

The Real Estate Investor's Guide to Private Mortgage Notes

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Notes, Mortgages and “Paper”:

Many Real Estate Investors know that frequently, creative financing in a Real Estate transaction involves the use of privately held mortgage notes, sometimes referred to as “paper”. This is especially effective if the investor who is buying a property for little (or nothing) down convinces the seller to “take back” a mortgage. When the seller, rather than a bank, is holding the mortgage, he/she has effectively become the buyer’s lender, although little or no money has exchanged hands. The seller and buyer agree that the buyer will purchase the property and make regular payments to the seller. The payments are secured by a promissory note backed by a mortgage on the property. The note and mortgage detail the terms, which include the total amount of the mortgage, amount of payments, rate of interest, how and where payments are to be made, and the period of the agreement. Should the buyer default, the holder of the note usually has the right to foreclose and take back possession of the property. There are many benefits to both parties when a private mortgage is utilized in a Real Estate transaction. The property transaction flows smoother and much quicker when there are no banks involved with their tedious and expensive qualification, approval and closing processes.

Benefits to the Seller:

- The seller will receive a regular steady monthly income, plus interest.
- The seller will receive a much higher rate of interest on his principal as opposed to investing the funds in savings, a CD, or even many stock or mutual funds.
- The seller’s “investment” is secured by a hard asset ... the Real Estate.
- The seller will pay income tax only on the funds received in any one calendar year, rather than the full lump sum resulting from a traditional transaction.
- Should the seller need a lump sum of cash, he/she has the option of selling their note (or a block of payments) to a funding company that specializes in purchasing notes.

Benefits to the Buyer:

- The Real Estate investor/buyer can acquire a property for little to nothing down.
- Rental income should cover the note payments and ownership expenses, plus create a positive cash flow ... for virtually no money of his/her own, the investor has created a stream of income.
- The investor/buyer does not have to qualify with a lending institution for a traditional mortgage.
- The investor/buyer does not have to come up with a large down payment.
- The investor/buyer’s loss is minimized should they default.

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The Value of a Note:

Note buyers use a strict set of criteria to determine what they will offer to a note seller.

- The terms of the note ... simple or amortized interest, balloon payment, etc.
- Number of payments made and payments remaining.
- The total amount of the note.
- The amount of the monthly payments.
- The rate of interest.
- The number of payments being sold.
- The credit worthiness of the payor, not the note holder.
- Have payments been made in full and on time?
- The age of the note.
- The value and condition of the asset securing the note. Should there be a default, they want to be able to convert the asset into cash.

A note has greater value if there has been some “aging” ... at least 6 months of payment history. A higher interest rate also increases value. Note buyers are very savvy at their practice, as they are putting their money at risk. They will easily detect false or artificially inflated notes. Again, fair and ethical behavior are key to a good transaction.

When you are buying property:

As an investor/buyer, you want to take possession of a property for as little of your own money as possible. For a seller to agree to holding the mortgage and receiving payments directly from you, there must be sufficient motivation for them to do so, but most importantly, they must have a good amount of personal trust in you and your intentions.

Building a good personal relationship with your seller can be critical. Be friendly, honest and direct in your negotiations. You should always operate from a position of what is legal, moral and ethical. Be ready to review your note, mortgage and other agreements with the seller’s attorney. You might even want to offer to show your personal credit report (as long as it isn’t too ugly). If your ugly credit score is a deal-breaker, you might be able to get a partner with a good score to guarantee the payments. Besides pointing out the benefits of a note during your purchase negotiations, you can also ask a few key questions that may help the seller to decide to hold the mortgage.

- 1) What if I could show you how to receive a regular monthly income, earn a greater rate of return on your money and have it 100% secure?
- 2) What will you do with the lump sum of cash you will receive if you sell traditionally? Do you have a place to invest it where you will receive an interest rate greater than what I am offering? Will the money be backed by something as secure as Real Estate?
- 3) If you put the money into the bank or mutual funds, what kind of interest do you expect to receive?
- 4) Do you think your funds will be as secure in the stock market?
- 5) What if I could show you that, should you later on decide that you would rather “cash-out”, that there is a source that will purchase the remainder of the payments due to you for a lump sum of cash?

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- 6) Did you know that you could sell just a portion of the note? By doing so, you could receive some money now in a lump sum, and continue to receive regular payments on the remainder.
- 7) What is the worst thing that could happen if I were to default? ... You would get the house back, and also get to keep all the money I have already paid you.

In keeping with ethical behavior, you need to advise a seller, who is considering taking back a note, that should he/she decide to sell their note, the offer from a note buyer will be less than face value of the note. The note buyer is assuming some risk and is also entitled to a profit.

When you are selling property:

As in buying property, a note can make all the difference when it comes time to sell your property. This is the “seller financing” deal. When you advertise your property for sale and offer seller financing, you are indicating your willingness to be flexible with your buyer. The benefits are huge:

- 1) Seller financing immediately expands your potential buyer market to all the people who cannot qualify for a mortgage loan with a bank.
- 2) You can sell for the full asking price.
- 3) You can use the interest rate you charge as a negotiating tool.
- 4) You create a stream of income for yourself.
- 5) You can sell for nothing down when banks usually expect something down.
- 6) The seller is not required to pay for PMI. (Did you know that PMI protects the bank, NOT the buyer?)
- 7) You will earn interest on the unpaid balance of the note.
- 8) You help good people with poor credit to make a move up into their own home.
- 9) You can close very quickly ... no banks are involved.
- 10) Need to cash-out later on? ... you can sell the note, or a portion thereof.
- 11) What’s the worst that can happen? ... you already know, that if the buyer defaults, you get the house back, and keep the payments they have already made.

Naturally, it is advisable that you perform due diligence to assure you have a good buyer with whom you want to work. As always, treat all your prospects fair and ethically. Do not gouge your buyer with a usurious interest rate.

Whether you are a buyer or a seller, notes are a great transaction tool for the creative Real Estate Investor. Remember, funding sources who specialize in purchasing notes will give purchase quotes only on notes that are already in effect.

Genesis Funding Resources is happy to assist investors in preparing their new notes, and of course we welcome every opportunity to seek purchase quotes for existing notes. Simply fax an application along with the note to us and we’ll provide your quote within three working days. There is no cost to the investor.

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