arnold has helped countless people in the United States and Canada successfully and lucratively obtain the capital they need to be successful in real estate investment. A master at networking, Lee connects investors to lenders from all over the United States and Canada.

PrivateMoneyBank.com is a culmination of his vast knowledge in the Private/Hard Money Sector.

PART TWO preview

November 20th at 11a.m. - 2 p.m. PST

- Different Strategies to Make Money with Ugly Paper
- Closing on Ugly Paper
- Where and How to Find Ugly Paper
- Marketing for Ugly Paper

Register for the PMB Networking Mastermind on December 10-12th: www.endless-wealth.com/vegas