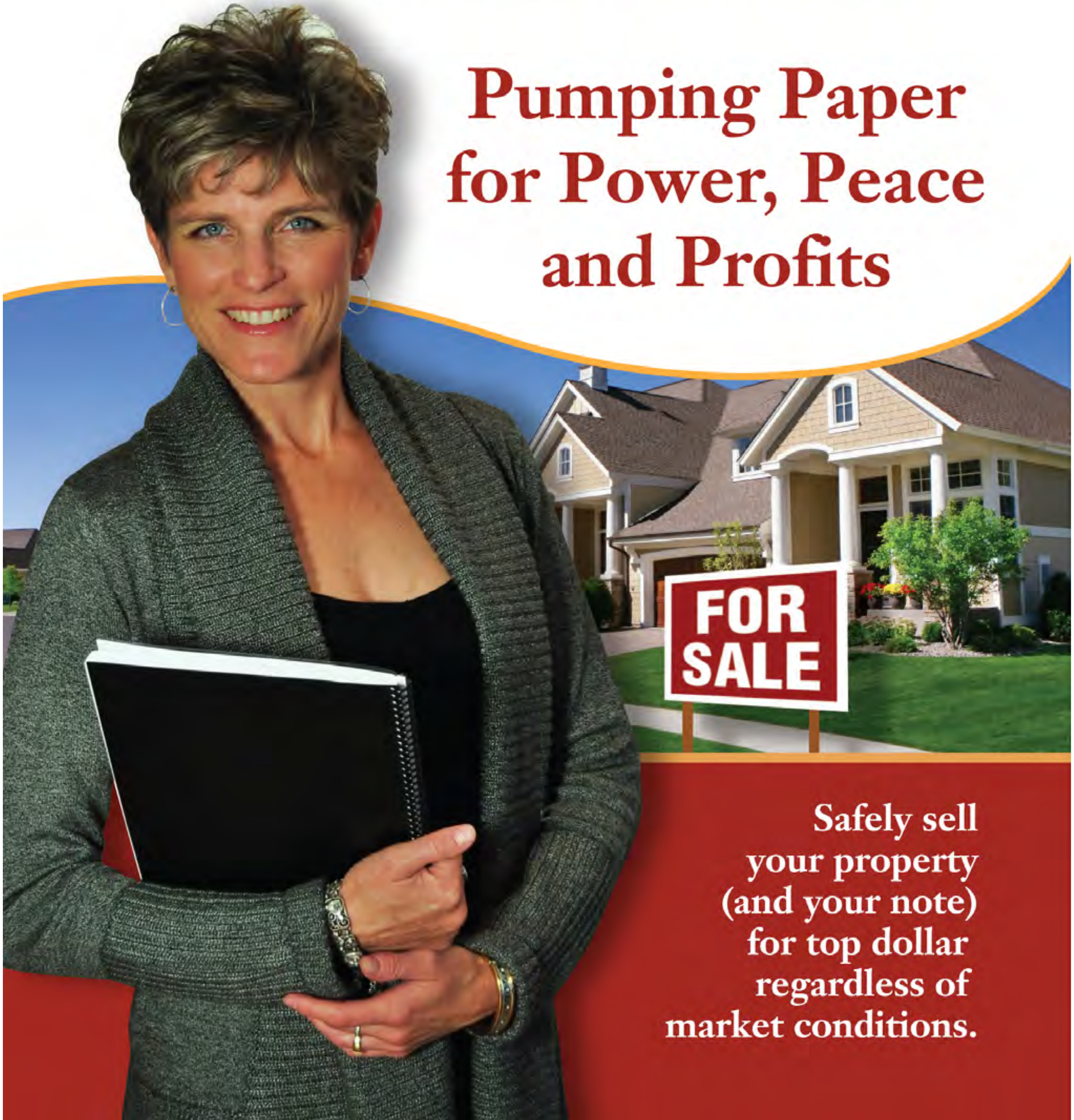
By: Dawn Rickabaugh, The Note Queen

Seller Financing on STEROIDS

Pumping Paper for Power, Peace and Profits



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 (dispel the myths 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.**

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Introduction

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

Even with government (taxpayer) stimuli, the credit market is still in hangover mode…throbbing headache, looking for a greasy burger and a strong cup of coffee... and things are not likely to get better any time soon.

Even good, qualified buyers are having a hard time qualifying for loans, especially jumbos and commercial, and many of the escrows that are lucky enough to open end up falling apart.

Increasingly, sellers are looking for ways to get the highest possible price for their property (or business) at a time when short sales and REOs, depreciation and tight credit markets are making it hard to move anything.

Many people are 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. That's where I come in.

This book is to help you intelligently and powerfully put a seller financing transaction together that meets your needs (or the needs of your client) now and into the future.

Owner financing helps you get top dollar for your property... make sure you can get top dollar for your paper in the event you or your heirs ever need to sell it. You want the strongest possible investment, don't you? If you're a buyer, you need to know the various ways you can acquire property without having to qualify for bank financing. You also need to understand how to protect yourself, and be ready to handle the objections sellers might have in extending terms to you.

If you get stuck, hire me, or join Owner Financing Club for A LOT of eye opening information about owner financing and notes. I guarantee that it is possible to get better terms than you ever dared believe you could ask for. Sophisticated investors, including many of my clients, are doing it every day.

BEFORE YOU CREATE A NOTE, READ THIS ONE!

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

Yes! If you've got good underlying financing, and you're willing to leave it in place for the next buyer, you can offer owner financing. But that's illegal, isn't it?

I'm surprised when people tell me this with conviction. If there is underlying bank financing, it may be a breach of contract to transfer title to the property (which gives them the right to accelerate), but it's not illegal, except in Michigan.

If it was illegal to 'wrap' underlying financing, then I'm quite confident that CAR's (California Association of Realtor's) legal documents would not include this option on the Seller Financing Addendum.

The bank's position is still secured by a deed of trust or mortgage, and is often more secure, as the new owner is often much more capable of maintaining the payments than the person who sold the property simply to get out from under payments that had become oppressive for them.

That said, since 1985, Michigan has had legislation penalizing licensed persons (Realtors, title companies, etc.) from participating in transfers that attempt to circumvent a DOS (Due-On-Sale) clause. Title companies will usually insure a 'Subject-To' or 'Wrap', but stipulate exclusions to coverage and require that disclosures are signed by all parties.

So, there may be some legal ambiguity. If we polled 100 attorneys, some would say it's illegal (because of the one state's precedent), but many would say that it's not. You should get your own legal advice and ultimately, only do what you're comfortable with. When there is underlying bank financing, I believe you may want to consider using the Title Holding (Land) Trust, or in some instances, a lease option.

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 - All Inclusive Deed of Trust),
- 'subject to'
- 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.'*

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, news flash . . . 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 (triggering 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.

Random note: This book can help you increase your cash flow, and... sometimes the first place to start is by getting rid of life-throttling liabilities. ***If you have more than $20,000 in unsecured debt,* CLICK HERE.**

What is seller financing and how does it work?

Ok, down to the basics. (Watch a couple of intro videos)

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 (terms).

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.

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!

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 don't lend the Trustor (the buyer that now owns your property) money, but you lend 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 right now. 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. (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, 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)

For the rest of this section, purchase the complete book here.

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 much in legal fees? And will the property be trashed, and/or will the market be even worse 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, or use a Land Trust to avoid foreclosure altogether, or a careful lease option. There are some very innovative ways to structure transactions to maximize both real and paper assets. Sophisticated investors are using these strategies every day.

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**.

[P.S. This represents traditional underwriting wisdom. In practice, the note business and owner financing is evolving to deal with the fact that so many people have compromised credit scores these days.]

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 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 can be very difficult 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.

But let's face it, many people have a lot of money but can't qualify for a traditional loan because they've had a recent short sale, foreclosure or bankruptcy. They're not necessarily a bad risk, you just need to know how to compensate for, and understand the reason for, trashed FICOs.

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 your note for a year or more. If you hire me as your personal underwriting department, I will make sure you minimize risk, and have a note you can sell at the earliest possible moment for the highest possible price.

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 a trust or lease option. (But ***only if you don't plan on cashing out***. You can't sell a beneficial interest in a trust, or a lease option agreement, 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 was 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 (my customized Seller Terms Application collects more relevant data than a 1003, but a 1003 will do)
- buyers credit score
- escrow instructions
- escrow closing statement/HUD-1 settlement statement
- title insurance (you should have a lender's title 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 are 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 .50 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 12%. There are only 3 companies in the country that want to buy a 5% note at face value, 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.

There may be a way to create more than one note to meet client objectives . . . one that is meant for sale, one that is meant for long term holding. Each situation is entirely unique and has it's own set of possibilities and limitations.

To customize a solution for your particular situation (and if you're a Realtor, to C.Y.A.) hire me to take a look.

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 any 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).

To ensure that the Payor's have the best chance of being able to refinance when the balloon is due or sooner, make sure they're working on improving their credit score.

SMART TIP

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

Can the buyer afford a 7-year amortization? Or a 15? When a note is fully amortized (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 always 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, (even if they can accurately print out amortization schedules), they usually do not understand the financial significance of how the transaction is engineered. That's why working with an owner financing or note professional will save you thousands.]

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.

The Deferred Sales Trust is also a great way to defer capital gains without an exchange and is popular for clients with highly appreciated assets.

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 12% 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 ADD 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. I will service some notes, so contact me if you'd like me to help you keep track of things.

Any time there's a 'wrap,' you must have a note servicing company to keep everybody honest!

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 a member of the community, you can download the Note Checklist I use to review notes that come across my desk, or when I'm helping clients to structure their owner financing transactions.

Most people sleep better if they've had a note professional look over everything before the ink is dry. There are 3 major components to making sure a note is worth holding or selling:

1. How the transaction is engineered
2. Core mechanical note details
3. Documentation needed to properly underwrite the buyer

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

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 (crucial)
- the deed or mortgage (important)
- escrow instructions and/or
- escrow closing statement
- payor's SS#'s (and credit score if you have it)

My fax # is: (626)451-0454 (or email me: support@notequeen.com)

[But please, save yourself some time. If you've posted your note on an ebay-type internet auction site, I won't be able to work with you…but I will pray for you. And if you're a note broker and want to work with me, then please review my policies.]

Be gathering these documents as well:

- last 12 months' payment history (bank statements, cancelled checks)
- proof of insurance with you listed as Loss Payee
- lender's title policy (if you didn't get this, you'll have to pay for a policy in order to sell your note in most cases)

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.

"What I really appreciate is that you taught us that we could sell part of our real estate note. No one else gave us as many options as you did. You helped us get the money we needed without giving up too big of a discount. When I want to sell more of this note, you're the first person I'll call. Thanks a million." – Dennis H.

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!***

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…

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 sometimes I function as a note broker, and I can do so in a couple of ways:

1. I can offer you a price for your note, OR
2. I can list your note, like a Realtor lists property

In real estate...there are people who want to sell their property FSBO and find their own buyer and do their own paperwork. They take their chances getting into escrow with someone who might not be able to close, and they believe they are sophisticated enough to negotiate all aspects of the transaction, and keep themselves on top of all the paperwork and legalities.

Alternatively, there are people who want a real estate broker to help them package their home for sale, find the buyer that will pay the most for it, and guide and protect them every step of the way. 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," most of whom have very little experience, and are brokers disguised as buyers.

These FSBO note sellers take their chances getting under contract with someone who has the reputation for doing the ol' bait-and-switch. (Get you under contract at a high price fully intending to reduce the offer after the due diligence process regardless of what they find.) Or they'll pull the plug entirely (not unlike banks just before close of escrow).

Here's a gem from a 2009 interview with Clint Hinman:

Clint: There are still a lot of companies out there that will price deals, but, if you look at what they've acquired, if you could ever take a look into the books and see what they're actually buying, you'll find that they are pretending to still be a valid player in the industry. I won't mention names but I could list at least 5 companies like that right now that still advertise in the newsletters, still show up at all the conventions, send out marketing pieces to all these brokers nationwide, and haven't bought a single note this year.

NQ: Why are they doing that, Clint?

Clint: Because they're waiting for the market to get better and they don't want to lose their exposure in the meantime.

It is true that the initial quote I give you for a note will have to be reduced if, during the due diligence process, I discover that you have intentionally or unintentionally misrepresented material facts, such as payor's credit, value of property, etc., but the bait-and-switch people have a different agenda.

FSBO note sellers will have to understand that they need to cover themselves in the area of recourse. (Do you want to be on the hook for guaranteeing the note payments after you've sold it at a discount?) **Make sure you know how to read contracts if you're going it alone.**

Many find the note selling process foreign and overwhelming, and would rather pay someone they trust and enjoy working with a reasonable fee 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.

[REALTORS, CPAS AND ATTORNEYS: you have a fiduciary responsibility to your client, why would you refer your client to a note buyer that is buying for their own portfolio? That might cost your client several thousand dollars. It is far better for your professional reputation to refer a client with a note to someone who will list their note to get them the highest possible price. There are many types of private and institutional buyers out there, and if you haven't been around the block for a while, you don't know how to scare up the best price for a note, guaranteed.]

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 pursue alternatives…perhaps there's something you just haven't thought of.

Many of the traditional buyers of privately held mortgages have tightened their buying requirements, making it difficult to get a quote on any note that contains so much as a freckle.

They won't look at it if the face value of the note is higher than the value of the property (big problem these days), or if the Payor's credit is below 600 (challenging), or if the Payor has missed even a single payment in 15 years. I can usually find a home for notes that others turn away. Call me: (626)470-3477.

Story Time (Realtors, pay attention):

A guy found me on the internet not too long ago, and he wanted to sell his note. He had sold his landscaping business 3 months previously, and now wanted to free up some cash to invest in short sales.

After we talked briefly about the mechanics of the transaction, I said, "Oh, I wish we'd had this chat before you closed, it would have made your note a lot easier to sell, and the discount a lot smaller."

"I asked my agent if he knew anyone that could help put the note together, and he said no!"

He was pretty exasperated at this point. Then when I got a copy of his closing documents, we discovered that not only was the transaction engineered poorly, but the note had errors to boot!

The dates and numbers just didn't match up (remember what I said about escrow companies not always knowing how to craft a good note?), now I'm not sure I can get a buyer for this note at any price! Additionally, the agent failed to make sure that they ran the buyer's credit . . . WOW.

If you're supposed to be the professional, don't let yourself look like a fool. You just might find yourself in a lawsuit down the road.

EXCLUSIVELY for Realtors . . .

QUIT WALKING AWAY FROM COMMISSIONS!

- You have listings you can't take
- Listings expiring unsold
- Sellers stuck on price
- Buyers (or properties) that don't qualify
- A transaction falling apart

Become an Owner Financing Expert, or know when to hire one. You most likely have several ideas in your head about owner financing: it's risky, my seller won't be able to get cash, **it's hard for me to get paid!**

Even if you know a lot about owner financing...

If you don't regularly buy and sell notes, then you don't know how to create a note that's worth maximum value on the secondary market, because things are changing all the time. What worked last year, doesn't work this year, and that could cost your client thousands $$$.

When a seller offers terms, they can still walk away with cash. ***If I'm involved in the underwriting process,*** I can sometimes buy the notes created immediately. There are many ways to use notes and private money to meet client objectives. Besides... banks have whole underwriting departments . . . **when your client is the bank on their own property, they need to hire a personal underwriter** . . . that's me.

If you have past clients that have carried paper, call them and ask them if they know they can sell the note to raise cash if they ever need to. It's an excuse to let them know you're still in business. Visit: What You Don't Know About Notes is Costing You & Hurting Your Clients!

Wrapping It Up

By now I hope you feel empowered to get what you need and want regardless of market conditions. This is a time of unparalleled opportunity, and you have options…it's about being informed and choosing the strategies that work best for you and the other parties involved in your transaction. I help 'regular' buyers and sellers get the benefits usually reserved for seasoned and sophisticated investors who spend thousands on seminars and have been investing for years.

I'm always developing materials for real estate professionals, note brokers, buyers and sellers that will teach them how to become Owner Financing Experts… expertise that the market will increasingly become desperate for.

Visit Note Queen Store to see what I've got available, and please consider joining our community at Owner Financing Club, a virtual real estate investment club & training center focused on owner financing and notes.

I'm increasingly partnering with people who want to invest in notes, so if you're interested, please fill out this page: Investment Opportunities, and seriously consider setting up a Self-Directed IRA.

I'd love to have you join me on Facebook (search for 'Note Queen: Owner Financing Strategies…and when you get there, 'LIKE' it for heaven's sake :-).

Dawn Rickabaugh is the broker/owner of Note Queen Capital Funding. She is a private money lender in Southern California, and buys seller financed notes across the country. She has a thriving business as a Real Estate Consultant specializing in Owner Financing, often helping transactions close in a way that leaves property sellers with paper she'd be happy to buy.

As a Real Estate Broker specializing in legal, ethical and intelligent alternative closing strategies, she is dedicated to liberating & empowering buyers, sellers and real estate professionals in today's market. (View mission statement.) She also unchains consumers from unsecured debt.

She is a writer, educator, coach and author of *"Seller Financing on Steroids: Pumping Paper for Power, Peace and Profits."* She has been interviewed and quoted by influential publications such as Investor's Business Daily, the WSJ's MarketWatch, and the National Association of Realtor's Real Estate Today Radio (which broadcast the interview locally on 790 KABC).

She is the creator of Owner Financing Club, a unique membership & training site dedicated to helping Realtors, buyers, sellers, and note professionals understand *"the dance between property and paper"*. She teaches how to effectively use owner financing strategies to put and keep real estate transactions together, limit liability and meet the financial objectives of the parties concerned. It is increasingly imperative that real estate principals and professionals understand how the discounted note market functions.

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 a blend of traditional and innovative real estate transactions. She has four young adult children and shares a wonderful life with her partner (and their chickens) in Temple City.

When banks say 'NO,' we say 'YES!'

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