Understanding Your Real Estate Note Quote

Six Factors That Influence A Note's Value

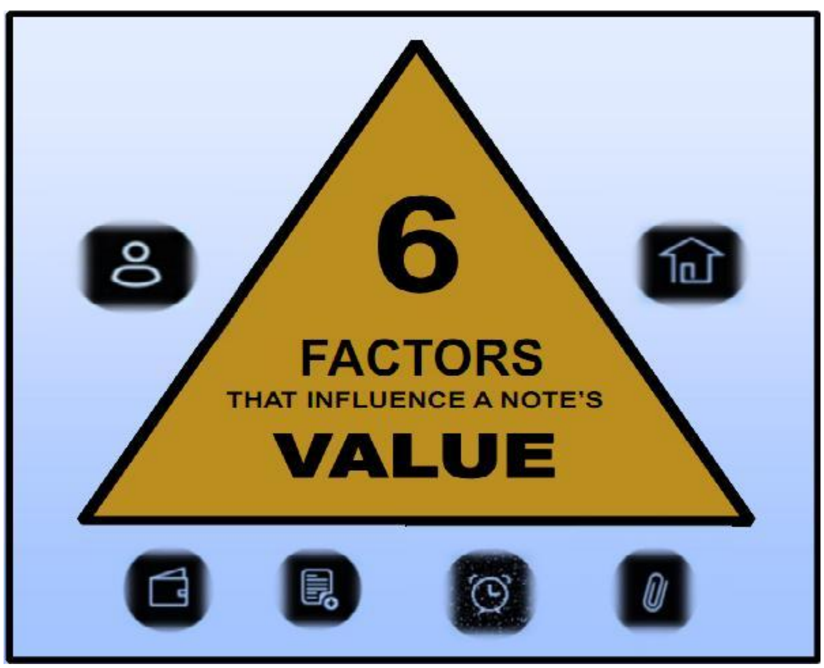
1 2 3 4 5 6

Capstone Capital USA

Analyzing Your Note Quotation

Congratulations, you have now received your note quotation. You are probably, yikes, now what do I do? Is this a fair quote? What am I looking at? Consider the following a summary of what has been presented in preceding chapters. Now you can drill down and learn more about understanding your real estate note quote – from a note buyers perspective. Note Buyers are Investors. They buy notes as a passive cash flow investment. They do not want to own the property and are risk adverse to Landlord or resale issues. To minimize their risk, they underwrite the note based on several key factors. They consider the worst case - what if scenario - what if the payor stops paying, and ...hope for best, that the payor will pay off the loan until maturity. Their underwriting criteria is based on experience. A super nice property with a great buyer will sell for 85-88% of the unpaid balance. If some of the factors are marginal, then they will pay less. This has to be weighed to sync with and what you require to meet your personal needs.

However, there are options to minimize the discount. We can blend market conditions and still be sensitive to your needs, to make the transaction work for you.



The # 1 Influence on a Note's Value is the

- BORROWER'S CREDIT - the person making the payments. Is the BORROWER bankable? This is the 1st item an Investor checks when going through the due diligence process. The borrower affects many other factors in the value on a note such as the collateral's upkeep, the down payment, seasoning etc. The credit on a buyer is not just their FICO score, but the 5 C's of credit and how each factor complements or redeems another. Included in the borrower profile:

- Type of buyer, rehabber or "mom and pop" (sold personal residence)?
- Credit
- Income (ratio or proof)
- Job / Employment

The # 2 Influence on a Note's Value is the

- COLLATERAL - the condition of the asset.

As they say, "every picture tells a story".

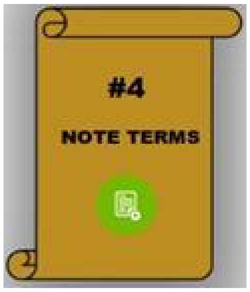
- Owner occupied or rental?
- Commercial or single family?
- Prior seller residence?
- What is the value?
  - Is there a pride of ownership?

The # 3 Influence on a Note's Value is the

- BORROWER'S DOWN PAYMENT -AKA "skin is in the game".

The % of down payment (preferably 20%) is important for 2 reasons:

- The amount of down payment determines the LTV (loan to value). The lower the better which investors look at when considering purchasing.
- It shows the buyer's commitment to the Property. The more they've personally invested, the greater chance they will stay current with payments and more inclined to maintain the property.



The # 4 Influence on a Note's Value are the

- Note Terms -

The Interest Rate, Amortization, and Balloon (if applicable) impact the note's value in the following ways:

- Interest: If a note has no interest, it is the nail in the coffin. If the interest rate low, it will also take a significant discount hit. The higher the interest rate, the less of a discount.
- Amortization: The longer the note amortization, the larger the discount. To neutralize this, clients may prefer a partial purchase as an additional option.
- Balloon: A note with a balloon has less of a discount because the money is closer to the payout. In certain cases a balloon that is too short can play a negative role in evaluating a note. The likelihood of refinancing to pay off a balloon must be logical & practical when cast against the buyer's credit & current economy.

The #5 Influence on a Note's Value is

- Seasoning or The Payment History -

What is the payor's track record on paying not only their monthly principle and interest payment, but are the property taxes and insurance being paid. This can make or break a deal.

- Is there a 3rd party verification confirming the payments from the Borrower, preferably from an outside Servicer?
- Is the note seasoned - how long have they been paying? 3-12 months = Better credit preferred. If 12 months or more a Sub 625 FICO may be OK. Are the taxes & insurance escrowed?

The # 6 Influence on a Note's Value is the

- Paperwork -

Finally you have the last factor in a note's evaluation, the paperwork. What investors verify are the following:

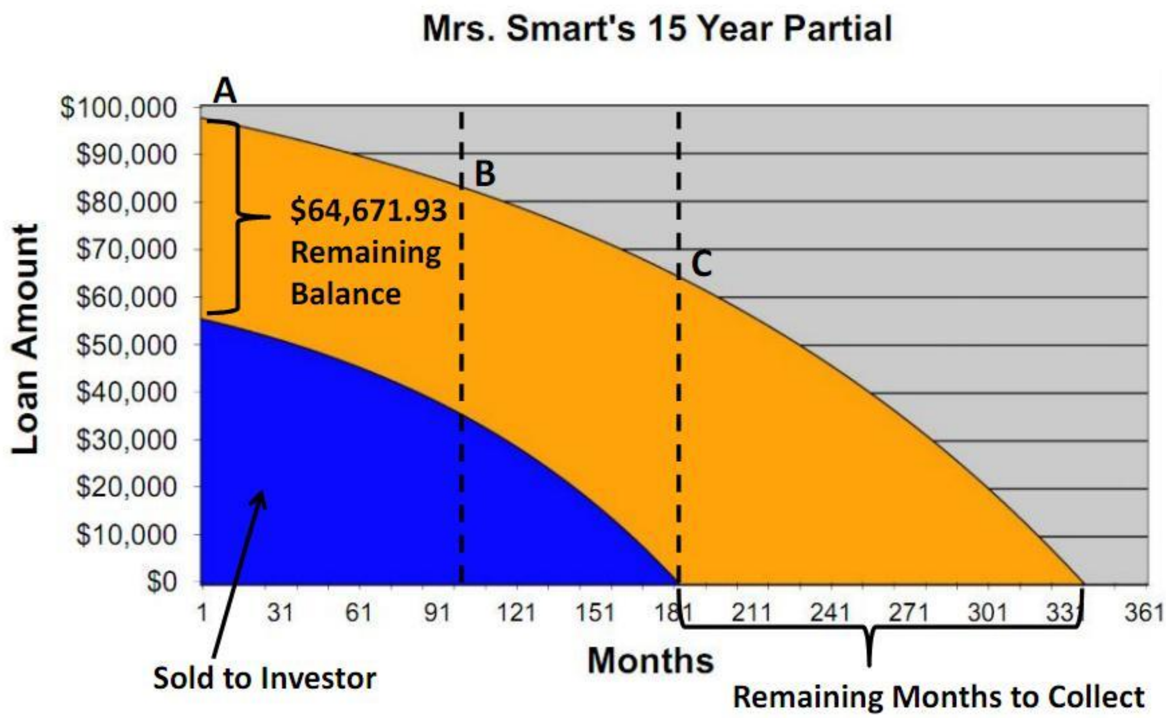
- Note, Deed of Trust, Land contract, etc.
- Federal disclosures
- Title insurance: note: if the note seller did not secure title insurance at the closing of the note, the fee to do so will be taken out at the closing of the note sale.
- Loan Application Verifications: includes income, employment and down payment. If the loan was originated after 1/10/2014, is the file Dodd- Frank compliant.

Of the 6 Factors, #'s 1 and 2 are pivotal for the note investor. If they present a high risk, the transaction may be subject to a heavy discount. To minimize the discount, a partial purchase may be the best approach, where sellers can get lump of cash, while at the same time giving the NOTE BUYER the security they need in this chaotic economic environment.

Partial Purchases

In addition to an outright purchase of the note, a "partial" purchase can be structured that gives you immediate cash for a set number of payments, after which time the note reverts back to you. If you need to raise a specific amount of capital, a partial allows you to receive exactly the amount that you need without having to cash out the entire note. A partial is one example of how we can work around a less than perfect note. Partial purchases are actually pretty common in the finance world. Banks have been selling loan portions (participations) to each other for over 50 years. It allows the origination lender to sell and recoup a large portion of their cash, which leverages their loans generating a better return.

The easiest way to understand how partials work would be to take a specific example. In the attached graph, we show a typical 30 year loan amortization along with a partial purchase of the next 15 years of payments. Mrs. Smart sold 15 years of her loan after receiving 24 payments. Her note had a very low interest rate of 5.95% because her real estate agent encouraged her to accept that rate to make the sale viable even though Mrs. Smart thought it was best to structure the rate at 8%. The monthly payments at 5.95% were $596.34. The loan balance at the time of her sale was $97,445.16, represented by Point A on the upper line of the graph. The investor purchased the next 15 years of payments for $55,493.87 which we'll track on the lower line. Since Mrs. Smart did not sell the entire loan, she still has equity in the loan as shown in the lightly shaded portion of the graph. Notice that as the payments are made, the lower line (investor's entitlement) reduces much quicker than the upper line (entire note entitlement). In other words, Mrs. Smart's equity increases with every payment made (the lightly shaded area gets larger). At the end of the 15 year period (point C), the entitlement due the investor has amortized to zero. The loan balance is still $64,671.93 and that is the amount that reverts back to Mrs. Smart. At the beginning of the sale, she receives a significant amount of cash for the partial purchase and also collects the remaining principle $64,671.93 plus interest at the end of the partial term. At her option, Mrs. Smart could either collect the payments on reassignment or sell that portion of the note. Mrs. Smart is aptly named!



Mrs. Smart's 15 Year Partial
A
B
C
$64,671.93
Remaining
Balance
Loan Amount
$100,000
$90,000
$80,000
$70,000
$60,000
$50,000
$40,000
$30,000
$20,000
$10,000
$0
1
31
61
91
121
151
181
211
241
271
301
331
361
Months
Sold to Investor
Remaining Months to Collect