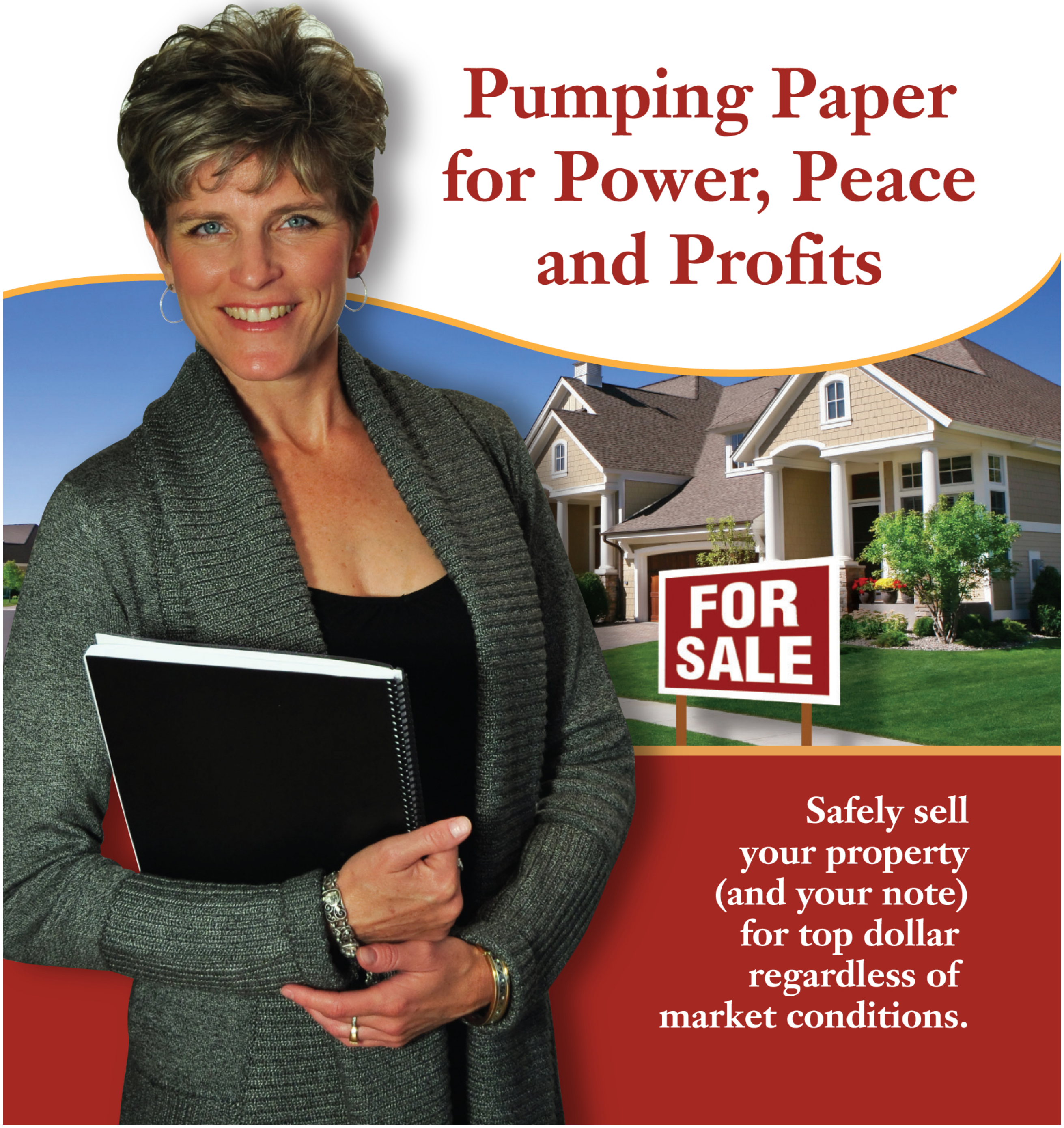
By: Dawn Rickabaugh, The Note Queen

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**

- Walk away with cash, even if you carry. The wonder of **'partials'** and 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 want to leave a **great inheritance** to your heirs and beneficiaries.

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To get the whole 2024 edition of Seller Financing on Steroids, all you have to do is opt in to my NQ newsletter with your name and email on my Note Queen home page :)

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 and Nevada, 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.

Perhaps you'll want to create two notes instead of one, or use the Title Holding Land Trust to avoid foreclosure altogether. 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 650 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 650, 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 really 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.

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? You don't you want to leave a headache to your heirs and beneficiaries do you?

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. (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 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 (do a short refinance) 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 super low

It's tempting to offer a super low 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 if you (or your beneficiaries) ever want or need to sell it.

But hey, my guess is that you are probably are sitting on a ton of appreciation over the past few years, so it all balances out.

Just to move inventory, builders are now aggressively buying down rates for buyers so they can get 5% - 5.5% financing, as well as throwing all sorts of other cash at buyers. **Builders see the writing on the wall first**… retail will figure it out soon enough. Take a 'heads up' from that and get ahead of the crowd. There really is a 'first mover advantage'… don't sit around.

It used to be that you could charge a premium on the interest rate if you carried paper… like 2-3% more. Now it's the opposite. If you want your price, you have to carry at LESS than the banks are charging for loans.

Just go in with eyes wide open… if you write a seller financed note at 5%, amortized over 30 years, don't be offended when a note buyer offers you .65 cents on the dollar. They're not being predatory, it's just the natural consequence of how you structured your deal. Maybe you just keep it in portfolio and rake in years of monthly payments. You got your price, right?

You can maximize what you can get for your note if you sell a **'partial'**. In fact, with the right planning as the note is being negotiated and constructed, you will take almost NO DISCOUNT on the principal balance of the note. You can get **cash now** without giving away **cash later**.

SMART TIP

Carefully choose the interest rate on your note

If you're going to take back a note / offer terms (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.

But you can only get away with charging 8-10% at certain price points… generally on a property worth less than $250,000. If the buyer can afford the payment at 9%, great. That means that your note will suffer a smaller discount if/when you go to sell it.

Important concept: the closer the face rate on the note is to the yield a note buyer needs, the smaller the discount.

If a note investor needs a 10% yield, well than that's not very far from 9%. If the face rate is 5%, well that's a lot farther away from 10%… so the discount required will be much steeper.

At the end of the day, the payment needs to be affordable for the buyer.

So if you've got a median priced home or higher, and you want your price, right now you've got to **carry at less than the banks are offering**. Buyers don't want and can't afford those interest rates and still give you the price you want.

There are many, many ways to craft a transaction to meet the needs of all parties. I'm just talking in generalities to illustrate concepts.

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).

Use of balloons in loans to consumers for their primary residence is usually considered a 'no-no'. Consult with a **Licensed Mortgage Loan Originator** to keep yourself compliant. See my recommended INDUSTRY TOOLS.

SMART TIP

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

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 . . . another 'no no' for homeowner loans

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 could 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 renegotiate the loan 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 a 5% late fee with a 15 day grace period is standard.

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 on your investment and commercial properties, include a **prepayment penalty** if you're trying to defer capital gains and don't want to be paid off early. Again, this is generally a 'no no' for residential properties that serve as the Payor's primary residence.

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, effortless 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

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**'.**

These days it's critical 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. (See resources page)

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

Things that need 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 5% with a 15 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… like on a borrower's primary residence.
- Default rate. If the loan goes into default, you want to have the interest rate jump up to the highest allowable by law. This makes the hassle and cost of a foreclosure more bearable

Dawn Rickabaugh is the owner of NQ Capital, a small, family-operated investment company actively buying property & paper, real estate & notes. 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 that will be worth something.

Dawn specializes in legal, ethical and intelligent alternative closing strategies, she is dedicated to liberating & empowering buyers, sellers and real estate professionals in today's market. (Meet Dawn)

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 Daily, the WSJ's Markey Watch, and the National Association of Realtor's Real Estate Radio Today (which broadcast the interview locally on 790 KABC).

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 adult children in their 30's and hopes to have grand babies before too long :)