THE NOTE OWNER'S HANDBOOK



YOUR GUIDE TO GETTING TOP DOLLAR FOR YOUR REAL ESTATE NOTE

EVERWISE
NOTE BUYER

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The Note Owner's Handbook

Your guide to getting top dollar for your real estate note!

INTRODUCTION

In the past five years, over $100 billion in real estate financing involved a seller-carried note.

These private notes are purchased, sold, and traded every day of the year.

Many people selling these notes don't have all the facts as to what makes their individual note more or less valuable to a potential investor or buyer.

It is not like funders are rushing to educate the note holder on how to get ***more*** money for their note. They are investors, after all – looking for solid investment at a fair price.

That said, the entire process ***does not*** need to be a mystery.

This guide will walk you through the entire process. Who the players are, how pricing is determined, and most importantly, ways you can ***increase*** the value of ***your*** real estate note.

There is not a single downside to having all of the facts. Too many people leave money on the table due to a lack of information. Worse yet, others prey on that lack of knowledge.

Knowing the ins and outs of how notes are traded not only gives you the knowledge to sell your note (if you decide to go that route), but also shows you how to do a better job of ***holding*** the note.

After reading this guide, you will be armed with more knowledge than 99% of all people that have carried back a note. These inside tips and strategies will help you make an educated decision on buying, selling, or holding a note.

Ready? Let's get started....

Tip #1 – Setting The Foundation

When a property is sold and the owner allows the buyer to make payments over time, instead of getting a bank loan, it is known as an installment sale. It's also called a seller carry-back, owner financing, seller financing, or a private mortgage note.

In essence, the seller has agreed to Be the Bank.

"**The 3 Ps**" - people, property, and paperwork – serve as the foundation for both bank loans and private real estate notes.

1. **People** – The property buyer has the leading role since they are the borrower obligated to make the monthly payments. The strength of the payer and their ability to repay will determine the quality of the note. There are additional people involved in a standard transaction that we'll meet in the next chapter.

> "The 3 Ps ***People, Property & Paperwork*** - serve as the foundation of real estate notes.

2. **Property** – The property serves as security for repayment. While homes make up a large part of seller financing, the property could be a rental, multi-family, mobile home, land, commercial property, or a business. The type, location, condition, and value of the property also affect the value of a note.

3. **Paperwork** – The documents are evidence of the debt owed. While this can vary by state, the most common types of paperwork include:

- **The Promissory Note** – The note is the promise and obligation to pay. It outlines the amount due, interest rate, monthly payment, due date, late fees, and any special terms along with what happens in the event of non-payment.

- **Mortgage or Deed of Trust** – This gives the seller (as the lender) a lien against the property. It is the security for repayment and allows the property to be foreclosed upon if the note is not paid. A mortgage is usually used in judicial foreclosure states and a Deed of Trust in non-judicial foreclosure states. It is recorded in the county where the property is located.

- **Land Contract** – This is an agreement to deliver the deed to the buyer after they have paid the debt in full. With a Deed of Trust and Mortgage the buyer receives the Deed at closing and gives back a lien on the property to the seller. With a Contract for Deed, the transfer deed is recorded after payoff.

Tip #2 – Meet The Players

Understanding the players in an owner financed transaction makes for profitable relationships. Here are the primary team members, along with common industry terms.

Seller – Note Holder - Payee: When a property seller accepts payments from the buyer over time using owner financing, they also become the note seller, note holder, or payee.

> “You have to be receiving payments to sell them for cash...

The payee is *receiving payments* on a note or contract. If the payee assigns or sells their rights to future payments to a note investor, they also become a note seller. When it comes to the legal documents the payee is identified as the “Beneficiary” on a Deed of Trust and the “Mortgagee” on a Mortgage.

Purchaser - Property Buyer – Payer - Borrower: The purchaser buys the property from the seller. Unless they pay cash, the purchaser will also become the payer.

The payer is *making payments*. When property is financed with a traditional loan the payments are made to the lender. When the seller finances the property, these payments are made to the seller.

The payer is identified as the “Maker” on a Note, the “Grantor or Trustor” on a Deed of Trust, and the “Mortgagor” on a Mortgage.

Note Buyer - Funding Source - Investor: When sellers prefer cash now instead of payments over time, they can sell their rights to a note buyer or note investor. This funding source can be a financial institution, retirement account, private company, or an individual.

Once the investor buys the note, they notify the payer to now make future payments to the investor instead of the seller.

Note Flipper – Note Wholesaler - Note Finder – Note Broker: When sellers want to liquidate a note for cash, they will often turn to a note professional. Similar to wholesalers or flippers in real estate, they earn a fee to act as a financial matchmaker between the note seller and the note investor.

Professionals and Advisors: Similar to a real estate transaction, the sale of a real estate note can involve a variety of professionals including:

- Attorney at Law
- Accountant or CPA
- Financial Planner
- Real Estate Agent
- Title Company
- Servicing Company
- Self-Directed IRA Company
- 1031 Exchange Facilitator

Tip #3 - The 5 Step Selling Process

Owner financing offers a great strategy for selling property quickly and providing payment terms for a hard to finance buyer or property. It can also provide a great source of income to you as the seller. But times and circumstances are apt to change, leading sellers to want cash now rather than payments trickling in over time.

When a seller desires cash, they can turn to an investor to sell all or part of the payments following these five basic steps:

1. Quote Request – The seller kicks off the process by requesting a quote from an investor or broker. The request is often in response to a marketing postcard, letter, or advertisement. Sellers also search the Internet or ask trusted professionals for a referral.

2. Offer and Acceptance – The initial quote is based on information contained in the Quote Request Worksheet. A review of the buyer's credit by the investor is the first big step in firming up the pricing. Reviewing documents allows the investor to verify the information provided is accurate. Once pricing receives preliminary approval and the seller accepts the offer, a written agreement is prepared and signed.

3. Appraisal and Title - The investor will perform an appraisal, Broker's Price Opinion (BPO), or other evaluation to "Tired of payments trickling in each month? Convert future payments to cash now!" determine the fair market value and condition of the property. A title report is obtained to verify who owns the property along with any outstanding liens or exceptions.

4. Due Diligence – An investor will check to see that real estate taxes are paid current and the property has adequate insurance coverage. The balance will be confirmed, which can include a verifiable payment history and/or a payer interview with estoppel. Once the investor has received, reviewed, and approved all contingencies, the transaction can be scheduled for closing.

5. Closing - The seller delivers the original documents to closing and executes the assignment documents transferring the interest to the investor in exchange for the purchase price.

When the big picture is laid out in 5 easy steps the process appears fairly straightforward. Unfortunately, there are many things that can derail a transaction. The remaining strategies help avoid pitfalls and assure top dollar pricing.

> Tired of payments trickling in each month?
> Convert future payments to cash now!

Tip #4 – The Money Recipe

Have you ever wondered why an investor might offer $97,000 to purchase a $100,000 note but only $80,000 on another note with the same balance?

The price an investor is willing to pay depends on the yield or return on investment they want to realize in combination with the perceived risk. While many factors influence price, there are five ingredients that are essential.

1. Equity
The more a buyer has invested in the property, the less likely they are to quit paying, go into foreclosure, or just walk away from the property. Ideally, you would like to see 30% equity or down payment, but realistically it will likely range between 10-20%. Much less than 10% and investors will severely cut the investment to value, limit to a partial purchase, or decline altogether, depending on credit.

2. Credit Rating
The credit report reflects the buyer's past payment habits making it a good indicator of how timely they will pay the seller. With the subprime mortgage crisis, investors prefer a score of 675 or higher but will consider lower depending on equity and seasoning.

3. Note Terms
A higher interest rate and shorter term generally make a note more valuable. Ideally the rate for seller-financed notes should be 4-6 percent higher than traditional bank loans. That puts an ideal interest rate between 8-10% for a standard residential note based on today's market (higher for commercial or non conforming properties).

A monthly amortizing payment is preferred over interest only payments since the buyer is building equity through amortization. While 30 years is most common, a 15 to 20-year amortization can shorten the term to help maximize pricing.

> "Many of the pricing ingredients were added to the note when it was created!

4. Property Type
The type of property that serves as security for the note also impacts risk. Generally, investors prefer an owner occupied home above a rental, residential to commercial, stick built home over mobile home, and improved property over vacant land. The greater the perceived risk the lower the pricing and exposure offered by an investor.

5. Seasoning
Rather than a cooking spice, seasoning refers to how long the buyer has been making payments. The general rule of thumb is the longer the better, with 12 months or more optimal. That is not to say that a note won't be sold unless there is a lot of seasoning. It just means the investor will be looking at other variables of the deal that minimize risk.

Tip #5 – Package Like A Pro

If you desire top dollar pricing for note payments start by gathering the information and documentation an investor will want to consider before making an offer. Ideally, a note investor would like to see the following to make an informed quote:

- Quote Request Worksheet
- Copy of the Closing Statement or Hud-1 Settlement Statement
- Copy of the Recorded Mortgage, Deed of Trust, or Real Estate Contract
- Copy of the Note (might not apply with a Real Estate Contract)

A sample Quote Worksheet has been provided at the end of this guide. An investor might have a specific form or gather the information online, but the basic information requested will be similar.

- **Contact Information** – How to reach the party requesting the quote
- **Property Information** – The type of property including current value, location, building size, improvements, acreage, zoning, occupancy, and any unique characteristics.
- **Historical Information** – The sale price, down payment, and financing arrangements used when the seller sold to the buyer with owner financing.
- **Note Information** – The terms of repayment including interest, payment amount, current balance, and remaining term.
- **Payer Information** – Buyer contact and credit information
- **Other Lien Information** – List any other liens on the property. Money still owed by the seller on the property is paid from proceeds at closing
- **Reason for Selling** – This lets the investor know how to best structure the offer to meet the seller's needs.
- **Type of Quote** – The investor generally pays the costs on a retail quote while the seller or broker covers costs on a wholesale quote.

> Grab attention! Provide copies of documents with the quote request.

It should go without saying that the investor quote is only as accurate as the information provided. If there is something unusual be sure to include in the comment section. For instance, if the buyer missed a payment two months ago let the investor know upfront. It will all come out during due diligence anyway, so it's better to get off to the right start.

Many investors will provide no obligation pricing based on just the worksheet information. Just know that you grab an investor's attention when the copies of the documents accompany the worksheet. It shows you're serious about doing business and provides the investor what they need to start the preliminary approval process and payer credit review.

Tip #6 – Getting A Firm Offer

Wonder whether you are receiving reliable pricing when submitting a quote request worksheet to a note investor? Here's how to know if it's a firm offer or just a soft quote when going to sell a note.

A soft quote generally refers to an initial offer made by an investor without review of the payer's credit. Credit plays a crucial role in pricing for both yield and investment to value (ITV) parameters. A quote without a credit review will likely be revised when credit is actually reviewed.

A soft quote is normally provided when only a Quote Request Worksheet is submitted without any supporting documentation. When there is no legal ability to pull credit and no indication of the payer's credit status, the investor will normally assume the best. The quote will be "subject to review of credit – assumes good credit" or "assumes a credit score of 675 or higher." This assumption will be incorrect and too high at least 80% of the time. That means there is a high likelihood the offer will go DOWN when credit is reviewed.

> "Assuming good credit just sets a deal up for pricing adjustments later!

The best solution is to receive a firm quote by submitting sufficient documentation for the investor to pull and review credit on the payer. Each investor sets their individual criteria for the minimum documentation required to pull credit. Most will pull credit with either an authorization signed by the note holder or a copy of the note and mortgage. The copy of the Closing Statement is also useful to verify sale price and down payment.

A firm quote is still subject to the remainder of due diligence items, but pricing should not change unless the property value comes in low or subsequent documentation does not support the information provided on the worksheet.

A firm quote should indicate, "Credit reviewed with pricing" and "subject to standard due diligence and underwriting review of documentation."

Quotes are generally returned within 24-48 hours or the next business day. The quote should come back from the investor in writing via e-mail and is normally good for 30 days. If the quote has not been formally accepted within 30 days, it might be subject to change in the event the investor's pricing model or cost of funds have altered. Some investors will also require a new credit pull after a certain period of time (generally 60 days), which could also cause a pricing adjustment if credit has worsened resulting in a lower credit score. By gathering accurate information and basic documentation upfront sellers can receive a firm offer.

Tip #7 – Balancing the Scales

Seller financing is often used because the transaction fell "outside the box" of conventional mortgage underwriting guidelines. There might have been an issue with the buyer's credit, the down payment amount, or the property. Sometimes the buyer and the property might qualify for financing, but the seller desired a quick sale, interest income, or an installment sale for tax reasons. However, many transactions will not be ideal in every category affecting pricing.

One area that is frequently overlooked by sellers is the current credit rating of the buyer. The investor will check the buyer's credit (not the seller's credit) so it pays to know the status before selling the note.

Sellers often wonder how they can pull the buyer's credit. This is traditionally done by creditors through one of the three credit reporting bureaus: Equifax, Experian, or TransUnion LLC.

The majority of note buyers will pull credit upon receipt of a copy of the existing signed note although some may want an authorization from the seller stating they are an existing creditor.

The Federal Fair Credit Reporting Act sets permissible purposes for obtaining and using a credit report. To paraphrase, it allows existing creditors and those that intend to use the information as a potential investor of an existing credit obligation to receive and assess a credit report. On an existing note, most legal professionals recognize the seller as an existing creditor and the note buyer as a potential investor. (Visit www.ftc.gov for more information).

To pull credit the seller or investor will provide the name, current address, and social security number (SSN) to the credit bureau. If the SSN is not available, they can try to pull without it. It also helps to have a prior address if the buyer recently moved.

> Strong equity and seasoning can help offset poor payer credit.

Once credit is obtained the report is reviewed along with the credit score. Credit scores range from 300 to 850 with a score of 720 or higher being most favorable for traditional mortgages.

If the score is lower an investor will start balancing the scales, weighing the positives against the negatives. If credit is poor it can be offset by strong equity. Substantial seasoning with proof of timely payments is also helpful.

When all five qualities of credit, equity, note terms, property, and seasoning are negative an investor will be hard pressed to make an offer. A transaction should have three to four positives to tip the scales in favor of a purchase.

Tip #8 – Only Two Degrees of Separation

When you buy something direct from the manufacturer you can usually receive a better price by avoiding distributor markups. It is similar when selling a note. It makes common sense that the closer you are to the source of funds, the fewer the number of people taking a piece out of the middle, the better the pricing.

However, there are times it makes sense to work with a third party note broker or consultant.

There are some large note investors that do not advertise directly to note holders. They could require any new transactions to come in through an approved broker or master consultant. On the positive side, there might be wholesale or improved pricing available due to the volume of repeat business they can bring to the investor. Keep in mind that if you are the seller "going it alone" you do not have a seasoned professional guiding you through the maze of investor requirements. It is similar to selling your house without a real estate agent. You can save the 3- 6% real estate fee, but you won't have access to the MLS, professional networking, and experience a qualified real estate agent brings to the table.

> "Travel the shortest distance between note seller and funder for better pricing and faster service."

The first important step is to identify whether you are dealing directly with the funding source or with a broker. Ultimately, the one controlling the checkbook will be underwriting, approving, and funding the note purchase. A professional and seasoned broker will be happy to let you know whether they are buying the deal themselves or referring to a qualified investor.

Collaboration is often necessary to access a unique source of funds or knowledge base. Just be careful to avoid a daisy chain of brokers and that each party is contributing something of value in exchange for their portion of the fee.

The investor customarily pays the fees earned by note brokers once a note purchase is completed. This might be a set dollar amount, a percentage, or a deduction from the price quoted by the investor, depending on the referral relationship with the investor. There are also note brokers willing to work for a set fee paid directly by the seller, providing for full transparency of the investor's funds. Be sure to clearly understand how everyone is expecting to get paid to avoid any surprises.

Tip #9 – Time Really is Money

We've all heard the phrase "Time is Money". But what does it really mean and why does it matter in the discounted note business?

Money today is worth more than money tomorrow due to its ability to earn interest. The Time Value of Money concept puts a price on the amount of time an investor has to wait for an investment to mature.

When making an offer the investor will use a mathematical formula to apply the desired yield to the note terms. To illustrate we'll use a note with a balance of $100,000 at 8% interest with 360 payments of $733.76 per month.

If an investor desired an 8% yield or return on investment, they could theoretically pay $100,000 for the note. This would be equal to 100% or 100 cents on the dollar.

However, notes are typically bought at a discount due to costs and the desire to earn a return that is higher than the note rate.

If an investor expected a 9% return, then the purchase price would be $91,194 for the $100,000 balance. This can be expressed as 91% or 91 cents on the dollar.

> "Money today is worth more than money tomorrow

Here is a look at what an investor would pay at varying rates of return for the same note:

N = # Payments	I = Interest	PV = Present Value	PMT = Payment	Price %
360 months	8%	$100,000	$733.76	100%
360 months	9%	$91,194	$733.76	91.19%
360 months	10%	$83,613	$733.76	83.61%
360 months	11%	$77,050	$733.76	77.05%

*PV reflects purchase price and is rounded up to next whole dollar

Notice that 1) when the yield and note rates are closer together the result is a smaller discount, and 2) as the yield goes up the price goes down.

The note terms, desired investor return, and the time value of money help determine the purchase price offered by an investor in combination with Investment to Value (ITV) limitations.

Tip #10 – The Two Most Important Acronyms

You've probably heard a lot of acronyms thrown around in the note industry. Two of the more important ones related to pricing are the LTV and ITV.

Loan to Value (LTV)
The LTV percentage determines "What is the likelihood the payer will continue to make payments based on equity?"

LTV is the balance of all loans divided by the property value (not sale price). For example, if a property is worth $100,000 and the payer owes $80,000, the LTV would be 80% (80,000 divided by 100,000).

The flip side of LTV is equity. Just subtract the LTV from 100 resulting in 20% equity for this property. The more equity a buyer has the less likely they are to quit paying or just walk away from the property. The buyer has something to protect.

Investment to Value (ITV)
The ITV percentage determines "What is the likelihood the investor will get their money back in the event of a default?"

ITV is the invested amount divided by the property value. For example, if an investor paid $75,000 for an $80,000 note and the value of the property is $100,000 then the ITV would be 75% ($80,000 or 80% is actually the LTV). Investors will also take into consideration any senior liens.

The LTV is already established so the only thing a note investor can control is their ITV. If a transaction has a high LTV an investor might try to lower the risk or ITV by reducing the amount funded.

The property type and the payer's credit greatly influence the maximum ITV an investor will consider. For example, an investor might be willing to invest up to 75-80% on an owner-occupied home if the payer has good credit. However, if the credit is challenged the ITV might be lowered to 70%, 60%, or even 50% of the property value.

If an offer is severely lowered due to an ITV issue the seller does not have to sell all the payments. It often makes more sense to consider a partial purchase then sell all the payments at a large discount.

> LTV is the likelihood payments will continue while ITV is the likelihood an investor can recoup their money.

Tip #11 – Reducing Discount With Partials

Before making a big purchase, smart shoppers will research the different options and compare costs. Many note sellers are familiar with selling all their payments, but some are not aware there are more choices.

The two main options are between a full and a partial purchase. If a note has 360 payments left, a full purchase would have the investor buying all 360 while a partial purchase would entitle the investor to something less.

A partial is just buying a portion and a full is buying it all.

A partial purchase can be structured in a variety of ways. Here is one example of this strategy in action.

A note has a balance of $100,000 at 8% interest with 360 payments of $733.76 per month.

An investor offers to purchase the next 180 payments of $733.76 for $66,379.

After the investor receives the amount purchased, the note is assigned back to the seller. Assuming the property buyer paid according to the note, the approximate balance at the time the note is reassigned would be $76,783.

So, the seller receives $66,379 for selling 15 years of payments to the investor ***and*** the seller gets the note back with a $76,783 principal balance and 15 years of payments still owed by the buyer. There are many benefits to a partial purchase. It allows a seller to only sell as many payments as necessary to raise some cash and keep the rest earning interest. The discount is minimized because the payments due sooner are worth more to an investor.

Partials are also good for investors since they reduce the cash amount advanced at closing, reducing risk and exposure. This is especially helpful when there are challenges to the transaction, including a small amount of equity or a payer with weak credit.

When working with partials it is important to fully understand the partial agreement. It outlines everyone’s rights and spells out what happens if the note pays off early or if the buyer stops paying all together.

Tip #12 – Sweat the Small Stuff

Before a note investor will pay cash to a seller for future payments, they perform what is called “due diligence.” This is really just a fancy word for research. You can simplify the process by being prepared for these common note investor requirements.

When an investor makes an offer to purchase a note, mortgage, deed of trust, or real estate contract, it is subject to underwriting and due diligence. This enables the note investor to verify the information provided, analyze the risk, and confirm pricing.

During the due diligence process investors remove any rose-colored glasses. Each detail is carefully reviewed and verified. If there are flaws, they will be discovered. It creates good will plus saves time, trouble, and money by telling an investor of any known problems upfront.

Here are the most common items an investor will require as part of due diligence prior to closing:

- Review copies of legal documents (Settlement Statement, Note and Mortgage, or Deed of Trust, Contract, etc.)
- Credit report on Payer/Buyer
- Current real estate taxes
- Proof of current hazard and fire insurance
- Payment history & verification of current balance
- Title Insurance Policy or Commitment
- Payoff statements for any property debts still owed by seller
- Current Property Value & Photos (Drive-by Appraisal, BPO, etc.)
- Payer Interview or Estoppel
- Additional items unique to the transaction

> “Due Diligence is the investor’s fancy word for research and verify.

The seller usually starts the process by providing copies of the existing legal documents to the investor. The investor will generally handle the remaining items, requesting additional information or document copies as necessary.

Many investors will cover the cost of due diligence, but policies can vary so be sure to verify. The option or purchase and sale agreement will outline this important information.

Tip #13 – The Purchase Agreement

Congratulations, you've received an offer for an acceptable price! Now what? The next step is to enter into a written agreement that spells out the terms.

All note purchase agreements will outline the parties participating, item for sale (Note and Mortgage, Note and Deed of Trust, or Contract), and a description of the property. Here are some other important clauses that should be included to avoid any confusion:

Price - The amount the investor will pay for the note at closing should be clearly stated along with the corresponding principal balance, interest rate, and remaining payments.

Purchase Type – A full purchase is fairly straightforward while a partial purchase is quite involved. Agreements may contain certain representation and warranties and whether the purchase is with, or without, recourse on the seller.

> "Demand offers in writing and read the fine print before signing an agreement!

Contingencies – Look for any items that must be completed prior to closing. These will often include a title report, appraisal, verification of current taxes and insurance, and payment history. If credit has already been reviewed and approved, make sure it is not listed as a contingency.

Covering Costs – There will be costs associated with title, appraisal, recording, and closing with the agreement indicating the party responsible for paying. If the investor is not paying these costs, you can ask for a cap or limit.

Cancellation Penalties – Find out if there are any fees for canceling the deal. It makes sense for an investor to recoup their actual expenses, but high cancellation penalties should be avoided.

Time Limitations – The agreement should have a time limit so if the transaction doesn't close the seller is free to sell the note somewhere else. A 90 day right to purchase is fairly standard.

Payment Adjustments – If additional payments are received before closing, the purchase price will be adjusted according to the contract. Ask for a copy or sample of the final closing agreement. This might differ from the initial offer agreement. Whenever entering into an agreement be sure you fully understand the terms before signing or seek the help of competent counsel.

Tip #14 – Invite The Buyer To The Party

Should you let the buyer of the property know that their owner-financed note is being sold to an investor? While the answer can vary depending on the deal, it is generally a good idea to let the buyer know what is going on. First, it is common courtesy to let the buyer know that their note is being offered for sale. Start with assuring the buyer that nothing will change for them except where they mail the monthly payments. The existing note and mortgage are legal documents so they can't be changed without both sides agreeing in writing.

Next, it is a good time to verify the buyer's contact information and any missing items such as where they have their fire and property insurance coverage. It is also likely that a potential note investor will contact the buyer prior to purchasing the note. Referred to as a buyer interview or payer estoppel, this helps let the investor know if the buyer is happy with the property, comfortable with the monthly payments, and other relevant information. A buyer is likely to be more cooperative if they know the investor contact is coming rather than receiving a call out of nowhere from a potential investor.

> "Offering the buyer a discount for paying their note off early can save money.

Finally, letting the buyer know of plans to sell the note can also be a good financial strategy. There are some buyers that are able to obtain refinancing and payoff the note. You can then receive the full amount due rather than a discounted price. It might even make sense to offer the buyer a discount if they pay off early, provided that discount is less than what an investor will want. Just be sure to put a time limit on any offers to the buyer for a discounted payoff or it can cause a potential problem or price reduction if the seller later decides to sell the note to an investor.

There have been rare occasions where a spiteful payer will try to discourage an investor's purchase without good cause. Experienced investors will know how to sift through any payer objections. Generally, all parties benefit from open communications.

Tip #15 – Property Value Still Matters

The current condition and value of the property will play a role in the investor's approval and pricing of a note purchase. While the investor is purchasing the note and not the property itself, it is the property that serves as security for the note. This means that if the buyer quits paying on the note the investor can foreclose and take back the property.

The investor will likely want to perform a drive-by appraisal ordered by their office to find out the current condition and fair market value of the property compared to other recent sales in the area. While you won't be able to influence the appraisal results, you can take a few easy steps upfront to alleviate any surprises later.

If you live near the property take a drive by to observe how well the buyer is caring for the property. Look to see how the yard, paint, roof and other areas are being kept. Does it show pride of ownership or appear ran down? Take a couple of quick pictures that can be provided to the investor when submitting the document package. If you don't live in the area, consider asking a local real estate agent or home inspector to complete this task for a reasonable fee (usually under $100).

> "Avoid surprises by knowing the current property value.

Next perform some research online to determine the approximate value of the property. While not 100% accurate, online sites like www.zillow.com or www.trulia.com can help estimate a value range for the property. It will also indicate whether values have gone up or down since the property was sold. A search of the county appraiser's website can also show how properties are selling in the area. If there have been changes in the economy, you might discover a property has actually decreased in value since the sale. If this is the case, then an investor will base their pricing on current property value when calculating the buyer's equity and the investor's investment to value.

While a buyer might have had a 10% down payment when buying the property, they could conceivably owe more on the note than the property is worth if the values went down by 10% or more. When this happens, a Funder is likely to limit their investment to a partial purchase or they might decline altogether. It is far better to know this and be prepared for the outcome when submitting the deal to the investor. It also shows the investor you are knowledgeable, realistic, and up-to-date on current market conditions.

Tip #16 – Verify The Payment History

To improve the value of a note, there should be a verifiable payment history. Unfortunately, many sellers fail to keep track of the payments received from the buyer. Without any proof of payments, an investor has to go on faith. There are two main ways to verify a payment history. The first and easiest is to let a professional handle it. The buyer makes the monthly payments to a third-party servicing agent that keeps track of the balance and sends the money along o the seller. They also provide the annual 1098 Mortgage Interest Statement and can hold original documents in safekeeping. The second method is for the seller to carefully track payments received directly from the buyer. If a seller chooses the “Do It Yourself” method over a third-party pro they will need to follow these steps:

> “Providing proof of past payments makes a note more valuable to investors.”

- Make a copy of each check or money ordered received (accepting cash is not recommended as the lack of paper trail makes it hard to verify).
- Keep a copy of the bank record of deposit for the payments received.
- Create a ledger reflecting the date and amount of payments received.
- Calculate the amount applied to interest, principal, late fees (if any), and the resulting principal balance. An amortization schedule or financial calculator can be helpful. Once calculated, record in the ledger or spreadsheet.
- Send out an annual statement to the buyer or payer along with the IRS 1098 Mortgage Interest Statement.
- Send collection letters as necessary for late payments, delinquent real estate taxes, or lapsed insurance.

Sometimes a payment history affidavit created from the seller’s memory can substitute for a payment record, but it still doesn’t add the value of verifiable proof. Even a copy of the most recent payment is better than nothing. Protect the value of the note by setting up a verifiable payment tracking method today!

Tip #17 – Track Taxes and Insurance

Next to delinquent payments, the most common default by buyers is failure to keep the property insured and the real estate taxes current. In fact, many buyers will make their monthly note payments but fail to pay the insurance premium or real estate tax installment.

Sadly, a lapse in insurance can be devastating to both the buyer and the seller. If the property burns down and is not insured, the seller will probably never see another payment from the buyer. Even worse, there will not be a property to take back for non-payment.

If a buyer fails to pay the real estate taxes for long enough the county can actually foreclose on the property. In most states, the lien for county taxes even takes priority over mortgage note holders, leaving an unsuspecting seller high and dry.

A note investor knows these risks well and will want to verify the taxes and insurance are current prior to purchasing the note, mortgage, trust deed, or contract.

It is fairly simple to verify whether taxes are current by contacting the county tax assessor using the property address or tax parcel identification number. This can be done with a phone call, a visit to the county tax assessor, or online.

To verify fire insurance the investor will ask for a copy of the declaration page showing the buyer as the insured owner and the seller as the insured mortgagee. They might also call the insurance company to verify the policy is current and the annual premium has been paid. If the seller does not have this information, it might become necessary to contact the buyer to find out where they are carrying insurance. Proof of insurance is not required on a land only transaction.

> “ Failure to keep real estate taxes and insurance current are common defaults that lower value.

Most documents require the buyer to keep taxes and insurance current and failure to do so qualifies as default under the note. Sellers can demand the default is immediately cured or start foreclosure. Sellers as lien holders may also elect to pay the delinquent amount to protect their interest and add back to the amount due, depending on the terms of the actual note, mortgage, deed of trust, or contract.

Some sellers prefer to avoid the headache by setting up reserves through a third-party servicing agent. This way the buyer pays an amount equal to 1/12th the annual amount for taxes and insurance establishing an escrow reserve account from which the bills can be paid.

Tip #18 – You CAN Judge a Note By Its Title

A tile policy insures ownership of the property and validity of liens. A note investor will first look to see if title insurance was obtained when the property was sold and financed by the seller. If there is an existing Mortgagee's Title Policy insuring the note holder, they usually just order an update.

Not sure if this policy exists? Simply look at the Closing Statement or HUD-1 Settlement Statement to see if there were charges at closing for both an Owner's Policy and Mortgagee's (or Lender's) Policy. To save time and money, provide a copy of the policy to the note investor with the documents.

A new commitment and policy will be required if lender's coverage was not obtained at the time the property was sold. This additional cost is often passed on to the seller. Here is a quick overview of how the title insurance process works when selling a note, understanding it can vary by state.

Title Commitment and Search
The title or abstract company will first search the ownership history of a property. Referred to as the chain of title, they are looking to see that there was a valid Deed recorded at the county from each owner to the next. If there are any breaks in the chain of title they show as exceptions. The search also looks at any encumbrances, loans, easements, right of ways, or other claims to the property. The results are issued in a commitment for title insurance along with requirements for insuring the new transfer.

Owner's Title Policy
The Owner's Title Policy is in the amount of the property sales price and insures the new owner is vested in fee simple title to the property through a Warranty Deed or other valid deed. If any prior owner, lender, or other party makes claim to the property and it was not reflected on the title policy then the title insurance company must pay a claim to the insured owner up to the amount of the policy. A one-time premium is paid based on the amount of insurance or sales price. If the owner financing involves a Real Estate Contract, Contract for Deed, or Land Contract the investor will always require a new title commitment and owner's policy. An investor will desire the Mortgagee's or Lender's Policy when the transaction is a Note and Mortgage or Note and Deed of Trust.

Mortgagee's or Lender's Title Policy
This policy insures the lien position of a note holder as evidenced by a Mortgage or Deed of Trust. This could be the bank or the seller in the case of owner financing. The policy is issued for the amount of the note. The cost is nominal, generally between $100-$200 if the policy is issued simultaneously with the Owner's Policy. The full premium will likely apply if issued at a later date.

Tip #19 – Safeguard Your Original Docs

Where in the world is the original promissory note? This important legal document should be kept in a safe place, and here's why!

The note is a promise to pay or IOU from the buyer, spelling out the amount and terms of repayment. In legal jargon, it is known as a negotiable instrument. Similar to a check, the original must be presented to collect or prove ownership. The investor will ask for a copy of the note upfront with the original provided at closing.

An investor may also request the original recorded mortgage or deed of trust at closing. However, if this original is lost, an investor will usually accept a certified copy from the county recorder's office.

The original promissory note is endorsed over to the investor at closing. Common endorsement language reads: "Pay to the order of, (Insert name of investor), without recourse." The seller then signs and dates. Sometimes the note endorsement is executed on a separate piece of paper to be attached to the note, also called an allonge.

Be wary if an endorsement states "with recourse" or fails to state, "without recourse." This indicates the investor could require the seller to repay the note in the event the payer defaults or fails to make payments.

A lost original note, on the other hand, can cause problems. If the original note becomes lost an investor may ask for a duplicate or replacement note to be signed by the payer or maker. This means going back to the person that owes money and asking them to resign, causing possible delays depending on their level of cooperation.

> **Safeguard the original note to prove ownership.**

The investor will also likely require a lost note affidavit from the seller stating the note has been lost and it will be presented if found at a later date. Some investors will consider accepting just the seller's lost note affidavit with a copy of the original note.

The best option is to avoid losing the note by keeping it in a safe deposit box or a fire and waterproof safe. Some sellers elect to have the original held by a third-party servicing agent for safekeeping. If this is the situation find out whether the investor will want the note released at closing. Whatever the method, be sure the original note is kept in a safe place that is easily located!

Tip #20 – Play "Outside" at Closing

When it comes time to officially close the transaction and exchange money for documents, be sure to use the protection of a closing agent. When an investor has performed their due diligence and is ready to purchase the owner financed note they will ask the seller to deliver original documents and sign the assignment package. The investor will want these original documents before the funds are released to the seller. As the note seller you are wondering "How do I know I will ever receive my money once I turn over the documents establishing ownership?" So, the investor wants the documents before the money is released and the seller wants the money before the documents are released.

Using the services of an outside closing agent easily solves this impasse. The outside closer will act as an independent third party (or fiduciary) protecting the interests of both parties.

> "Don't transfer the note and hope for payment. Require an outside closing to handle the exchange of original documents for money.

An outside closing is basically an exchange of money for documents. The outside closer will receive the proceeds from the investor into their trust account and also receive the documents from the seller. It is not necessary for either the investor or the seller to physically be present for the note closing with the use of overnight delivery and wire transfers.

The fee for an outside closing will average $200-$400 and can be paid by either party or split equally. Most title companies, real estate attorneys, or escrow agents will offer these services. They may even reduce or waive the fee if other services, such as title insurance, are being purchased through their office.

Unless the note seller and investor can meet face to face to exchange documents for certified funds, a note seller should demand an outside closing. If an investor hesitates, simply offer to pay the nominal fee. If they still refuse it is a sign of a serious a problem.

Any legitimate note investor should be willing to participate in an outside closing through a licensed and bonded closing agent. Outside closings are common practice, offering protection and peace of mind to both note sellers and the note investors.

Tip #21 – Become A Super Star Note Seller

Ready for some advanced strategies? Use these insider secrets for stellar pricing performance:

1. **Payment Adjustments** – If note payments are received and retained by the seller prior to closing it is reasonable for the investor to adjust the original offer. After all, the investor is now buying a smaller balance and fewer payments so some reduction is in order. It is industry practice for brokers and investors to simply deduct the full amount of each payment received from the purchase price. This is in their favor, as the principal balance does not go down by the full payment amount. If you want to put a few extra dollars in your pocket ask the investor to adjust by either 1) principal only; 2) yield, or 3) the same cents on the dollar figure applied to the new principal balance. Most investor will use one of these methods when asked; they just might not offer it up front.
2. **Recast Note** – If a note has unfavorable terms, such as a short-term balloon, it can be beneficial to the seller and the payer to modify the note terms. If a term is excessively long, show the buyer how much money they can save by paying a little extra each month.
3. **Improve Credit Score** – If the buyer has a poor credit score that is severely impacting price it might be better to wait on selling the note. In the meantime, approach the buyer on working to improve their score. This might help the buyer to refinance into a lower rate in the future. Consider working with a credit-reporting bureau to report the payments received on the seller financed mortgage note. Timely mortgage payments can quickly improve a buyer's credit rating.
4. **Interior Appraisal** – If the buyer has made improvements to the property that might not show on a drive-by appraisal consider providing an interior appraisal. This will take the cooperation of the buyer so the appraiser can gain access to the inside of the property. Most buyers will cooperate if they are offered a copy of the appraisal at no charge once completed. If interior improvements have been made the value could be higher than the sales price and potentially increase the offer.
5. **Flat Fee** – Ask a note broker or master consultant to work on a flat fee basis or a percentage basis. This fairly compensates the note broker but avoids the possibility of large undisclosed fees. Most brokers earn income by deducting their fee from the investor's offer before making the offer to the seller.

Congratulations! You have completed this note selling guide. Start using these tips today to receive top dollar pricing by contacting our company for a no-cost analysis. Use the enclosed worksheet or just give us a call. We are here to help!

Appendix – Quote Worksheet & Transaction Checklist

The following pages include a Quote Request Worksheet and a standard Transaction Checklist.

Quote Request Worksheet

Contact Information
Name ..... Date.....
Company .....
Phone ..... Email .....

Real Estate Information
Street address ..... County .....
City ..... State ..... ZIP.....
Current estimated value $ ..... Based on.....

☐ *Residential Type* ☐ Single-family ☐ Mobile Home & Land
☐ Multi-family (2-4) ☐ Mobile Home Only
☐ *Occupancy Type* ☐ Owner-occupied ☐ Rental ☐ Vacant
☐ *Commercial* (Type) .....
☐ *Vacant land* (Acreage & Improvements) .....

Description of Property & Area.....
.....
.....

Historical Information
Date of sale .....
Selling price .....
Down payment .....
First lien .....
Second lien .....

Prior Mortgage Information ☐ Yes ☐ No
(If yes, please state amount & terms)
.....
.....
.....
.....

Note Information
Date of note .....
Amount .....
Term in months .....
Payment amount .....
Balloon amount .....
Balloon date .....
Interest rate .....
Due date 1st pmt .....
# of pmts paid .....
# of pmts left .....
Next pmt due .....
Balance .....

Payer Information
(Name, address, SSN, or credit information)
.....
.....
.....
.....

Seller's Motivation
.....
.....
.....
.....
.....

Quote Requested
☐ Referral ☐ Retail ☐ Wholesale

Buy Total Note .....

Buy _____ pmts for .....

Buy _____ pmts for .....

Closing costs paid by .....

Quoted by .....

OWNER FINANCED NOTE

TRANSACTION CHECKLIST

QUOTE REQUEST

- INFORMATION WORKSHEET
  - Terms of repayment
  - Description and address of the property
  - Payer Information (Name, address, and SSN)

The following items are standard information and documentation for the purchase of a private mortgage. The seller provides copies of existing documents while the note investor will generally handle the due diligence and closing documents

PRELIMINARY APPROVAL PACKAGE

- SIGNED OPTION/PURCHASE AGREEMENT
- CLOSING STATEMENT
- RECORDED SECURITY INSTRUMENT (Deed of Trust, Mortgage or Contract)
- SIGNED NOTE (If Deed of Trust or Mortgage)
- PAYMENT RECORD (pay history, cancelled checks, deposit slips, amortization schedule)
- TAX AND INSURANCE INFORMATION
- PICTURES (If available)
- COPY OF PREVIOUS TITLE POLICY (If available)
- COPY OF MOBILE HOME TITLE (If applicable)

FINAL APPROVAL PACKAGE

- ORIGINAL APPRAISAL (Acceptable format from an approved provider)
- ORIGINAL NOTE WITH PROPER ENDORSEMENTS
- ORIGINAL RECORDED SECURITY INSTRUMENT (Or a county certified copy)
- NEW TITLE COMMITMENT OR EXISTING LENDER'S POLICY
- VERIFICATION OF ACCOUNT
  - Seller Collected - signed payor estoppel or proof of delivery
  - Servicer Collected - Verification of Account, Authorization, & Transfer Package
  - Pay History (copies of checks, money orders, bank deposit statements, etc)
  - Verbal Debt Verification
- OTHER DOCUMENTATION (As requested on the Closing Review Checklist/Approval Form)
- CLOSING INSTRUCTIONS (Place, scheduled date, and wiring information)