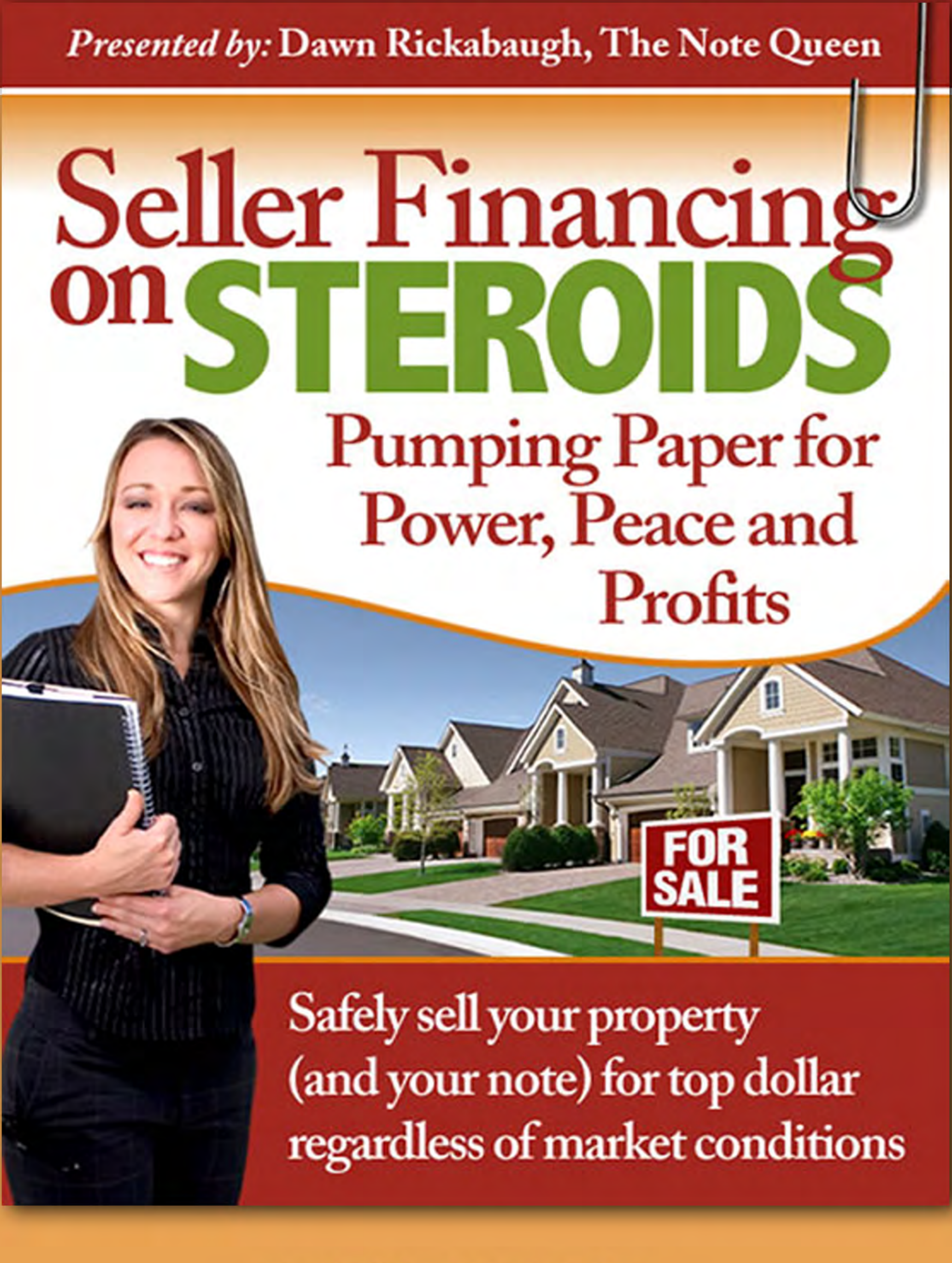
Presented by: Dawn Rickabaugh, The Note Queen
Seller Financing on STEROIDS
Pumping Paper for Power, Peace and Profits
FOR SALE
Safely sell your property (and your note) for top dollar regardless of market conditions

'Owner Will Carry'

Gets the Job Done, But **DON'T**

Buy a Nightmare When you ***Sell Your Property!***

- Learn how seller financing can help you sell your property quickly, and for the **highest possible price** (and still be able to sleep at night)

- Discover which seller financing strategy is right for you, and how to structure it to give you **power and peace of mind**

- Supercharge a high-end property that isn't selling, or **rescue an escrow** that is falling apart

- Make sure you have a **note you can sell** for the highest price/smallest discount possible (and avoid the nasty surprise of finding out that *you can't sell your note at all!*)

- Discover fire-proof ways to get the benefits of owner financing without EVER **worrying about foreclosure**

- Investors: buy cheap and sell high using seller financing, and still walk away with cash (the myths and truths of the **Simultaneous Note Sale**)

- **Defer capital gains!** You're **tired of managing property**, but you don't want to pay all those taxes. You want to sell for a fair price AND receive **hassle free retirement income.** [You'll love: ***"How to Avoid Paying One Red Cent to Uncle Sam When You Sell Your Property"***]

Table of Contents

Intro . . .

Let's face it . . . the real estate market just isn't functioning that well over all. Hardly a week goes by that I don't hear a disaster story about how difficult, if not impossible, conventional loans are to get these days.

Even with government stimulus's and bailouts, the credit market is still in hangover mode . . . throbbing headache, looking for a greasy burger and a strong cup of coffee (and if you make too much noise, it'll likely punch you in the face).

Even good, qualified buyers are having a hard time qualifying for loans, especially jumbos (anything over $700,000), and many of the escrows that are lucky enough to open end up falling apart anyway.

And . . .

More and more sellers are looking for ways to get the highest possible price for their property at a time when short sales and REOs, depreciation and tight credit markets are decimating price point.

Seller Financing to the Rescue!

Many people are rightly turning to seller financing (owner financing, seller carry back, carrying paper) to get the benefits they're looking for, but most do not understand which strategy would work best for them, and how to structure the transaction for maximum protection and profit.

This book is to help you intelligently and powerfully put a seller financing deal together that meets your needs and gives you peace of mind.

Can I offer seller financing if I already have a loan on my property?

Yes! If you got good underlying financing and you're willing to leave it in place for the next buyer, then you can offer owner financing. So . . . what's 'good underlying financing?'

If the loan that you are paying on is a low, long-term, fixed product, then you have 'good underlying financing.' An example would be a 5.5% 30-year fixed.

That means your interest rate is **low** and **fixed** at 5.5% (it will never increase, even if interest rates go through the roof), and it's **long-term** (you have this loan for the next 30 years . . . you don't have to pay it off for a very long time, or refinance because of a balloon payment in 3 years).

When you are leaving existing financing in place, you will either use a:

- 'wrap' (AITD),
- lease option,
- contract for deed, or
- title holding (land) trust

Which strategy you use will depend on the deal and how much risk tolerance you have. We'll go over this more in the section on 'Various and Sundry Owner Financing Strategies,' but the idea I want you to 'get' is:

> ***Whether you've got equity,***
> ***Good underlying financing,***
> ***Or some combination of the two,***
> ***There's a seller financing plan***
> ***That's right for you!***

Yeah, I know . . . too cute for words, huh? **cough**

OK, enough of that. Here's another thing to bring up about now . . .

When most people hear 'seller financing,' they usually think of carrying a small 'second' after the buyer gets a regular loan. A 2nd note and deed of trust is the difference between the buyer's down payment, and the loan they are able to qualify for. For example:

Sales price:	$350,000
Down payment:	$20,000
Bank loan 1st:	$280,000
Seller carry back 2nd:	**$50,000**

This can work (unless the bank won't let another loan be recorded against the property) but if you're the seller, you just need to understand that this is strictly a gamble.

If you get your payments on the note, great! If you don't, then just know you're probably going to walk away. It won't be worth the money or hassle to keep a large 1st current while you foreclose on a small 2nd, unless we're in a rapidly appreciating market (which, um . . . we're not).

For this reason, a small 2nd like this will have absolutely NO VALUE in the secondary market. This means you won't be able to sell it for cash . . . OK, maybe $1, but that's tops.

But it can still make sense, because what's the alternative? If you don't grant this buyer a $50,000 2nd, then you'll fall out of escrow and be hanging out on the market again for who knows how long waiting for another buyer, or you'll have to do a massive price reduction. Sure, there are risks to selling and carrying a 2nd, but there are also . . .

Risks of NOT selling:

- extended DOM (days on market) - how many more mortgage payments will you make waiting for the next buyer?
- the risk of further depreciation in the market (necessitating more price reductions)
- renting it out instead, accepting a negative cash flow and the fact that you'll have a lot of repairs to make after your tenants are gone
- inflation - in my mind it's not a matter of 'if,' but 'when.' Sure you can hang out for the perfect buyer in the perfect market and get your price, but your dollars will be buying you less and less, so the sooner you sell for a fair price, the better. In fact, **selling for less NOW can ultimately give you more *VALUE* than selling for more LATER.**

So, taking back a 2nd can be an acceptable risk, because at least you have ***the chance*** of collecting the equity you want.

What is seller financing and how does it work?

Ok, down to the basics.

I guess on the surface, it could sound like seller financing is where the seller of a property goes out and gets a bank loan and gives it to the buyer so they have the cash to buy the property, but NO, that's NOT what seller financing means (although there are strategies we'll talk about later that almost seem like that).

When you own a property, you either have a loan against it, or you don't. If you don't, then you own your property 'free and clear.' (And by the way, congratulations! You may be interested in the chapter about deferring capital gains).

If your property is worth $200,000 and you own it free and clear, then you have 100% equity, or $200,000 in equity that you could potentially 'loan' to a prospective buyer.

If you have a 50% LTV (loan-to-value) loan against your property (i.e. a $100,000 loan on your $200,000 property), then you have 50% equity, or $100,000 in equity to loan.

Your EQUITY (and/or your existing financing) is what you can potentially 'loan' to a prospective buyer.

That is how you, as the seller/owner, are providing the financing.

So, instead of having the buyer go out and get a bank loan, **you become the bank**. You will take a down payment from the buyer AND receive the monthly payments from the buyer as they pay you for your property in installments (little bits at a time).

That's why seller financing is also known as an installment sale . . . the buyer is paying for your property in monthly installments (plus interest). This is why the IRS (according to IRC 453) allows you to defer capital gains when you carry paper (use the installment sale/seller financing).

Because you are collecting the payment for your property a little at a time, Uncle Sam says, "OK, since you are playing nice and only getting a little of your equity back at a time, we'll play nice, too, and only take our capital gains a little at a time."

That way, most of your equity can stay working for you. If you take an all cash offer, then you may have a hefty capital gains bill to pay. What if it's $200,000? Ouch! That $200,000, if left at work for you in the property, even at 6% could make you an additional **$12,000 a year** in interest!

Hey, don't knock it! That'll buy you a cappuccino and a nice bottle of wine every day for an entire year! (Or, for my tree-hugger, health-nut, save-the-planet, organic-raw-foodist friends, you can get 266 boxes of the best-tasting wheatgrass on the planet - try some for free at www.EasyWheatgrass.net)

Let's put this another way . . .

Take out your deed of trust (if you have a loan against your property) and look at it. It identifies a Trustor, a Trustee, and a Beneficiary.

- If you own the property, then you are the **Trustor.** The Beneficiary is trusting you to pay back the money they lent you, but just in case you don't, they will have the Trustee repossess the security=collateral=your property to satisfy the debt.

- A title company is usually listed as the **Trustee**. This entity is responsible for foreclosing on the property on behalf of the beneficiary if you, the Trustor, quit paying according to the terms of your promissory note. They are the Trustee for the Deed of Trust which contains a Power of Sale clause that allows them to sell your property at a Trustee's Sale.

- The **Beneficiary** is the lender, the entity that made a loan against the property, the originator of the promissory note secured by a deed of trust against your property.

When you offer seller financing, then you put on a different hat. Instead of being the Trustor, you play the role of the Beneficiary. You didn't lend the Trustor (the buyer that now owns your property) money, but you lent them your **equity**.

And if they don't pay you your remaining equity according to the note(s) as promised (promissory note), then the Trustee will foreclose and give the property back to you (if you pay them a nice chuck of change to do it, of course).

Story time:

A cute little old couple owned a commercial building down the street from my house. They had run a travel agency business out of it for over 25 years, but one day as we passed it to get our afternoon coffee, we noticed a handwritten sign on the back door that said: FOR SALE BY OWNER.

My partner needed an art studio, but we knew we would never qualify for a commercial loan, and that we needed the property to carry itself (with a mortgage at home and 4 kids to feed, we didn't need another expense).

But what could we lose? I picked up the phone and called John.

It was like negotiating with my grandparents. They were so kind and polite, and Patricia always wore a purple knit hat and kept trying to give me old magazines she'd collected. (One day I'm going to proudly sport a little purple hat and play lead guitar in a rock band).

The best part about it was that they insisted on carrying paper. I couldn't have enticed them with all cash or a juicy bank loan if I'd wanted to. They wanted to play the role of the juicy banker.

Seller financing was a major part of their retirement plan.

They owned the property free and clear, and they wanted 20% down and would carry at 7.5%, amortized over 30 years, due in 15.

They placed a 25% pre-payment penalty on it for the first 10 years so I couldn't pay the loan off early, because if they got paid off early, they would have a big capital gains liability, and it would defeat their reason for carrying paper in the first place. At the time, bank CD's were paying all of 2-3%, so the strategy made a lot of sense.

Ultimately, they took 15% down, and carried at 3.75% for the first 18 months, and 7.5% thereafter.

Here's what it looked like:

Sales price:	$370,000
Down payment:	$50,000
First note and deed of trust:	$320,000
Interest rate:	3.75%, then 7.5%
Term:	amortized over 360, due in 180

Monthly payment: $1,481.97 (first 18 months, $2,206.28 thereafter)

So, they got $50,000 down and now they get $2,206.28 every month from me, which is basically their pension fund/retirement plan. I guess that's lucky for them, because if they'd have had their nest egg in the stock market like many people did, they'd have lost half of it by now, and be wondering where their next TV dinner was going to come from.

If they'd have sold for all cash, they'd have paid about $70,000 in capital gains, and had $300,000 to stick in a bank CD at 2.5%. Let's see:

Principal:	$300,000
Interest rate:	2.5%
Monthly interest:	$625

Instead they only paid about $12,000 in capital gains, had enough money left over from the down payment to pay off the remaining mortgage on their home, and they get $2,206.28 per month instead of $625. Not bad.

And it's worked perfectly for us, because we collect $2,950 a month plus utilities from the downstairs tenants in the building, so all we're left with covering is the insurance, about $350 a month. That's much less than we would have paid just trying to rent an 1,100 sqft art studio somewhere.

Now, I've got the property up for sale, because it won't be long before all the kids are out of high school, and we're planning our escape!

I'm offering it as a sale-lease-back, because we still need to use the upstairs unit for another couple of years, but I'd like to increase my cash flow from the property and reduce my exposure to potential vacancy if my tenants ever decide to call it quits.

But remember that pre-payment penalty? And guess what? I have no intention of paying capital gains. So here's the current description on my listing:

> *"Owner will carry. No bank financing needed. Beautiful 2-story commercial building in the heart of Temple City. Close to Seafood Village, between City Hall and Chase Bank on the north side of the street. There is approximately 2,500 sqft on the first level, with the remaining 1,100 on the second level. Owner is looking for a sale-lease-back, intending to retain leasehold of the 2nd level for approximately 3 years. Seller must carry, terms flexible. Open to lease option, contract for deed,*

or partnership in a title holding (land) trust to preserve existing tax basis and defer capital gains."

Here's how the deal could end up looking if we use the Title Holding (Land) Trust:

Purchase price or MAV (mutually agreed value): $947,000
Down payment or Initial Contribution: $150,000
Remaining amount: $797,000
Interest rate: 7%
Term: amortized over 240, due in 60
Monthly payment (lease payment): $6,179.13

So, instead of the building just barely carrying itself, we could pocket $3,972.85 each month instead ($6,179.13 minus the $2,206.28 I owe to my 'grandparents'). The 'buyer' would cover taxes and insurance, maintenance and repairs, and worry about any potential vacancies.

And out of that $150,000 down payment, I won't pay a lick of capital gains. I won't pay any taxes until the trust is terminated 5 years from now, and even then, **I may decide to 1031 exchange my beneficial interest in the land trust for another 'like kind' investment for 100% deferral of capital gains and depreciation recapture.** That sounds kinda nice.

The deal could be put together a hundred different ways, so it'll be fun to see how it comes together. (And I'll talk more about the Land Trust in a later section).

Am I offering seller financing for the right reasons, or because I have a bruised ego?

Because owner financing can be such a powerful tool for getting top dollar in any market, sometimes sellers go that route, even when they shouldn't. They are so attached to getting a certain dollar amount for their property, that they can lose sight of the big picture. That's why I could have entitled this section:

So You're Stuck on Price - Let's Have a Heart to Heart

(AKA: Life Coach Moment)

Obviously, I love seller financing and real estate notes, and any non-traditional way of closing real estate transactions. I've almost made it a point of personal religion to avoid institutional financing.

I'm not sure I even believe in banks. The only thing that makes me think they might be real is the fact that they are owning/controlling more and more of the real assets in the nation.
Pretty good trick really:

Loan people **pretend money**, and if they don't pay it back, take their **real property.**

And the Federal Reserve . . . probably we shouldn't go down this slippery slope, because the cobwebs are getting a bit thick. Just consider doing a little mind-bending research some time: www.GaryNorth.com, www.AddisonWiggin.com, www.IOUSAtheMovie.com, www.MichaelCovel.com, www.BrokeMovie.com, and if you're particularly adventurous: www.ZeitgeistMovie.com)

OK, so back to our regularly scheduled program . . .

Owner financing is a great way to maximize price point, but is price always the most important thing? Is offering seller financing just to get the highest possible price always the right thing for people to do?

No.

Some people need to get top dollar because they have very little equity. They owe almost as much as their property is worth (or maybe even a little bit more), and they're trying to avoid a short sale and/or default. They at least want to take a stab at preserving their credit.

Some people own their properties free and clear, and are carrying paper as part of their retirement strategy. While they obviously want the most money possible, monthly cash flow and deferring capital gains is the most important conversation.

Some people need top dollar because literally, the property represents their life savings, and they need to salvage every penny they can out of it. (And if that's you, make sure you REALLY structure the transaction carefully so you can sleep at night and eat more than cat food the next morning).

And some people want to offer seller financing just to get a price that's stuck in their heads, because they don't want to 'lose money.' Their egos just won't allow them to 'take a loss.' They don't want to look silly, feel foolish or play the part of a chump.

It's these people that I want to chat with for a moment. Or maybe I'll just tell you a quick story . . .

Story time:

Harvey and Hedwig heard about what I'd done for Heinrich (you'll read about him later), and contacted me for help with their million dollar property in the Seattle area.

Six years previously, they had purchased a beautiful 5 acre estate, and had been pouring love and cash into it ever since. A year before they flew me up for a consultation, Realtors had pegged the value of their home somewhere between $1.2 and $1.5 million. Now, the numbers were coming in below a million, and it was just more than they could stand.

So, they decided that they would hire me to set up a seller financing transaction so they could maximize the price they could get for the property.

Great! I'm all over that! Because I knew that they had attractive underlying financing in place, I knew I could safely put a deal together for them with the right buyer using the Title Holding (Land) Trust.

While I was up there, my objectives were to:

- Talk strategy (there's a lot to explain to people about the title holding trusts and seller financing in general)
- Interview Realtors to help them choose the right one (we needed a professional comfortable with non-traditional financing)
- See the property and take photos for an internet flyer and blog
- I even took my video camera to create a home spun virtual tour to capture the magic of the place, share the feeling of being there, and tell the story of the people and property behind the transaction
- enjoy locally produced red wine and a view of the Cascades . . .

But during the course of my 2-day stay, I got to know more about them than I'd become aware of even after several phone conversations. I learned a lot more about why they were selling, and what they hoped they'd be able to do once the property was sold.

And that's when I knew we needed to have a 'Come to Jesus' talk . . .

Here's what I discovered that made me talk them out of using my services as a seller financing consultant: they both wanted to be out of the 'rat race,' and both were contemplating major life transitions.

Harvey wanted to go live in Spain. He wanted the freedom to live in a tiny apartment without air conditioning, and just immerse himself in the language, the culture, the people, the food . . . the simple goodness of living and being. Hedwig wanted to start teaching yoga while rehabilitating their Palm Springs home.

Neither of them wanted to be tied to having to make a certain amount of money each month. Although Harvey had always made good money in his business, it just didn't inspire him any more . . . he was ready for a whole new chapter in his life. And what would most make them feel like they could safely make these life transitions?

Money . . . a big chunk of money in the bank.

"So why then," I asked them, "Would you accept a relatively small down payment ($100,000) and carry paper on your house just to push the purchase price closer to a million than $900,000?"

After closing costs, that would only give them about $40K in the bank . . . not exactly the kind of money that would set their minds at ease. It would be almost impossible for them to throw themselves at their new adventures with complete abandon.

Yes, they'd have monthly cash flow, but what if something went wrong? What if the buyers got laid off from Microsoft or Zillow and couldn't make the payments? Then pretty soon that positive cash flow turns into negative cash flow, because the underlying bank loan, taxes and insurance would still have to be paid.

And what if the defaulting buyers hadn't taken good care of the place? What if they had let the landscaping dry up? Then there would be money to spend and repairs to make just to put it on the market again, and will the market be better at that time, or possibly worse?

And what if something catastrophic happened? What if a hot air balloon crashed into the house? It would be hard to recover that thinly won equity.

The potential for loss is too great with only a 10% down payment, and it just wouldn't be worth it, especially when their whole way of life could be compromised. It would be a different story if the equity tied up in the property didn't represent such a significant amount of their net worth.

If they just listed and sold at $900,000 to a 'regular' buyer, then they would have closer to $250,000 in the bank . . . now that starts to sound a little better. It sounded to me like selling for $900,000 to a conventional buyer who could qualify for traditional financing would meet their true objectives better than getting $1,000,000 a little at a time.

But that ego thing is a tough one. It can spew out all sorts of arguments that tempt you to trade in your dreams for shallow satisfactions and the promise of just a little more money. It rambles on:

*"But it was worth $1.2 just last year, and I don't think the market has fallen that far, and **I don't want to just give the property away.**"*

The ego likes to believe that there must be some conspiracy going on, that the real estate professionals providing comparable market data must be sitting in dark alleys, calculating ways to rob him of his just rewards.

I went on to torture him with an especially annoying line of questioning . . .

"And what would it mean if you were to 'give the property away' at $900,000?"

"Well that would mean that someone is taking advantage of me."

"And what does it mean if someone takes advantage of you?"

"Well, that means I wasn't very smart . . . that I was naive and incompetent. You know, the last property I sold increased $200K in value after I sold it . . . I'm not going to be that stupid again. I vowed I would make up for that 'loss' with this property."

"Now, you sold your business at the top of the market a couple of years ago, right? I mean, you couldn't have timed that sale any better, could you?"

"No, I hit that one just perfect. I could see the trends that were coming, and I sold just before the economy started tanking."

"So in one instance you hit the top of the market and sold for top dollar, and in the other, you didn't. So one transaction made you feel like a genius, the other a total failure."

And that's what most of us do . . . we let the profits we make or lose directly determine our sense of self worth. We act like suffering a financial loss is a shameful, dark family secret . . . dirty laundry that must be buried in some corner of the collective subconscious until some future generation airs it out and sets it free.

Harvey just had too much baggage attached to his property, and it was compromising his ability to make a sane decision. He was spending a lot of time and energy (and he was willing to risk everything) just to avoid 'taking a loss,' because somehow that would be conclusive evidence that he is indeed a dunce. But check this out . . . did he really ever even take a loss?

His last property he bought for $500,000 and sold for $650,000. A couple of years later, the subsequent owner sold it for $850,000. So naturally, Harvey logged that in as a $200,000 loss when in reality, he made a $150,000 profit.

He bought their current property for $600,000, they put $200,000 into it, and now the market says it's worth $900,000. But instead of feeling like he's sitting on a $100,000 profit, he insists that he's taking a $300,000 loss because he could have sold it last year for $1,200,000.

Whew! Why do we do these kinds of things to ourselves?

All I'm saying is, be willing to ask yourself some tough questions, and take a good hard look at what it is you really want to experience next in your life, and try really hard not to get attached to the numbers.

Protect your quality of life at least as fiercely as you protect your 'profits.'

Make the most out of advertising "Owner Will Carry"

There are lots of good buyers out there that just can't get a loan for one reason or another, so when you advertise "Owner Will Carry," you greatly expand the pool of potential buyers for your property.

Loans are harder to get, from conventional to jumbo, so when you take the financing dilemma out of the equation, your chances of quickly closing a satisfactory transaction greatly increase. If a buyer doesn't have to worry about jumping through 948 hoops trying to qualify for bank financing, then they're going to be very excited to talk to you.

Well, if they can't qualify for a bank loan, are they really good buyers?

Maybe, maybe not. But what about all those people who have ruined credit because of a divorce, or a credit card dispute, or a foreclosure because they got stuck at the top of the market with one too many investments? Are these bad buyers? Not necessarily. A low FICO doesn't always mean you should avoid business with these people. You just have to be smart about it.

Sellers are turning to non-traditional methods of closing real estate transactions because they just need to to get their deal closed, or they are doing everything they can to get the highest possible price for their property, and it's a good strategy. But I contend you should advertise "Owner Will Carry" even if you don't intend to carry the financing for a buyer, because you will attract a lot more attention = more potential buyers = a quicker sale at a potentially higher price.

Another Story:

I helped a successful contractor buy a good rehab fixer in a great neighborhood, but before he could start his project, his finances got stuck. Worker's Comp came in and froze all of his assets for several months.

By the time he'd completed the upgrades and repairs and actually got on the market, it had turned, and he'd lost approximately $100,000 in potential profits. So, of course, now he's just trying to break even and price point is all he's thinking about.

I knew he had excellent long-term financing that he could potentially leave in place for the next buyer, so I advised him that because he was so attached to price, he should probably offer terms.

He'd done a great job rehabbing the property, it was clean and showed extremely well, but he needed to pull out all the stops. There are tons of books out there on how to stage, prepare and market your home, but rarely do sellers realize that advertising "Owner Will Carry," "No Bank Financing Needed," is often the most powerful way to make a property more attractive and provide an edge over the competition.

He eventually succumbed to my cajoling. Even though his first choice was to get a buyer with conventional financing, he agreed to let me advertise 'Owner Will Carry' when I listed his property, not because he wanted to, but because he could.

I've found that this type of advertising will usually double the amount of interest that I get on a property.

We made OWC a focal point of the advertising with yard signage, in the MLS description, and on Craigslist and other internet sites.

I also talked him into listing below $500,000. He was dead set on getting $550,000, but the comps showed me it was probably only worth about $515,000. I told him if he listed at what he wanted to get, then he would languish on the market with all the other unrealistic sellers and end up losing even more money as he chased the market down.

Once again, he listened to me, but only after I hit him over the head with his own cave man club several times.

Additionally, I urged him to treat the sale of his property like an auction to create bidding fervor. For several days he basically lived at the property showing loads of prospective buyers and their agents his handiwork. We told inquiring minds that we wouldn't be reviewing offers until Friday of the following week, and advised everyone to simply submit their best offer.

Within a week, we were sitting on 25 written offers. We countered them all and were in escrow at a purchase price of $549,000 after only 10 days on the market.

And he didn't end up carrying. He accepted a conventional cash-to-new-loan offer which allowed him to liquidate his position and walk away, clean and simple, with all of his money.

There was no way that would have happened if he had listed for $549,000 . . . probably not if he had listed for $525,000. And advertising OWC definitely got us some extra phone calls and foot traffic.

How can you have the best chances of selling quickly for the highest possible price?

- Offer seller financing (even if you really want a cash buyer) and make it a major focal point of your advertising:
  - Sign riders in the yard: "Owner Will Carry," or "No Bank Financing Needed," or "Special Financing Available"
  - Make sure your agent features the special terms in the description area of the listing that will get picked up by Realtor.com (you need to choose an agent who understands owner financing intimately)
  - Create nice internet flyers that get uploaded to all the home sites, including Craigslist
  - Create a mini blog for your property and put up lots of pictures and information about the property and its history, and maybe even...
  - Shoot some video. There are expensive virtual tours you can pay for, but lots of times, something personal and authentic is more effective. People emotionally relate to stories, so tell the unique story of the property, and the people who are selling it. Viral video is rapidly becoming one of the most powerful ways to market.

- List low. List at least 5% below what you expect to get (the seller above went into escrow at 10% above asking price in 10 days)

- Make sure your property looks good. Stage it and make sure it smells and feels good.

- Create auction type fervor by having a compressed showing 'season' where prospective buyers rub elbows. You might want to have refreshments, and possibly even an appraisal and home inspection sitting out for them to peruse. And tell everyone to simply submit their best offer for review at a later date.

How to avoid 7 deadly and common mistakes when you carry paper

Deadly Mistake #1: Take a small down payment, or none at all

Gosh, isn't it amazing the price you can get for your property if you don't ask for a down payment? You can make owning a home cheaper than renting if you want to!

It's OK with me if you take a small down payment to sell quickly for the price you want . . . just don't be offended when I offer you a small price for your note, or I tell you I can only buy a partial, or that I can't buy it at all.

Why? Because the risk of default is so high. If things got tough, it would be too easy for the buyer to just walk away, because they don't have enough 'skin in the the game.'

And actually, if they can no longer afford the payments, then it would be wonderful if they would just walk away. But normally, they don't. They wait for you to foreclosure on them. In California, that can take anywhere from 5-18 months, in other states it can take 2-3 years . . . ouch.

Sure, you'll get the property back, but after how many missed payments, and after how many legal fees? And will the property be trashed, and/or will the market be even softer when you finally have possession again?

Accepting a small down payment all too often translates into financial loss . . . there's just not enough of a financial buffer if something goes sideways. It's like sitting on a porcupine and wondering why you're not feeling so cushy and cozy.

SMART TIP

Take the largest down payment you can get.

Getting a 20% down payment will greatly reduce the statistical likelihood of default (and make your note much more valuable). Remember when that's what it took to buy a property? A 10% down payment is usually acceptable for an owner occupied single family residence (O/O SFR).

A down payment creates **Protective Equity**. Protective equity protects the seller (note holder) from financial loss if the buyer (note payor) defaults.

The larger the down payment, the greater the instant equity a buyer has. Think of a down payment as the layer of cream on a fresh cup of milk. The thicker the layer of cream, the richer and tastier it is (and the more you'll have to fight your brother for it).

If you get a 20% down payment or more, then you'll have a note that's worth holding or selling. It'll be rich and tasty, and note buyers will fight each other for the chance to buy it (which translates into a higher price/ smaller discount, right?).

If you're going to take a small down payment, you'll want to find a way to reduce or eliminate your exposure to foreclosure (or the risk that a note buyer will have if they buy your note).

Perhaps you'll want to create two notes instead of one (and only sell the first), or use the Title Holding Land Trust to avoid foreclosure altogether.

Deadly Mistake #2: Don't ask for the buyer's SS# and don't run a credit report, (or, if you've actually done these things, try to lose the credit application and report so it's unavailable to give a prospective note buyer).

There have been a few times I've been able to offer a really good price for a note, just to have the deal fall apart because the note holders couldn't come up with social security numbers for the Payors.

The investors out there that will pay the most for your note (ask you to take the smallest discount) will want you to have a Social Security number on the buyers (note Payors), and they'll want their **FICOs to be 620 or above**.

There are note buyers out there that will buy your note even if you don't have the buyer's SS#, but they'll probably be offering you a LOT LESS for your note.

And even a great note by all other accounts will be hard to sell if the Payors' credit scores are low. **It's almost impossible to sell a note where the FICOs are coming in below 600.**

Why? Because, statistically speaking, the lower the credit score, the greater the chances that the buyer (note payor) will default.

SMART TIP

Have the buyer provide their SS# by filling out a credit application (1003) and signing it, run credit, and if it doesn't come back above 620, run from the deal, unless . . .

There are always ways to compensate for the risk of lending (your equity) to a buyer with poor credit, but still, it's a tough conversation with credit scores in the 500's.

If you're going to do the deal anyway, be sure to take a larger-than-average down payment, and be willing to season the note (collect ***at least*** 12 months of payments) before trying to sell your note if you want a decent price for it. You might even want to work with the Payors to improve their credit scores before you put your note on the market.

And even if you're not thinking of selling your note, don't you want a strong investment that doesn't have you addicted to Milk of Magnesia? Don't you want to leave a good asset to your heirs and beneficiaries?

Putting your transaction together in a way that will make your paper (note) valuable on the secondary market, will automatically assure you that you've placed yourself in the most powerful position possible, no matter what happens down the road. It provides the most flexibility long term.

If the down payment is small, and the buyer's credit scores are low, then I **HIGHLY RECOMMEND** that you consider using the Title Holding (Land) Trust. (But only if you don't plan on cashing out. You can't sell a beneficial interest in a trust the same way you can sell a note).

Deadly Mistake #3: Lose the original note

The original note is the "green stuff," it's the currency, it's "the thing you're selling;" it's a *negotiable instrument*. A copy just won't do! The original John Henry (signature) of the Buyer/Payor, even if it's not very attractive, fluid or sophisticated, is the silver lining in your paper.

Losing the original note is akin to committing Original Sin all over again, and do you really want that on your conscience? Won't you have enough to worry about on Judgement Day?

And it kind of makes sense, doesn't it? Would you be able to pay your mortgage by sending in a nice photocopy of your check to Bank of America? Or the Federal Government? (Wait, they don't own all of the real assets in the country yet, right? Sorry, got ahead of myself).

I was recently working with a probate attorney in Los Angeles who is liquidating an estate holding a $500,000 seller carry back note, secured by a commercial property.

I was able to offer the estate more than the Payor on the note was offering, so we were ready to open escrow, but none of the heirs/beneficiaries could find the original note. And that put the estate/note holder in a very awkward position. The Payor could potentially cause problems if he found out and wanted to contest the loan.

So, instead of alerting the Payor that they couldn't find the original note and asking him to sign a new one, (which he probably would have refused to do) they just decided to go the path of least resistance and let him refinance them off at a lower price than they could have gotten if they'd had all their ducks in a row.

SMART TIP

Keep your ORIGINAL note in a safe place

And while you're at it, place all the other important note documents right alongside it:

- copy of the deed of trust or mortgage
- buyers credit application (1003)
- buyers credit score
- escrow instructions
- escrow closing statement/HUD-1 settlement statement
- title insurance (you should have a lender's policy)
- hazard insurance documents (you're the Loss Payee, right?)

If I'm buying your note, I want to be the legal holder of the note, so I need the original note in my possession, and the note properly endorsed to me: ("For value received, Pay to the Order of Dawn Rickabaugh" and it must be signed and dated by the Note Seller).

If the original note is in my possession, and is properly endorsed to me, then I am a holder-in-due-course, which gives me some substantial protection should any legal issues arise.

In some cases where the original note cannot be found, you can purchase a bond, but it's expensive. In essence, a third party company may be willing to insure the payment on a note that can't be located, but they'll charge you through the nose for it.

Deadly Mistake #4: Make the interest rate on the note nice and low

It's tempting to offer a low interest rate to entice a buyer to give you a fat, juicy price for your property. It's OK if that gets the job done and you're happy with it, but you just have to know that you're writing in the discount you will ultimately take on your note.

Don't write a seller financed note at 5%, amortized over 30 years, and then get offended when a note buyer offers you .60 cents on the dollar. They're not being mean or predatory, it's just the natural consequence of how you structured your deal.

Perhaps you're happy making 5% on your money . . . if so, great, sit back and collect those payments! But no experienced note investor will buy a note at a 5% yield. They're going to want a minimum of 9-12%. There are only 3 companies in the country that want to buy a 5% note at face value. That's Fannie Mae, Freddie Mac, and FHA, and none of them are going to buy a seller financed note.

There is usually no reason to give a borrower, who may not even be able to get a conventional loan, the same kind of low rate they could get with the best bank loan out there. This only benefits the borrower.

SMART TIP

Charge at least 2-3% more than the market rate

If you’re going to take back a note (especially if you want it to be worth something on the secondary market) charge the highest interest rate that you can, without violating usury laws, of course.

Sellers will say, “The buyer said they could get 5.25% from Bank of America, so I gave them 5%.”

Why would they ask you to carry the financing if they could get 5.25%? They probably couldn’t, and even if they could, you should charge a premium (more than the going rate) for the ease of the financing you’re providing and the closing costs you’re saving them.

So, if a typical buyer can get a 6% 30-year-fixed down at the local bank, then you should shoot for at least 8-9%. This not only gives you a fair return for the service you’re providing and the risk you’re taking, but also greatly decreases any discount that you will take when you go to sell your note.

But sometimes, buyers have you over a barrel. They’ll say, “Take it or leave it . . . if you won’t give me the terms I’m asking for, I’ll go to the next desperate seller hanging out there on the market and get what I want.”

It’s not that charging a low interest rate is bad, or the wrong thing for you to do, you just have to go into the deal with your eyes wide open and know what you really need, now and into the future.

Deadly Mistake #5: Create a short-term balloon

Because of the Time Value of Money (TVM), which says that money to be received sooner is more valuable than money to be received later, it can seem like putting in a 5 year balloon is a good thing. No need to wait 30 long years for payoff, right?

In previous markets, this made a lot of sense. The market was going up, and financing was cheap and easy to get. It was simple to refinance. But now it's a different story, isn't it?

A balloon only adds value to a note when there's a clear and obvious exit strategy, which means easy, available and cheap financing laying around for the Payor to scoop up (or evidence that they have the cash to pay it off).

So, you have this balloon . . . what's going to happen 5 years down the road if property values have decreased? What if interest rates are high? What if something has happened to the buyer's (Payor's) credit score?

They probably won't be able to refinance and pay you off, so now you're stuck with either restructuring the note, or foreclosing and taking the property back.

Most note buyers these days buy a note with a balloon anticipating that they'll end up restructuring the loan and extending the repayment period, which decreases the return (which means they'll need to buy it at a steeper discount than you would normally think, based on the calculations of your nifty little HP).

SMART TIP

Fully amortize your note over the shortest time period possible . . .

Can the buyer afford a 15-year amortization? Or a 20? When a note is fully amortizing (meaning it's completely paid off by the end of the term), we don't have to worry about the buyer's future ability to refinance a balloon payment.

If you're going to ask for a balloon, push it out to 7, 10, or 12 years. The longer we have for the real estate and credit markets to stabilize, the better.

Investors will think . . . "OK, things are not great now, but I'm pretty sure in 10-12 years the market will have recovered and we'll be in a better situation. By then, this Payor should have no trouble refinancing, especially since the principal balance on the note will be a lot smaller."

Another idea is to ask for Stepped Payments. This is where the interest rate remains the same, but the monthly payment due from the buyer increases by a certain amount or percentage every year. This leads to a faster pay down of the loan balance.

Stepped Payments also provide seniors, who are often on fixed finances at retirement, a stream of income that helps them deal with inflation, and the reduced buying power that their money will have with each passing year.

P.S. Avoid 'interest-only' loans . . . no one wants to buy them!

Deadly Mistake #6: Fail to include a provision for late payments and a due on sale clause to your note

A couple I talked to recently had a one year old note that they were trying to sell. Not only were the terms of the note difficult to understand, but it failed to include a late payment charge, and didn't have a due on sale clause.

"But yes!" they insisted, "see right here in the escrow instructions? It definitely states that the late payment fee for missed payments is 6%."

Well, it's comforting that you had great intentions, but apparently escrow failed to incorporate your instructions into the note documents, and you didn't notice! Oops.

[HEADS' UP: escrow companies, title companies, real estate professionals, accountants and attorneys do not necessarily know much about putting together a strong note and calculating the numbers correctly; and unless they regularly buy and sell notes in the secondary market, they may not understand the financial significance of how the transaction is structured. That's why it's crucial that you work with a seller financing specialist/note broker when you're putting your owner financing deal together]

Without a late payment provision, you have no way of covering yourself for financial losses when you have a Payor that regularly pays late.

Without a due on sale clause, the property could be sold and you could be receiving payments from someone you haven't had the chance to underwrite (determine if they're a good risk or not). Also, what if interest rates are higher? Wouldn't you like the chance to improve your return?

SMART TIP

Make sure your note includes a late payment fee, and make sure the note and deed contain the due on sale (acceleration or alienation) clause.

You'll have to check with the guidelines in your state, but usually a 6% late fee with a 10-15 day grace period is acceptable.

Put the due on sale clause in both the note and security instrument (deed of trust or mortgage). It might sound something like this:

> *If the trustor shall sell, convey or alienate said property, or any part thereof, or any interest therein, or shall be divested of his title in any manner or way, whether voluntarily or involuntarily, without the written consent of the beneficiary being first had and obtained, beneficiary shall have the right, at its option, to declare any indebtedness or obligations secured hereby, irrespective of the maturity date specified in any note evidencing the same, immediately due and payable.*

Also, if it's permitted by law, include a **prepayment penalty** if you're trying to defer capital gains and don't want to be paid off early. Generally things are more regulated for residential properties that serve as the Payor's primary residence. It's usually easy to enforce a prepayment penalty on investment and commercial properties.

Deadly Mistake #7: Don't keep a careful accounting of the note payments you receive

Let's pretend that you have a nice juicy note you're trying to sell . . . you got a 20% down payment from a buyer who had a 700 FICO, the loan amount was $100,000 at 12% interest. Fully amortized over 20 years, you're supposed to be enjoying $1,101.09 a month.

Wow, isn't that great? Wouldn't you be able to sell that baby for a nice fat price? C'mon . . . with an average discount, someone's looking to bag a 15% return, for heaven's sake!

Yeah . . . unless the payments don't come in on time. You could have a 42.9% interest rate, but it doesn't matter, the return is irrelevant if the money isn't flowing.

When someone buys a note (or if you are holding a note for retirement income) the most important thing they want to know is how likely it is that future payments will continue to be paid as agreed.

Most note buyers (the ones that will give you the best price) are not buying hoping they'll get a chance to foreclose and own the property. They just want a predictable return.

That's why payment history is so important to document.

Now, if you've got a note that's in default, the only people who will buy it are the ones that wouldn't mind owning the property securing the note, and they'll ask you to take a really steep discount for rescuing you from the foreclosure scenario.

SMART TIP

Have a note servicing company service your note if you're too ADHD to keep flawless records yourself.

Document when the payments come in, keep copies of cancelled checks and bank statements so you won't have any trouble proving that you've got a **'performing ass**et**.'**

And it's really not a bad idea to have your note serviced by a third party note servicing company. It's not expensive, and your payment history is flawless, which is very handy when you go to sell your note. They also file any relevant documents for you, such as 1098s and 1099s.

Stuff that needs to be in every note:

- Origination date (should be the same date as the security instrument: deed of trust or mortgage).
- Date interest begins
- Date the first payment is due (and how often? Monthly? Quarterly?)
- Term and maturity date and/or the date a balloon payment is due and it's estimated amount
- Principal amount of the note (face amount)
- Name of the Payors/Borrowers/Buyers
- Name of the Payees/Lenders/Sellers
- Location where payments are to be sent
- Interest rate
- Exact dollar amount of the payment to be made in each period "or more" if there is no prepayment penalty
- Attorney's fee clause (so you can be reimbursed for legal fees if you have to sue to enforce the terms of the note)

More stuff you want in a note, especially if you're the seller:

- Late charge provision, usually 6% with a 10 day grace period
- Due on sale clause, so if the property is sold, you have the right, but not the obligation to 'call' the loan (demand total payment) or renegotiate the terms of the loan
- Prepayment penalty (if you don't want capital gains - just check on the laws in your state. Sometimes a prepayment penalty isn't allowed)

[If you're the buyer, you don't want any of those last few things, and you'd be smart to insert a 'first right of refusal' to purchase the note at the maximum discount offered any other buyer if the note is ever for sale]

Various and sundry owner financing strategies

There are several owner financing strategies to choose from . . . they rest in front of you like dabs of paint on an artist's palette. The brush you pick up and the color you choose to stroke across your canvas will determine whether you'll end up with a masterpiece that will hang proudly and fit perfectly in your living room, or a bad craft project you'll end up wanting to shove your foot through.

Putting together an owner financing transaction is an art form. There are an unbelievable amount of factors that must be accounted for if all parties are to be properly educated, satisfied and protected, now and into the future.

And it's impossible to list all the variables. Every transaction is unique. That's why consulting with someone who understands real estate, as well as real estate notes, along with a pinch of financial planning will REALLY make a HUGE difference in how your deal turns out. [And it helps to choose someone who can act as a life coach (who may perhaps make you a little uncomfortable) and help you get at the root of what it is you really need, not what you think you want].

OK, so let's talk briefly about the major strategies out there:

1. **Installment Sale - (Seller Financing)**
2. **The 'wrap' or AITD (All Inclusive Deed of Trust)**
3. **'Subject To'**
4. **Title Holding (Land) Trust**
5. **Lease Option or Lease Purchase**
6. **Contract for Deed (Sales Contract/Land Contract)**

1. Installment Sale - (Seller Financing)

I think we've covered this quite nicely already . . . no need to waste any more space. I'm mainly thinking of those properties that have no existing financing (the owner owns them free and clear), or the situations where the buyer gets a bank loan for as much as they possibly can, and then the seller carries back a 2nd.

Pretty straight forward. The deed is transferred to the buyer upon close of escrow, just like in a 'regular' sale. The next two are just variations of the installment sale.

2. The 'wrap' or AITD (All Inclusive Deed of Trust)

This is where the seller has existing financing on the property that he intends to leave in place. He'll take the down payment and create a note that is larger than and incorporates the existing note. The new financing wraps around the old financing like the flesh of an olive around its pit.

This is easy to do with private notes, especially if there's no due on sale clause. Remember the example in the beginning? I was talking about the commercial building I have for sale that has an existing seller financed note on it. If I wanted to wrap the underlying financing, I could, and here's how it could look:

First note: $797,000 (wrapping a $320,000 note)
Monthly payment: $6,179.13 (wrapping a $2,206.28 payment)

My monthly cash flow would be $3,972.85. If you have existing financing that contains an alienation (due on sale) clause, as most conventional financing does these days, you may get away with a wrap, you may not.

The bank will eventually find out that a title transfer has occurred, and when they do, they may do nothing, or they may decide that their reserves are uncomfortably low and decide to 'call in' everything they can. Then, things will get complicated if the financing can't be easily replaced.

A wrap is easy and cheap, but I wouldn't do it if everyone would be knee deep and lose out on their investment objectives if the bank called the loan. If you've got cash or a rich and generous relative, then don't worry about it. If the loan gets accelerated, you can just pay it off.

If you can't afford for anything to happen to the underlying financing, then you'll want to consider using a Title Holding (Land) Trust, a lease option, or Contract for Deed.

P.S. A wrap/AITD is a great way to solve a Mortgage Over Basis problem when it comes to capital gains on an investment property. You just have to get the underlying lender to provide you with a written waiver promising not to accelerate the loan.

3. 'Subject To'

Please don't try this at home. A 'subject to' purchase option actually used to be included in the official CAR (California Association of Realtors) documents years ago, but it confused everyone, so they eventually removed it.

And I don't think there's ever a reason to use it. It leaves the seller wide open if the buyer quits making the payments. How do I know to avoid this like the plague?

Because I used this once, and although everything turned out alright in the end, it was too stressful along the way, and at 45, I just don't need another reason for grey hair and wrinkles. I'm in that, "Do everything to hang onto my youth," mode, and reducing stress is part of my plan.

'Subject to' is when the buyer buys a property 'subject to' the existing financing. They take over making payments on the loan that is already in place, and if there's extra equity, then the buyer also makes a monthly payment to the seller on a 2nd note and deed of trust. If the buyer is on the up and up, then everything works out.

But if the buyer/payor stops making the payments, how long will it take you to find out, and what are you going to do? You can't foreclose to regain possession unless he stops paying a on 2nd he owes you.

Your name is on the loan, but you can't get control of the property, which won't make you very happy, unless you have nothing to lose and you were ready to ditch the property anyways.

Even if you intend to give the buyer the advantage of the balance and terms of your existing loan, still do a wrap (or better yet, use the land trust idea). You'll have more control. You can just make your wrap identical to the terms of your original loan.

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OK . . . so that 'wraps' up the conversation to this point. In each of the above examples, title is transferred to the buyer at close of escrow. In the following strategies, title is not transferred to the buyer until a later date.

4. Title Holding (Land) Trust

The “Illinois” Title Holding (Land) Trust is a revocable, inter-vivos, beneficiary-directed trust that is accepted in most parts of the country, and may arguably be the best possible means of real property asset protection and of transferring real estate.

The benefits of the Title Holding Trust are as follows:

- Asset protection
- Powerful and simple estate planning
- Preserves property
- Defer 100% of capital gains (and depreciation recapture) until the trust is terminated (anywhere from 1 to 20 years)
- Under most circumstances, a beneficial interest in a land trust may be exchanged for other ‘like-kind’ real property without recognition of gain or loss under the IRC’s Section 1031
- Prevents a lender from exercising any “due on sale” clause
- Allows for loan payment take-overs without violating the due-on-sale clause, or having to assume a loan
- Eliminates exposure to foreclosure
- Be able to evict a defaulting “resident beneficiary” according to tenant law
- Reduces the risk of taking a small down payment, (or providing a private loan where the LTV is higher than you’re comfortable with)
- Get privacy, safety and legal protection
- Protection from litigation, creditor judgments, tax liens and probate issues
- It’s quick and easy (you can often close in 21 days)
- Preserve tax basis (property is not reassessed - at least in CA)
- Acquire a property with a low down payment and no bank qualifying

- In some cases, freezes the seller's equity until some point in the future when housing has begun to appreciate again (the seller will get their equity at some point in the future)
- Sell without short sale or foreclosure, even if you're a little bit upside down (if you have a decent loan and you're not too far behind on payments)

When writing about land trust practice for the Illinois Institute for Continuing Legal Education in 1974, attorney Henry W. Kenoe wrote:

> *"No arrangement of legal interests could have attained the popularity and wide usage accorded the land trusts unless its applications were practical and responsive to the needs of those dealing in real estate interests."*

Extensive discussion of land trust applications are found in: Department of Conservation v. Franzen, 43 III. App. 3d 374, 356 N.E.&d 1245, 1 III. Dec 912 (1976). These discussions indicate that the land trust (Title Holding Trust) offers multiple advantages "...not available otherwise..." in a less complex and simplified form.

As recently as 1994, attorney F. Bentley Mooney, Jr. wrote an article in the well-respected Commercial Investment Real Estate Magazine: "Protect Your Assets With a Land Trust."
(www.ciremagazine.com/article.php?article_id=774)

Up-to-date information can be found Exeter Exchange Services: (exeter1031.com/benefits_of_a_title_holding_trust.aspx), and there's more great info at www.1031trustexchange.com.

About the due-on-sale clause:

FDIRA 1982, better known as the Garn-St. Germain Act under Title 12 USC Sec. 1701-j-3, allows lenders to enter into and enforce loan contracts containing a Due-On-Sale clause. There are a few exceptions to this that the Title Holding (Land) Trust takes advantage of:

- Granting of lease-hold for less than 3 years that does not involve an option to purchase, and
- Transfer into an inter vivos trust in which the borrower is and remains a beneficiary.

The Process:

1. The property seller (Settlor) vests both legal and equitable title of the property with the Trustee of a land trust to be created, and subsequently

2. Transfers a beneficial interest in the trust to a Resident Beneficiary (the 'Buyer') upon mutually agreed terms and conditions of the principal parties (which usually involves a financial contribution or 'down payment')

- Right of possession, management of the property, as well as the right to rents, issues, profits and proceeds of sale or mortgage financing are vested in the Beneficiaries.
- The rights, privileges, duties of the Beneficiaries are NOT considered interests in real estate, but characterized as personal property (chattel).
- The Trustee has no duties or powers other than to execute deeds and mortgages or otherwise to deal with property as directed by the Beneficiaries, who have Power of Direction

- Power of Direction (a property interest separable from the beneficial interest), provides the possessor with ability to direct the Trustee in how to deal with the property

3. A Beneficiary Agreement is drafted between the parties

4. The Resident Beneficiary (Buyer) leases the property from the Trustee through an Occupancy Agreement.

Quick Story . . .

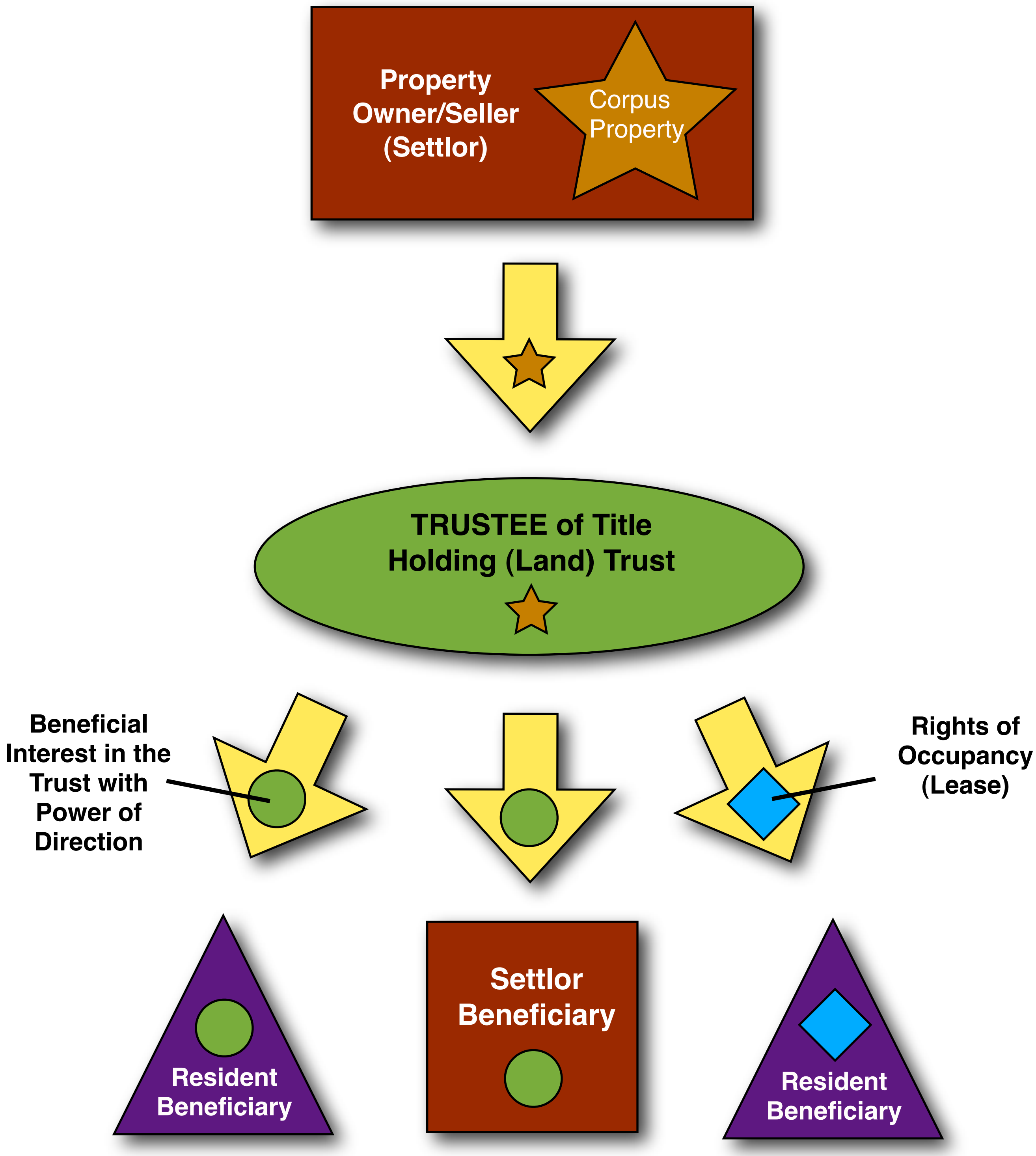
Remember I promised to tell you about Heinrich? You know, Harvey and Hedwig's friend? Well, Heinrich owned a very expensive second home in Palm Springs. He paid $2.5mil and put another $500K into it. And then the market happened. And instead of it being easy to make that $16,000 a month mortgage payment, it was strangling him.

So, he put the house on the market for $2.9mil with a very good agent. Several months and several price reductions later, it was still sitting unsold, the listing was about to expire, and Heinrich was heading for foreclosure.

At that point, when he had nothing to lose, he was finally ready to let me advertise 'Owner Will Carry.' I explained that we would use the Title Holding Trust to preserve his excellent financing ($1.7mil @ 6.75% fixed) for the next buyer. I worked with his agent so we could coordinate.

We ended up finding a Canadian buyer who was thrilled to pick up this property without bank financing (which would be almost impossible for him to get), and Heinrich turned a pending foreclosure into a positive cash flow of almost $4,000 per month. And, the agent squeaked out a healthy commission, so she was thrilled!

Anatomy of the Transaction



5. Lease Option or Lease Purchase

A lease option is simply where the tenant buyer gives the owner option money up front for the right, but not the obligation, to buy the property at a specified price some time in the future.

The tenant buyer generally pays more each month than a regular tenant would, and usually a portion of each monthly lease payment is credited towards an eventual down payment if they decide to purchase.

The lease option violates a lender's due-on-sale clause, so if they found out, a bank could 'call' any underlying financing. A lease option (if an option fee is taken or rent credits given) can lead to an inability to evict a defaulting tenant.

Such a tenant in default can claim having "Equity" in the property, and in so doing, force a judicial foreclosure process versus an eviction. This can afford him/her months of free rent while the litigation rages on. As well, terms can be changed on a whim relative to buy-out provisions, repairs, equity credits (rent credits), etc.: all requiring extensive, expensive, legal action to rectify.

6. Contract for Deed (Sales Contract/Land Contract)

This is essentially a "Lay Away Plan." The property's legal title is relinquished to the vendee (buyer) only after all debt has been paid off: i.e., there is no legal ownership of the property until it's completely paid for.

The CFD is a direct violation of a lender's due-on-sale clause; there is no means for eviction; the vendee (resident/buyer) holds an "equitable" interest in the property, allowing only for foreclosure, ejectment and quiet title in the event of a breach of contract. Further, any parties' creditor liens, lawsuits, judgments, marital dispute litigation and tax liens attach to the property, and the death of any party throws the property into probate.

And because title is still in the name of the seller/vendor, they could potentially encumber (place more loans on the property) without the knowledge of the buyer/vendee.

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Of all these, I recommend the Installment Sale, in some instances a typical wrap, but the Title Holding (Land) Trust remains one of my favorites for a lot of reasons.

The simultaneous note sale - myth or reality?

A simultaneous note sale, or 'simo,' is when a seller carry back note is sold as soon as it's created. The seller offers owner financing and creates a note for the buyer, and immediately turns around and sells that note to a note buyer the same day. That way the seller walks away with cash even though they've offered terms.

This strategy was popular and worked really well when everything was 'working well' in the credit markets, including sub prime, option ARMs.

Clint Hinman, editor/owner of Noteworthy (www.noteworthyusa.com) was kind enough to spend a few minutes on the phone with me and share his perspective on simos. I'll print part of that interview here, but you'll want to listen/read the whole thing at some point. It's excellent, and Clint is one of the most honest, upstanding and generous leaders in the note industry today. You'll want to subscribe to the Noteworthy Newsletter.

NQ: So, what's the deal with simos? They've pretty much disappeared in the last couple of years, haven't they?

Clint: Well, the biggest difference between two to three years ago and today is who has the upper hand in the buyer/seller relationship. Right now, it's a buyer's market. Brokers of notes and sellers of properties no longer have the leverage they once had.

When Mortgage Backed Securities were the rule of the day, these companies were starved for product. They were buying up anything and everything that they could buy. Simply put, there wasn't enough product just relying on old-fashioned seller financed notes that had been seasoned for 3, 4, 10 years.

So the only way to get more product was to create more product. The simultaneous closing, although it wasn't necessarily created at that point, became much more prevalent because now these companies were pushing real estate investors to create the notes as quickly as they could. They'd buy them fresh off the block, and push them into a security right away.

There was very little risk of default while they held it because obviously they pushed them off into securities and somebody else absorbed the risk. And of course that was what was happening with more than just these simultaneous seller finance closings. This is what was happening with the sub-prime mortgages as well.

In essence, you were just putting a bunch of hooey in a security, calling it Triple A, thanks to the rating agencies, and selling it to pension funds half a world away who had really no idea what really stood behind their securities.

NQ: Okay, so now there's basically nobody out there doing simultaneous closings anymore . . . like nobody?

Clint: Right. There's no market for it, and most of the niche buyers that survived this latest debacle want seasoning. They want the borrowers to show that they have the willingness and the ability to make payments before they'll touch the note.

NQ: For how long?

Clint: It typically depends on the parameters of the note. With good credit, a really strong third-party-verified down payment and payment history, secured by a plain vanilla-type property, some will buy with as little as 1-3 months' seasoning, but I will tell you that I just updated Noteworthy's database of note investors . . . it's called Direct Connect, and without exception, everybody asked that we remove simultaneous closings from the types of notes they'd buy.

NQ: And for the buyers who are still out there buying them, it seems that the discounts are pretty hefty, aren't they?

Clint: They are. Again, it's all a matter of credit, equity, or loan-to-value. Real estate investors that go into a property and pay $20,000 for it, do minimal fix up or rehab, and then sell it for $60,000 can't figure out why investors won't buy their note after 3 months.

And it's typically because the valuations on the property don't hold up because a Realtor and appraiser can see that it was sold just a few months earlier for far less than it was resold for. So, obviously note investors don't want to be caught holding the bag on notes secured by properties that are far over-valued from what they're really worth.

Most note buyers have a 12-month seasoning requirement on rehab-type flipper paper. It's separate from your traditional *'mom and pop America'* selling a property to maybe their renter. So, I want to point that out . . . rehab paper is looked at completely differently than your traditional seller financed note.

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It seems like the 'mom and pop' paper (after 1-3 months) can get somewhere between .70 to .80 cents on the dollar, starting with an 80% LTV (loan-to-value) note. If there's only a 10% cash down payment available from the buyer, it would be wise for the seller to create a 10% 2nd so they could preserve a little more of their asset.

A note investor doesn't seem to want to be in for much more than 60% ITV (investment-to-value), so the smaller the note, the less of a discount the note seller will take.

A possible exception to everything above . . .

I recently stumbled upon an investor who is doing simultaneous closings . . . sort of. They can sometimes get around the seasoning issues that plague investors who are buying cheap REOs all cash and then wanting to flip for top dollar using owner financing, and then sell the note, of course, so they get their seed capital and some of their profits out of the deal quickly.

This investor will pay .85 cents on the dollar for a newly created note ***that they've underwritten even before it was created.***

After they review the buyer's loan application (1003) and tri-merge credit report, they will decide if the buyer qualifies for the program or not. Here's a snapshot of the program:

- Only owner occupied SFR's (single family residences), and there are some parts of the country they won't touch. No mobiles or row homes
- 5% minimum cash down payment from the buyer
- Buyer's credit scores need to be above 600
- Seller carries a 10% - 15% second
- Seller creates and immediately sells an 80% - 85% first at .85 cents on the dollar
- Face interest rate on the 1st note will be somewhere between 8.5% - 10% (when 12 timely payments have been made, the buyers will most likely be able to qualify to refinance at a lower rate with the same company, and they can be working on improving their credit scores to boot).

So, here's an example of what a deal might look like:

- Purchase Price: $100,000
- Down Payment: $5,000 (plus closing costs)
- Seller Carry Second: $10,000
- Seller Carry First: $85,000
- Proceeds From Selling First Note to Investor: $72,250

So, the seller/investor/builder walks away with $77,250 cash and a note for $10,000 that will 'hopefully' get paid off when the buyers refinance in a year or so.

It won't make sense for everyone, but it is an option that's out there if the seller can absorb the 15% discount and wait for the 2nd to pay off down the road.

And even though the buyer will have what sounds like a high interest rate, most of the time they still come out ahead owning instead of renting on an 'after tax' basis.

This strategy will only work for a buyer that is pretty close to qualifying for FHA, but falls through the cracks for some reason. It's definitely not a golden hammer, but just one more tool to help in the disposition of property and paper.

[Disclaimer . . . I've yet to close my first transaction with this investor. I have a couple deals in the works with them, but as of this writing, nothing has closed yet.]

How To Avoid Paying

ONE RED CENT

To Uncle Sam When You Sell Your Property

A.K.A. How to Turn Your Best Investment into an Even Better One!

DOES ANY OF THIS SOUND FAMILIAR?

"I would sell my property, but I can't because…"

- I refuse to pay all those capital gains . . . and I don't want to exchange into another property because I'm tired of managing property and dealing with tenants.

- I need the income . . . this is my retirement!

- It's a bad time to sell . . . I won't get a good price.

- I've got tenants/family members that don't pay me enough, but I just don't have the heart to raise their rent or kick them out.

- I want to give my children a good inheritance. I'm leaving the rental properties to them . . . we already have a trust set up.

If you hear yourself in any of the above, keep reading. This special report will expand your understanding, and give you more options than you may have previously thought possible.

Many people have wisely invested in real estate over the years to achieve their financial objectives. Acquiring income-producing property is one of the best ways to create wealth.

However, at some point, many people tire of managing their properties. They are tired of dealing with tenants and the necessary repairs. Perhaps health problems are forcing them to slow down. ***They want smart, safe investments that are less management intensive so they can relax, travel, and enjoy life.***

With Seller Financing, you can **DO LESS** and **GET MORE**, turning your best investment into an even better one. Seller Financing can turn real estate into a paper asset secured by real property. Structured properly, this is one of the safest, most coveted investments in the market today.

BUT I DON'T OWN INVESTMENT PROPERTY . . . SHOULD I STILL KEEP READING? . . .

ABSOLUTELY!

If you own nothing more than your own primary residence, this information can be extremely valuable when the time comes for you to sell. I'll address this more in detail later on, but for now, let's get started!

THE BEST WAYS TO DEFER CAPITAL GAINS

There are actually several strategies for deferring capital gains . . . several exit strategies when disposing of real estate that help you escape a massive tax bill and maximize your income for retirement:

- **Installment Sale - (Seller Financing)**
- **Title Holding (Land) Trust**
- **1031 Exchange**
- **Deferred Sales Trust**
- **Lease Option or Lease Purchase**
- **Contract for Deed (Sales Contract/Land Contract)**

I won't be talking about the last two, because I do not recommend them as a general rule. You can get the benefits of a Lease Option or Contract for Deed without the risks through the Title Holding (Land) Trust. And let's face it . . . when we're dealing with your retirement income, we can't afford to be sloppy.

(Besides, someone recently mentioned that the contract for deed option may not actually help you defer capital gains any more, but I haven't had a chance to research that one yet).

The Installment Sale and the Title Holding (Land) Trust both help a property seller **GET TOP DOLLAR**, because you are offering terms (offering seller financing). When a buyer doesn't have to get a loan from a bank to buy your property, then they are willing to pay more for it.

The 1031 Exchange and the Deferred Sales Trust require a buyer to pay all cash, or to be able to get a bank loan. Many times this means that you will not get the highest price for your property, but you're free and clear of it.

Installment Sale - (Seller Financing)

WHAT EXACTLY IS SELLER FINANCING, ANYWAY?

We talked about this already, but sometimes it helps to hear it again. Seller Financing is when a seller becomes the bank (the beneficiary) by acting as a lender to finance all or part of the sale of their own property. The seller is literally "carrying back," or "carrying paper," on the property being sold.

Instead of a buyer giving the seller a down payment and getting a loan from a bank for the rest, the buyer gives the seller the down payment AND the monthly payments.

The seller receives payments according to the terms agreed to in a Promissory Note, which is secured by a Deed of Trust (in California) against the seller's property until the note is paid off.

Seller Financing applies to all types of real estate: homes, land, mobile homes on land, apartment buildings, condos, office buildings, farms, commercial, industrial, and warehouse properties to name a few.

WHY WOULD ANYONE CARRY BACK PAPER?

Many people (including professionals) mistakenly believe that only desperate sellers agree to carry paper and finance the sale of their own property. While it is true that some sellers (who would rather have all cash) carry the financing just to get their property sold in a rough market, many sellers use Seller Financing ON PURPOSE!

HERE ARE SOME OF THE BENEFITS OF SELLER FINANCING:

- Defer capital gains
- Get full market price by offering terms
- Get a good cash down payment now
- Collect hassle-free monthly income for years
- Your note is secured by a property you understand and whose value you know
- Sometimes you get more each month than you could collect in rent
- Never worry about dealing with tenants or maintaining the property
- Pay no more property taxes or insurance

Let's face it . . . federal capital gains will probably be going up. For this reason, more and more people are looking for ways to avoid paying them.

When someone in California sells a non-owner-occupied investment property (or a high end luxury home) they will have to pay a 25% capital gains tax. For example, someone who makes a $400,000 profit on the sale of their rental may immediately owe the government $100,000 right off the top.

OUCH!!!

Historically, many people have used the 1031 Exchange. They can defer 100% of their capital gains indefinitely using this technique, moving from one type of investment property to another.

But a 1031 Exchange can be complicated, and a lot of sellers just want out of real estate all together. They just don't want another property to deal with.

According to IRC 453, the Installment Sale (Carrying Back a Note through Seller Financing) allows you to defer capital gains as well. You only pay capital gains on the amount of principal you collect each year.

Because you are receiving the payment for your property in installments (a little at a time), the IRS allows you to pay your taxes in installments (a little at a time). You will pay capital gains on the down payment you receive, and then on the amount of principal you receive in each subsequent year.

Many people think that they need all cash when they sell a piece of property, but do they? Some do, some don't. What most people need, more than a huge pile of cash, is income. If you had enough income on a regular basis, would you need a large chunk of change all at once?

Carrying the financing does not mean you can't walk away with cash at the close of escrow. Many people don't need all of their cash out, but they usually want enough to cover closing costs, and maybe a few thousand to buy a new car, pay off credit cards, or put a new roof on their primary residence.

HOW MUCH CASH SHOULD YOU ASK FOR?

That's a personal decision, and also depends on what you and the buyer agree to. Many different scenarios can make sense given the circumstances, but a good rule of thumb is to get 10% down.

Many people are just happy to get rid of their management headaches, and replace it with a nice steady monthly income for retirement. There's nothing easier than depositing a note payment. Collecting rent can be effortless, but you still have to deal with tenants, maintain the property, and pay property taxes and insurance from time to time.

Because you have owned the property that is securing your note, you know what you're getting into. You know its strengths and its weaknesses. If you had to take the property back, it's unlikely that you would have any huge surprises. You would have a pretty good idea of its approximate market value at any given time.

Many people are real happy to be secured by real estate. The returns may not be as exciting as what the stock market can sometimes deliver, but to most people, a solid return in the real estate sector is better than losing money.

Personally, I consider collateral I can drive to, stand on or hold in my hand to be superior to promises of governmental agencies and corporate entities. I'd bet on real property, gold or silver before I'd bank on the promises of the FDIC.

NEVER WORRY ABOUT DEALING WITH TENANTS OR MAINTAING THE PROPERTY

When you use the Seller Financing technique, you become the banker, not the owner.

As the note holder, you will never receive a phone call from tenants, or have to worry about replacing the roof.

MANY PEOPLE ARE CONCERNED ABOUT LEAVING A GOOD INHERITANCE

Maybe they've promised to leave certain properties to each of their heirs, and have even set up a trust.

Owners who are worried about leaving a good inheritance behind often do not consider what a great asset a note is, especially one that is secured by a first deed of trust. It is just as easy to leave a note to heirs as it is to leave them a piece of real estate. Notes can be held in a trust just like property is.

In fact, a note can be a superior asset depending on the person doing the inheriting. Instead of inheriting something that needs to be managed, they simply inherit a hassle-free stream of monthly income.

BUT WHAT ABOUT MY TENANTS?

Many property owners won't sell because they are concerned about their tenants and don't want to displace them. Sometimes family members live in the rental, often paying far below market rents.

Even when owners are struggling financially, they are often reluctant to raise rents or kick these low-paying tenants out because of the emotional repercussions. These owners often feel trapped by the situation.

What can they do?

If you feel protective of your tenants, (you can't bring yourself to raise rents or evict them), there is still a way to sell and get the some of the benefits you're looking for. Call me.

HEY . . . WAIT A MINUTE! I DON'T HAVE INCOME PROPERTY, AND YOU PROMISED THAT I WOULD GET SOMETHING OUT OF READING THIS . . .

Let's say you're ready to sell your primary residence. You don't have the same capital gains concern (unless the value of your property greatly exceeds your home owner's exemption). Is Seller Financing still something you should consider?

WITHOUT A DOUBT!

If you own your property free and clear (or have great underlying financing) you can use Seller Financing to sell your property quickly, for full price, regardless of market conditions. In these times, everyone should evaluate their options for carrying paper.

The market is still good for flexible sellers!

For high-end LUXURY residential properties, home owners can still get slammed with capital gains. Some are getting around this by using the Installment Sale, or turning their primary residence into an investment for 12-18 months before selling.

Then they get the best of both worlds: home owner’s exemption AND the ability to do a 1031 Exchange with the rest of it through proper use of the Title Holding (Land) Trust.

Title Holding (Land) Trust

The Title Holding Trust may very well be THE BEST vehicle for acquiring, holding and transferring an interest in real estate. In fact, I often refer to it as:

SELLER FINANCING ON STEROIDS!!!

More than a simple land trust, this is a whole transfer system. But why should you use it? What are the advantages?

- **It's like the Installment Sale, only better**
- **Never worry about foreclosure; simply evict a defaulting "resident beneficiary"**
- **Get privacy, safety and legal protection**
- **Sell for top dollar because you're offering terms**
- **It's quick and easy (you can often close in 21 days)**
- **Defer 100% of your capital gains until the trust is terminated**
- **Keep your tax basis (the property is not reassessed)**
- **Protection from litigation, creditor judgments, tax liens and probate issues**
- **Reduces the risk of taking a small down payment**
- **Freezes the seller's equity until some point in the future when housing has begun to appreciate again (the seller will get their equity at some point in the future)**

The Title-Holding Land Trust (based upon the well-known "Illinois Land Trust") is accepted throughout the United States. This revocable, inter-vivos, beneficiary-directed trust may arguably be the best possible means of real property asset protection and/or transferring real estate.

The land trust is unique in that a property's legal and equitable titles are vested in the trustee, rather than in the owner of record. The land trust's beneficiaries remain fully in control of the property and the actions of the trustee.

As a result of this beneficiary-directed third-party trusteeship, any property so held is effectively hidden from public view and shielded from legal actions by lawyers and creditors.

When there are multiple (unrelated) beneficiaries in the trust, the property and its title become virtually immune to tax liens, creditor judgments, lawsuits and charging orders. Even the IRS can't touch a property in a co-beneficiary land trust.

THE TRUST TRANSFER SYSTEM INCLUDES:

1. **A simple Land Trust**
2. **An Assignment of Beneficiary Interest**
3. **A Beneficiary Agreement**
4. **An Occupancy Agreement (i.e. a tenancy agreement whereby a co-beneficiary 'leases' from the trust, versus holding a title interest in the property)**
5. **A Power of Attorney from a non-participating beneficiary to the party handling the management of the property.**

When combined, these documents effectively afford a would-be buyer all the benefits of home ownership, including income tax deductions in most instances.

The Title Holding Trust System gives a seller who is willing to leave his equity (or his existing financing) in place a quick, easy and safe method of disposing of the property, while also giving a buyer virtually 100% of the benefits of ownership.

The trust system provides the seller an excellent means of AVOIDING:

- Immediate capital gains taxation
- Hanging out in a dead market with a stale listing when properties aren't selling
- Risky seller carry back scenarios (like Lease Option and Contract for Deed)
- The hassle of becoming a landlord with negative cash flow (OUCH!)
- Tenants who will destroy your property
- A state's withholding tax if the trustee is a corporation (at least in California)

The 1031 Exchange

WHAT IS A 1031 EXCHANGE?

Section 1031 of the Internal Revenue Code allows you to dispose of certain real property and defer the payment of your federal, (and in most cases), state depreciation recapture and capital gain income tax liabilities by exchanging the real property (relinquished property) for qualified use "like-kind" property (replacement property).

IS 1031 EXCHANGING A NEW CONCEPT?

NO. Section 1031 of the Internal Revenue Code was first introduced in 1921. The purpose or intent behind a 1031 exchange is to encourage you to reinvest 100% of your net proceeds into like-kind replacement property when you sell qualifying property.

WHAT ARE THE BENEFITS OF DOING AN EXCHANGE?

1031 exchange transactions are one of the last remaining strategies available to defer the recognition of capital gain and depreciation recapture income taxes on the sale or disposition of qualifying property.

Usually, when you sell your investment property you will trigger Federal and state capital gain and depreciation recapture income taxes, which will leave you with much less to reinvest.

This makes it extremely difficult for you to trade up in real estate value, increase your cash flow and ultimately your net-worth when you have to recognize and pay these income tax liabilities.

By completing a 1031 exchange you can defer your capital gains and depreciation recapture and keep 100% of your proceeds from the sale of your investment properties available to reinvest in other like-kind replacement properties, especially to trade up in value and improve your cash flow.

But you'll need an all cash or cash-to-new-loan offer, so you'll have to be ready to sell at a lower price than you could get if you were using one of the powerful "Owner Will Carry" strategies like the Installment Sale or the Title Holding (Land) Trust.

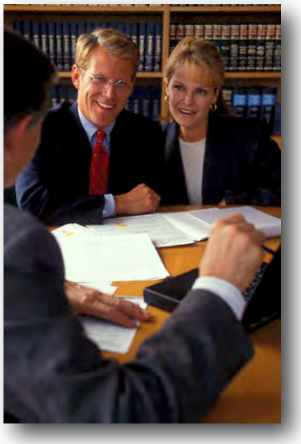
For more info, and to get an illustration of how this could work for you, please visit:
www.my1031x.com/notequeen

The Deferred Sales Trust

The Deferred Sales Trust (DST) is a product to consider using when you want the ***benefits of an installment sale***

- **Defer capital gains**
- **Get monthly income for retirement**

without some of the risks. You'll never have to worry about having to foreclose if the buyer defaults, because your monthly payment is not secured by the property, but a third party company that CREATES AN ANNUITY for you.



You don't have to trust the buyer to pay you, you have to trust the company to stay in business and pay you.

The Deferred Sales Trust kind of takes over where the Private Annuity Trust left off. You just have to be willing to accept a low rate of return, say 3% - 4%.

This strategy is gaining popularity among those who have highly appreciated assets that are marked for sale, or assets that would be hard to exchange, such as business interests.

HERE'S THE ANATOMY OF THE TRANSACTION:

- **Seller 'sells' his property to a trust owned by a third party company**
- **Trust lists and sells the property conventionally (getting cash or CTNL from buyer)**
- **Trust pays seller with a payment contract called an "installment contract," which is basically an annuity, paid over an agreed period of time**

Deferred Sales Trusts are drafted pursuant to IRC 453, the same as the installment sale in the seller financing scenario. ***The capital gains tax is realized or triggered, but not recognized or paid*** (not until the seller starts receiving the payments, and even then capital gains are only paid a little at a time).

You need to price your property to sell. If you're not going to offer terms through an Installment Sale, or through a Title Holding (Land) Trust (which helps maximize price point), then you'll have to be very realistic on price.

To learn more, and to get an illustration of how it would work for you in your particular situation, please visit: **www.myDSTplan.com/notequeen**

Once I have a great note, how can I sell it?

First off, **there is no 'standard discount.'** The discount you will have to take when you sell your note depends on multiple factors: type and location of property, amount of protective equity, priority of the note (is it a 1st or a 2nd?), cost of dealing with a potential foreclosure, payment history, credit and financial strength of the payor, trends in the local real estate market where the security is located, trends in the national economy, yahdah, yahdah, yahdah . . .

Now that we have that out of the way . . . the best way for me to get you the most accurate quote on your note is to have these documents in front of me:

- the note
- the deed or mortgage
- escrow instructions and/or
- escrow closing statement
- payor's SS#'s

These documents help me understand exactly what you have for sale.

My fax # is: (626)451-0454

But please, save yourself some time. If you've posted your note on an internet auction site like eNoteWorld or America's Note Network, I won't be able to work with you . . . *but I will pray for you.*

[And if you're another note broker, I can work with you on your deal if you are comfortable with me having direct contact with your note seller. If you don't think you can trust me, I understand, but I've spent too much time on

multiple broker deals just to have them go nowhere, so I can't do them anymore unless I am working directly with the note seller. Of course, we'd share the commissions]

If you're selling your note, be thinking about how much cash you really need. Are you open to selling a part of your note? You will often have greater success with a "partial." The discount will generally be smaller, and there are more buyers for your note. You can get some cash up front, but then still have payments coming to you down the road. Just something to think about.

The discount required depends on many different factors. YOU ultimately determined the value and marketability of your note when you created it. That's why it's so important to ***consult with a note professional BEFORE you close the deal!***

Sellers who carry back paper (and the agents, escrow, title, attorneys and CPA's who advise them) often do not understand the secondary trust deed market. If there are lethal weaknesses in your note, or in the way your transaction was set up, then you probably won't have the option of selling your note at all. Just hang on and hope the buyer keeps making those payments!

Is the Note Queen a note buyer, or a note broker?

The answer is: "both." I occasionally buy notes for my own portfolio (just like I occasionally buy properties for my own portfolio), but frequently I function as a note broker.

In real estate, there are people who want to sell their property FSBO and find their own buyer and do their own paperwork. Alternatively, there are people who want a broker to help them package their home for sale, and help them find the buyer that will pay the most for it.

Statistics show that even paying a commission, most sellers net more by working with a broker, and the process is less stressful and cumbersome.

In the note world, people who have notes to sell can do it FSBO. They can do all the research and dig through the maze of institutional and other buyers that might make a bid on their note. They can post their note on an ebay-type service and take calls and emails from hoards of "buyers," many of whom have very little experience, and are brokers disguised as buyers.

Many find the process foreign and overwhelming and would rather pay someone they trust and enjoy working with a reasonable fee (generally 3-5% of the face value of the note) to help them understand the process, package their note, and find the buyer that will pay the most for it. These sellers often net the same or more than when selling FSBO, and definitely find the process much more palatable.

When someone is selling a property, I educate them about their options and their ability to sell creatively and carry paper, thereby achieving their objectives more readily.

When someone is selling a note, I educate them about the different ways they can sell a note. They can sell part of the note, or all of it. They can sell a payment stream, or just the balloon. They can sell half of each payment to raise the cash they need now and still have some money coming in.

If it turns out that you aren't able to sell your note, or the discount is just too steep, you can hire me to help you restructure and renegotiate your note with the existing Payor. Perhaps there are solutions you just haven't thought of!

If you're interested in learning more about how the market decides the value of your note, keep reading!

PRESENT VALUE APPROACH

The fair market value of a mortgage, trust deed or land contract is determined by the present value approach. Present value is defined as the sum of all future benefits accruing to the holder when such benefits are discounted to the present by an appropriate discount rate. A discount, if applicable, is determined by the market using the following factors:

DEGREE OF SAFETY

This is the certainty with which the return from investment is expected. Present value increases or decreases according to the safety factors. The higher the perceived risk, the higher the yield required, and the deeper the discount expected. Protective equity, credit score of Payor, seasoning and payment history combine to create the level of safety, and therefore yield requirements, on any given note.

PROTECTIVE EQUITY

The cash down payment made at the time of purchase represents the hard

equity most important in determining the safety of a note. The less protective equity available, the less valuable the note is. A potential note buyer will always get an appraisal to establish the fair market value of the collateral securing the note; however, it is important to remember that equity provided through appreciation is significant, but it is not as important as hard equity.

CREDIT SCORE

If this note were sold and due diligence uncovered a credit score below 620-650, there would be a deeper discount required, as the note would represent more risk to the investor.

SEASONING

A note is considered seasoned when at least 12 payments have been received. A well-seasoned note is more valuable than a “green” note.

PAYMENT HISTORY

Payment history addresses how timely payments have been. A history of late payments would decrease the value of the note.

BALLOON

Notes with balloon payments are considered riskier than fully amortizing notes unless there is a clear and obvious exit strategy. The availability of affordable conventional financing is crucial.

TIME VALUE OF MONEY

In general, the longer it takes to collect all the payments on a note, the deeper the discount will be. Money to be received sooner is more valuable than money to be received in the future.

For example, based on a yield requirement of 10%, $1,000,000 to be received in 5 years is worth $607,788.59 today. That same $1,000,000 is only worth $136,461.51 in terms of today’s dollars if it will not be received for 20 years. You know that when you were a kid, you could go to the movies for under $1, but now, that $1 won't even buy you popcorn to eat while you're watching. This inflationary aspect is greatly intensified by the Fed's recent determination to print as much money as it takes to ward off recession.

INTEREST RATE

Present values increase and decrease inversely proportional to interest rates. The higher interest rates are in general, the lower the fair market value of the note, as the investor needs to obtain a higher yield by paying less up front for a given cash flow. When interest rates are low, the note can generally be sold for more. In the current climate, even though interest rates are low, there is a credit crisis facing the economy, and investors need a higher return to consider the purchase of a note. This equates to deeper discounts. Additionally, a note with a high interest rate is more valuable (would require a smaller discount) than a note with a low interest rate.

LIQUIDITY

This factor is the ability to liquidate an investment rapidly with a minimum loss of principal. Trust deeds are not highly liquid by nature, and a note seller always has to take some discount on principal when selling. In general, a willing buyer would not consider the fair market value to be equal to the principal balance due. Even under the best circumstances, an investor will need at least a small discount to cover closing costs should the note pay off sooner than anticipated.

MANAGEABILITY

This factor is the extent to which the investment requires attention and management over time. A note buyer must get a higher return on a trust deed investment than he could get with corporate bonds or a certificate of deposit. He needs to be compensated for the work and oversight required to acquire and effectively manage the cash flow, including the potential time and cost of foreclosure. The more complex the note (and the collateral securing the note), the higher the yield required by the investor, which translates into a lower market value.

Another consideration is the position of the note. A first deed of trust is safer, and less management intensive, than a second deed of trust. Junior liens are less valuable, as they represent substantially greater risk. If the Payor defaults, a junior lien holder will have to make payments on any senior liens while they wait for the foreclosure sale date.

LEGAL IMPLICATIONS

The note and deed of trust must be drafted properly for a potential note seller to get full market value for the note. Improperly drafted documents, incorrect note calculations, or weak enforcement provisions, will adversely affect the value of the note.

Just for Fun: “Eliminate Indecent Exposure to Foreclosure!” (published in random local papers)

"Get your clothes on, Ethel!" I'm wanting to say that line came from a song inspired by the streaking culture in the '70s.

I'm sure many people were offended by the 500 nude participants at the University of Maryland in 1973 that started the whole phenomenon, and the rash of streaking incidents that followed.

In fact, when I was in 5th grade, my 'almost boyfriend' streaked past my house one night, and of course I did my best to feign offense (even though I was secretly disappointed that I didn't see anything).

The funny thing is that the same people who are so opposed to being exposed to the human body will often think nothing of taking a 5% down payment (or less) from a 560 FICO on a seller carry back.

They'll take 10% down (or less) on a commercial property, or a high end luxury home and feel pretty nifty getting the price they wanted.

And they won't even try to be private about it. In fact, they'll march right over to the County Recorder and acknowledge their dirty deed in the public records!

That's what I call Indecent Foreclosure Exposure.

Of course we know that most of these note holders will be surprised at the discounts they'll have to take when they go to sell their prized promissories, if indeed they can sell them at all.

And the reason is the exposure to foreclosure. No investor wants to be left holding the bag when these statistically risky loans begin to default.

These deals just don't have enough duds on . . . they're shamelessly streaking around without enough protective equity, which all too often translates into capital losses.

Now let me back up for just a minute. I'm obviously having some fun here, and I don't want you to get the idea that these types of transactions are intrinsically evil.

In this arena, morality is subjective . . . it depends on what sellers need and want at the time. The only thing I find objectionable is watching a naive seller sustain a nasty financial surprise that significantly affects their quality of life.

It can make sense to endure foreclosure exposure, but sellers need to have a realistic grasp of the inherent risks and rewards.

And if you're a real estate agent, then you'd help yourself (CYA) and your client by facilitating an understanding of both the short and long term implications of the owner financing strategy they are considering.

If taking 5% down is the only way to quickly sell a property at a good price, and the seller understands the risks, then why not?

There are definitely risks in NOT selling:

- extended DOM - how many more mortgage payments will they make waiting for the next buyer?
- the risk of further depreciation (more price reductions)
- renting it out instead, accepting negative cash flow and lots of repairs after the tenants are gone
- inflation - it's not a matter of 'if,' but 'when,' so the sooner they sell for a fair price, the better. Selling for less now can ultimately provide more value than selling for more later

So, selling with a scantily clad seller carry back can make sense . . . at least there's a chance of collecting the desired equity. It just wouldn't be realistic to expect to sell the note without taking a substantial haircut.

To reduce indecent foreclosure exposure, sellers can ask for a larger down payment, or use a lease-option or contract for deed. And if they really want to shield the property, they can put it in a Title Holding (Land) Trust.

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Whew! I’m tired of writing, so this is . . .

THE END!

Dawn Rickabaugh is a CA Real Estate Broker specializing in legal and ethical creative financing. She regularly puts and keeps real estate transactions together using proven seller financing strategies. She also buys and brokers notes secured by real estate, and is therefore poised to help sellers and their agents understand how to carry paper safely. She loves teaching intelligent use of the Installment Sale and the Title Holding Land Trust for the maximum benefit and protection of all parties.

Dawn originally graduated from Brigham Young University in 1987 with a Bachelor of Science in Nursing, and worked for several years in the ICU and ER at Huntington Memorial Hospital in Pasadena. She now pursues her passion for helping people through traditional and innovative real estate transactions. She has a wonderful partner and four amazing teenagers, and loves her life in Temple City.

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