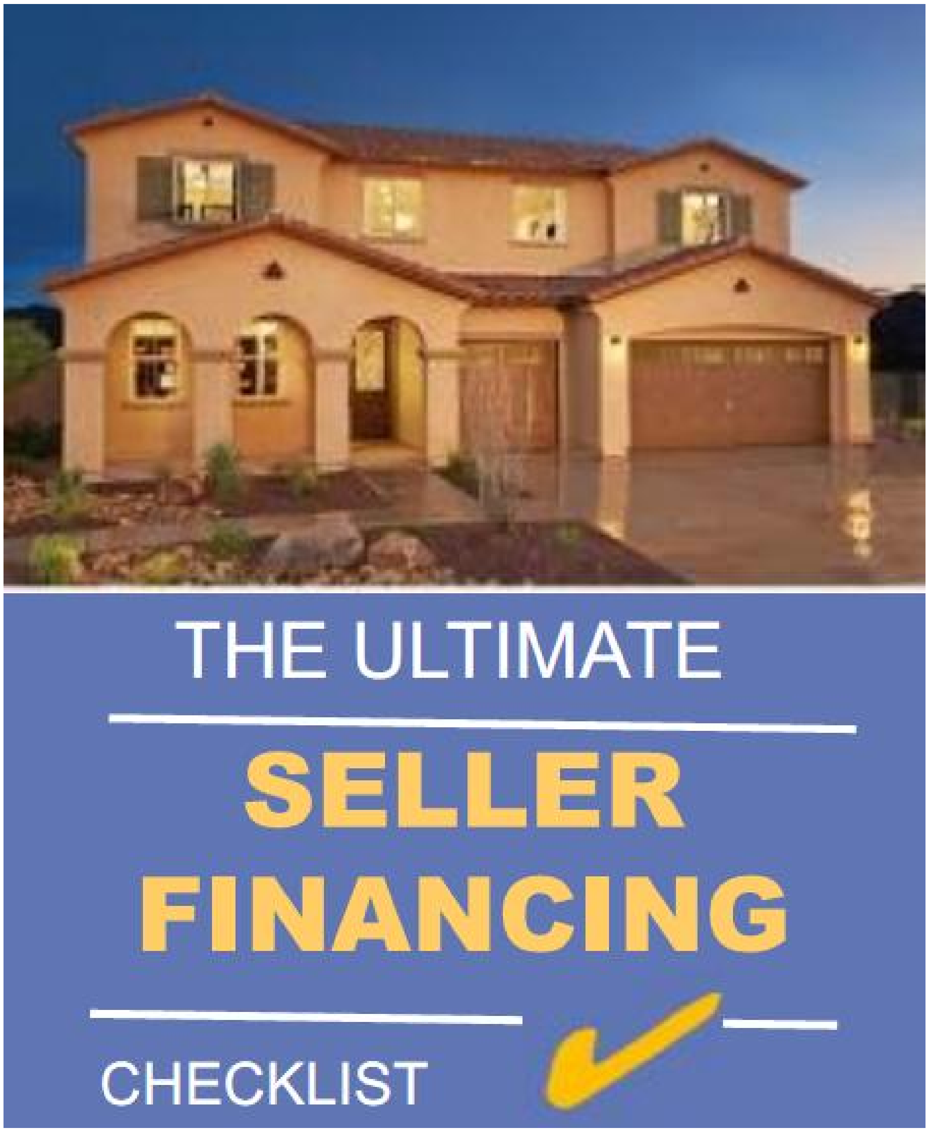
Common Sense Seller Financing Techniques
To Maximize Note Returns



By Dave Franecki
Capstone Capital USA, LLC
888 387 2956
Dave@CapstoneCapitalUSA.com

8 No Nonsense Guidelines!!!

Expect a big pay off on your unpaid principle balance? Even though the note is not structure properly? Unrealistic expectations from the lender will occur when the paper was poorly written. Would you rather have $90,000 to sell your $100,000 note for only $70,000 or less? The difference in usually comes down to the following. Here's the biggest mistakes note sellers make and how to avoid flushing money down the drain.

- **Tip #1- Incorporate the Dodd-Frank - CFPB Guidelines**

The Dodd-Frank legislation was passed on January 10, 2014. It imposes some very stringent guidelines on private lending. Not following those guidelines will leave the original lender and the subsequent note buyer with huge liabilities. This includes balloons, interest rates and qualifying the buyer to name just a few.

- ✓ **The Seller Financing Solution?**

Engage the services of a Loan Originator to create a compliant file which will be the very same documentation required by a traditional lender. Equal to Fannie Mae 1003 Loan Application which will include the 8 items to make a compliant file:

- *Income and Assets*
- *Employment Status*
- *Debt to Income Ratio*
- *Credit history****
- *Monthly Mortgage/Rent*
- *Monthly Mortgage Related Obligations*
- *Monthly Debt Payments*
- *Other Monthly Debt Obligations*

The buyer can and will pay the required fee which could be as high as $1500.

********* *The payer's credit report lets you know how timely they have paid bills in the past. This is a good indicator of how they will pay on a seller-financed note. It also has a huge impact on how much an investor is willing to offer, should the seller ever decide to sell the note payments. Sadly, many sellers never check credit when offering owner financing. Have the buyer fill out a simple one page application that grants permission to pull their credit upfront or ask the buyer to pull their own credit and provide the report. Whenever possible, avoid accepting owner financing from any buyer who is not current with timely payments in the prior 24 months. Blemishes or job situations happen, on going negligence is systemic.*

Good Documentation = Good Loan = Higher Profit

- **Tip #2 – Charging a below market or alternatively a high Interest Rate**

Money today is worth more than money tomorrow. A simple look at escalating food and gas costs will show a dollar today won't buy as much next year or the year after! This concept, known as the time value of money, plays a large role in investor note pricing.

All factors being equal, an investor will pay more for a higher interest rate note. We've seen sellers charge 5% or less on notes. We have also seen interest rates above 10%. Imagine the discount when an investor wants a 10% yield!

- ✓ **The Seller Financing Solution?**

Charge at least two to four percent above the standard bank loan rate for a similar loan transaction—typically 8-9%. Be sure to take into consideration the credit, property type, and down payment, which may justify further increases in the interest rate.

- **Tip #3 – Low or No Down Payment**

The down payment determines how much equity the buyer has in the transaction. The greater the equity, the less likely a buyer will default. There is a reason banks require mortgage insurance whenever a buyer puts down less than 20%! In desperation, some sellers will even accept a zero down payment. Unfortunately, these buyers have even less at stake than a renter. A renter at least has a security deposit along with the first and last months rent!

- ✓ **The Seller Financing Solution?**

Require a down payment of at least 15% to 20% at closing. When little to nothing is invested in property, there is little incentive to "fight" to save the investment. Consider creating 2 notes a 60% first and a 20% second to get a reasonable loan to value. The amount of the down payment should be tied to the credit score of your buyer. Someone with a 750 credit score might be less of a risk than someone with a 550 credit score. RULE OF THUMB: Someone with 650 or below credit score should put at least 20% down. Not demanding a high down payment with low credit is the same tragic strategy that sub prime lenders used. MAKE THE PAYMENTS AFFORDABLE.

- **Tip #4 – Collect Payments Like a Pro**

Sellers tried to save money and collect the payments them self vs outsourcing thus saving one time set up fee of up to \$200 and \$18 to \$15 /monthly which can be paid by the buyer. This lack of payment validation by a 3^{rd} party servicer will give cause for discounting the note value and hurt the buyer when and if they choose to refinance.

- ✓ **The Seller Financing Solution?**

Engage the services of a loan servicing company when the note is originated and have the buyer pay the set up fees and the monthly servicing fees.

- **Tip #5 – Mortgage Balloon Payments**

Ballooning a 1^{st} or 2^{nd} mortgage, with no payments expecting a full payout tries to be a nice guy, with no money down from the buyer, thus creating a 2^{nd}, balloon only to make it easy on the buyer, but creates poorly written paper.

- ✓ **The Seller Financing Solution?**

If you do put a balloon clause in your note, make sure it is not a short fuse. Short term balloons are a foreclosure waiting for a place to happen. Odds are you are going to have to extend and modify the note when the balloon comes due. This in itself can open up another can of worms. For example, if there are inferior liens, and you extend or modify your first lien, does this endanger or change the collateral of the inferior liens? This is a rhetorical question, which is telling you if you have to extend your first lien, get permission from the inferior liens. If you do not, you run the risk of your first lien being converted to a second. It will be simpler to have a balloon of 10 years or so, and not have to deal with the reality that in 5 years, your buyers are not going to miraculously go from a 550 credit score to a 750 credit score, while at the same time the property appreciates 50%. Keep it simple.

- **Tip #6 – No Tax, Insurance or HOA Escrows**

Not requiring the escrowing for tax, insurance or HOA proration and leaving it up to the buyer to pay as when and if………

- ✓ **The Seller Financing Solution?**

Require that the borrower's payments include escrowing for taxes and insurance included with payable to the servicer with each monthly payment just as it would be done in a traditional transaction. Set up an escrow account to collect taxes and insurance included in the payments. If you use this method, be sure to stipulate it in the note. The advantage is you will be assured your insurance and taxes will be paid. The disadvantage is the bookkeeping and accounting necessary to collect and disperse the funds. One solution is to have a note servicing company collect your payments, keep all the records, and disperse funds at the end of the year. This service costs anywhere from $15 to $25 a month, with a set up fee, and can often be passed on to your payor.

- **Tip #7 – Lender NOT listed an Additional Insured at close of escrow**

Not being added as an additional insured is usually an oversight, but can leave a lender up a creek without a paddle.

- ✓ **The Seller Financing Solution?**

Include / require that hazard insurance is placed on the property with you listed as a loss payee. You would be surprised at how many note holders are not listed on the insurance policy. This puts your collateral at risk should the property owner collect damage money on the insurance policy, and not make improvements. Or worse yet, have the property completely destroyed by fire and you not be paid off. In this case you would be the proud owner of a large note collateralized by land only. NOT GOOD.

- **Tip #8 – Obtain both title insurance and a lenders title policy**

By getting title insurance and a lender's title policy, you will not only cut down in the cost should you want to sell your note in the future, but it will also guarantee you are covered should there be any "time bombs" lurking where you buyers owe judgments, IRS liens etc.

- ✓ **The Seller Financing Solution?**

Typically the buyer will pay for the lenders title policy at close of escrow.

A variation of any of above mistakes will result in heavy discounting of the existing note, maybe as high as 50%.

- ✓ **The Seller Financing Solution?**

Sell a(Partial) stream of payments and you as the lender keep the risk. Hold the back end of the note, sell the front 60 payments to free up cash and continue that process.

Other items come into play when valuing a seller financed note ranging from property type, to seasoning terms, to 1st or 2nd position notes.

The lesson, it is best to consult with a note professional before creating the note. Either pay them for the expertise or give them an option to buy the note in the future.

Just remember that when the buyer receives a break, it's coming out of your pocket as the seller!

Safe Seller Financing

These 8 tips for safe seller financing can help protect sellers. They also make the note payments more valuable to a note buyer. After closing, many sellers find they would prefer a lump sum of cash rather than payments over time.

We work with investors that buy real estate notes. If you would like a free no cost analysis of your note, please feel free to contact our office.

Capstone Capital USA
461 W. Apache Trail Suite 66
Apache Junction, AZ 85120
888 387 2956

Dave@CapstoneCapitalUSA.com
www.CapstoneCapitalUSA.com

