Self-Employment & The Private Mortgage Industry

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Dedication

This book is dedicated to those insightful individuals who recognize and seek out self-employment as the means to achieving their ultimate career goals. Their individual dreams embody the future of the American enterprise system.

Table of Contents

Introduction

It's no secret: Self-employment may very well be the only way to achieve financial success and independence in the United States today. This book will show you how it is both possible and profitable for anyone to become successfully self-employed, if they are willing to work hard, educate themselves in a solid business and choose that business carefully.

As you look at your employment options, it is increasingly apparent that the corporate guarantees of previous generations no longer exist. With the frequency of takeovers and downsizing, increasing trends toward scaled-back benefits and nonexistent retirement plans, there is no security in working for someone else. Corporations no longer offer the career paths that made it possible for our parents to be successful.

Today, Americans intent on building a future with a successful business are realizing that self-employment may be the only way to achieve financial security and personal gratification.

If you have come to that realization for yourself, you are not alone. Almost everyone with good instincts and the spirit of self-reliance understands the power of being in control.

For most people committed to self-employment, the big stumbling block is, "What kind of business should I start?" Gone are the days when the family trade was learned at an early age and the business was passed on from generation to generation. Today, parents and children alike are frustrated because there is no clear-cut destiny, no legacy to be passed on. So, which direction do you choose for success?

My own experience with starting and running more than 45 businesses in the past 20 years has shown me two things. First, people feel frustration as they are drawn to self-employment, but don't know what to do. Second, I have learned how anyone with entrepreneurial drive can take a real, solid business and make it work. Often the only stumbling block between frustration and success is finding the right business and training ground.

My personal mission in life is to empower adults to become successful and effective in their lives. I've done this already, through appropriate training programs, for several thousand new entrepreneurs, and I plan to do it for thousands more.

By profession I'm an attorney, but at heart I'm an entrepreneurial educator. At the age of 30, after building my business portfolio to include real estate investments, a chain of nine sporting goods stores, the largest institutional athletic distributorship in the state of Florida, and a multicity commercial law practice, I set out on the financial lecture circuit to teach Americans how to become successful in business. I designed and developed the *Desktop Lawyer*, a set of audiotapes, manuals and software as a complete compilation of all my legal documents to enable businesspeople and investors to represent themselves in business transactions. It was in meeting so many interesting people, all eager to make their lives and livelihoods better, that I decided to establish and operate the National Mortgage Investors Institute as the first institution in the nation focused on teaching adults practical entrepreneurial skills in the private mortgage field.

When I first became acquainted with the private mortgage business, I was overwhelmed with its simplicity. I realized that in addition to being incredibly lucrative, the business was a perfect home-based, self-employment opportunity for just about anyone, anywhere in the country.

Profitable self-employment in a home-based business: It was this realization that launched the National Mortgage Investors Institute (NMII). I had found at least one good, solid solution for those people drawn to self-employment but without a plan to follow. Since then, NMII has trained several thousand people, everyone from truck drivers and mechanics, housewives and retirees to engineers, CPAs, lawyers, doctors and corporate executives.

Despite their diverse backgrounds, the potential of the private mortgage business is what attracted these people and helped them take the steps to realize their dream of becoming self-employed.

So, what is it that makes the private mortgage business so ideal for self-employment? Potential customers are everywhere. There are more than $220 billion worth of private mortgages held in America. That means anyone who holds a mortgage is a potential customer. Their names are available and can be located with informed search techniques and patience.

Starting the business requires little or no cash. Unlike buying a franchise or starting most other businesses, the private mortgage business requires very little cash to start and operate successfully. There is no inventory, you don't need employees and it can be done from your home, part time or full time.

You get the benefits and the rewards of self-employment, of being your own boss, choosing your own hours and building a solid future in a situation where you are in control.

If you are convinced that self-employment is the only way to really make money and secure your future (and you should be!), then read along as I explain how the private mortgage business works.

In any event, I know you will enjoy this easy-to-read book and I look forward to receiving your comments.

Chapter One — The Key to Starting Your Own Business

Begin looking at ways to start your own business in America and you will soon discover that there are only three real options.

#1 Purchase an existing business

It's a nice thought, but even on a small scale you're looking at an upfront investment of between $60,000 and $250,000, and beware the liabilities. Things are seldom as they appear. Buying a business today means the risk of inheriting unhappy customers, disgruntled employees, undisclosed liabilities and maybe even a lawsuit or two.

#2 Buy a franchise

While it's a legitimate way to get into business, it's also a very expensive way. Upfront costs and franchise fees almost require you to be independently wealthy before you even start the business!

If that's not enough, you can count on ongoing royalties and licensing fees, which actually puts you in the position of paying for your business forever. And the more you make, the higher the royalties and fees.

#3 Start an entirely new business from scratch

Starting your own business gives you the security of knowing what you have and being in control of the money you spend on it. However, starting a traditional business comes with the uncertainties associated with startup situations — like staying in business through the initial pre-revenue and preprofit stages.

I believe that starting your own business is the only way to secure your future. The key, however, is to get the proper training and to start the right business: a business where you don't have to spend your life savings (or more) to get started, that enables you to profit almost from day one, and that allows you to work at home, full- or part-time.

The private mortgage industry is that type of business. In the following chapters, I will share the specifics that make the private mortgage business so exciting to so many different people.

Chapter Two — Just How Does This Work?

To use a well-worn cliché, you don't have to be a brain surgeon to figure this one out. In addition to the positive aspects we've discussed already — little or no investment capital, the chance for profit early on, a market waiting to be found — the private mortgage business can be ideal as a home-based business for many who attempt it. I stress that you don't need a college degree and you don't have to be rich. If you understand the concept, use the system and work hard, you have the potential to succeed in the private mortgage industry. Of course, you have to learn all the necessary steps, precautions and legal formalities. But I know that just about anyone with average intelligence can master this business and master it well, and I know this from experience.

I'm sure you've probably seen real estate business tactics — usually taught on late-night TV — that promise big bucks and great investment returns for little or no work. At this point, you might be concerned that the private mortgage business is related in some way. Let's put that matter to rest: This is NOT a "buy real estate with no money down" scheme. This has NOTHING to do with buying real estate or foreclosed properties. This has nothing to do with lending money or helping mortgage bankers to originate loans. And this is definitely not a "get-rich-quick" program.

So what is it? The private mortgage business simply entails finding people who hold mortgages, arranging for them to sell those mortgages at a discount and receive the cash now, and reselling or placing those notes with note buyers who profit from the high yields and security of the note.

Let's go through this one step at a time. First, you locate people who are collecting payments on a mortgage. Usually, they sold a house and agreed to hold a mortgage to help the sale along. Why, then, would they want to sell that mortgage? Simple: They want the money now in a lump sum rather than continuing to collect payments over a period of time. Whatever the reason, they want cash now and will discount the overall value of the mortgage to get it. Locating mortgage holders is often a matter of public record, followed by a marketing effort on your part. Finding sellers and contacting them is the most important aspect of this business.

Once you have identified a seller who is open (and in many cases eager) to sell his or her note, you then gather information that will help you and the note buyer make a bid on and structure the note purchase. If the note is secure and has a decent interest rate, the better the offer will be. And the better the offer is, the more money you may well make as the broker or "financial middleman" of the transaction.

So, who buys the note?

Let's discuss in detail exactly how you profit from this situation — and how you can continue to profit from situations just like this. Private note-buying companies are in the business of buying notes. They are often called funding sources because they have the cash to fund the transaction. This is important because it means that you DO NOT HAVE TO HAVE CASH in order to buy and sell mortgage notes. You don't risk your own money in any way. As a broker, you work with a note seller and a note buyer to facilitate the transaction. The money you make is the difference between what the note seller will sell for and what the note buyer will pay. This difference is often called the "spread."

In this type of straightforward transaction — where you find the seller and work with the buyer to purchase the note — you are operating as a private mortgage broker.

In order to be a successful private mortgage broker, you need to do three things. First, you must continuously work to locate people who are note owners. As many note holders are uninformed about their options, part of your job is to let them know that they can sell their note. Second, you must develop a working relationship with the note buyers, or funding sources, so that you can find the types of notes that they want and bring the two together. And third, you must collect the information and discuss the transaction with the note seller so that the sale can be completed.

Many people make money as self-employed private mortgage brokers, working out of their homes, either part-time or full-time. However, as I have watched successful brokers grow in the business, they usually discover, just as I did, that there is more than one way to make money with private mortgages.

Consider a couple of options (and there are many more…):

You can buy the mortgage yourself. Instead of using a note buyer, you can negotiate and purchase the note directly from the note seller for your own portfolio. Private mortgage brokers usually discover this way to make money after they have closed a few brokered deals. They now have some cash in the bank and they get a call from a seller who has a relatively small note. They start realizing they can buy the note themselves and increase their profit. Once you start investing in notes yourself, you are in an ideal situation to select the really profitable or secure ones for your own portfolio. Another beauty of the system is that once you bring these notes into your own portfolio, you don't have to keep them for the full term. You can opt to sell them at any time to one of your note buyers.

You can make a partial purchase and buy only part of a note. For example, pay $4,000 now and you can buy just the balloon payment and get $5,000 in 18 months. You can buy just the first five years of a 10-year mortgage note, or you can buy the last three years. A partial purchase allows you to buy any part of the payment stream.

Alternatively, you may decide to make a reverse partial purchase or purchase the payment stream and part of the balloon.

You are starting to see some of the ways you can make money when a note is purchased. Whether you are brokering, buying or negotiating for partials, you are providing a much-valued service to the note seller. The flexibility of the process helps to assure that you can structure a deal for almost every note seller you have.

Let's say a man wanted to buy a fishing boat. At $18,000, prior to the discounting, he was looking to get "fishing boat money" for his mortgage. Selling the mortgage satisfied his need. But what if his note was much more than he needed? He might assume that he didn't want to discount an income stream to get money that he didn't need at the moment. Is that a lost opportunity for you as a broker or buyer? Certainly not. You can simply offer to buy a partial, say the first two years of payments, or you can offer to buy half of the payment for the first four years. And on and on.

The diversity of the options not only increases the profit potential, but assures you a stimulating and rewarding career. After all, even with money this good, doing the same thing every day would get old. I have people in the industry tell me all the time that the most satisfaction they get is from figuring out the best way to buy a note. Industry professionals call it "structuring the deal."

The good news is that everyone wins. The seller is happy. The buyer is happy. The broker earns a fee by adapting the transaction to the parties' needs.

Chapter Three — The Private Mortgage Business — A Solid, Recognized Niche of the Financial Services Industry

As you look to self-employment, you need not only think in terms of money and profit, but in terms of personal satisfaction, fulfillment and pride in your work.

If you're like most people I know, *myself included*, it would not be very hard to decide which was more important — making money at your craft or being happy with what you do. Sure, sometimes just the money can make you happy, but not for long. I strongly believe that you have to enjoy both the task and the money in order to feel truly happy and fulfilled. So, for a moment, let's itemize the benefits of the private mortgage industry.

Benefit #1: Obviously, as you become successful in the private mortgage industry, you will generate income for yourself. If you become more creative and start building your own portfolio, you will actually be establishing a positive future cash flow for yourself. I've seen many people achieve that goal — they are able to quit working the traditional jobs they have and live quite comfortably from their mortgage portfolio.

Benefit #2: Creativity in the private mortgage business pays off. Notes are flexible and you can buy or sell all of a note or just part of it. Use this flexibility and you will increase both your profits and your job satisfaction.

Benefit #3: Whether you are brokering or buying, notes are recognized for high yields, making your tasks easier.

Benefit #4: Mortgage notes are backed by real estate and real estate has always been considered the best collateral in the world. Remember when banks were stable based on the amount of real estate they held? It wasn't until they got into other investments and viewed themselves as developers rather than lenders that banks started to have problems. Ironically, now banks are afraid to loan money at all, which was actually one of the driving forces behind the creation of privately held notes. And as more notes are privately held, more people will want to cash out. This cycle is more than a trend; it's a recognized financial certainty that benefits private mortgage professionals.

Benefit #5: Because notes are desirable and valuable, they represent liquid assets. For the broker, this assures ready and eager buyers. If you purchase notes for your own portfolio, it gives you the ability to sell those notes for cash when a better and more profitable note comes along, or if you just plain want the cash.

Benefit #6: How often have you heard the saying, "It takes money to make money"? I disagree. If you have money, you should be able to make money. But even if you have nothing but your enthusiasm and willingness to work and learn, you can make money in the private mortgage business.

Think about it this way: For virtually every note you find, you can find a note buyer. The option to buy will always be there, regardless of how much money you have in the bank.

Benefit #7: If you get to the point where you are able to invest in the notes yourself, your investment is safe. Owners of private notes are positioned to recover their investment, no matter what happens. Either you get the payments or you get the property.

Perfect for Self-employment

As you can see, the values and benefits of mortgage notes clearly support the potential of the private mortgage business. I believe that the icing on the cake, however, is the actual system which enables valuable notes to become a profitable business.

Why the Private Mortgage Industry Is Perfect for Self-employment

- Real estate as collateral
- Yields a solid return
- Low overhead

Three things put the private mortgage note business at the top of the list for exciting and solid self-employment choices.

First, notes are extremely secure because they represent ownership of an interest in real estate — a mortgage interest — which is obviously the most tangible collateral there is. Other financial investments are backed up only by a performance history (a past record of being successful) or future claims (someone says it will be valuable based on events that have not happened yet). Recent events in the financial services industry clearly point to the fact that, given a choice between debt in real estate and a piece of equity, go for the debt.

In addition, when you are buying a mortgage, you're actually buying both a mortgage note and the mortgage. The note is a promise by the mortgagor to pay the holder of the note a certain amount of money over a specific period of time. The mortgage says that if you don't get paid, by law, you can foreclose on the property and get your money back.

Taking back the property opens even more doors for you — you can sell it, rent it, lease it or, if it's residential, even move into it. Also, unlike other forms of collateral, real estate can't be easily moved or destroyed. And if some of the property is damaged, you're the beneficiary of the insurance.

Second, mortgages are desired by note buyers because they yield solid returns. For the risk versus the return, few investments perform better than mortgage notes. Some bonds, for instance, provide a higher yield than mortgages but will be considerably more risky and are not secure. Investing in high-yield bonds requires you to risk losing your whole investment. Remember junk bonds? They proved dangerous to everyone's financial health.

It is entirely possible for mortgage notes to yield 12%, 15%, 20% or even higher. And, if they are properly researched and screened, these relatively high-yield mortgages are extremely secure.

Your biggest risk is having to foreclose on a property due to default and then being unable to sell the property for enough money to maintain the required yield. However, even that risk can be minimized by properly screening potential mortgage deals, a technique that can be learned through training. Adjusted for the risk factor, the return on mortgage rates is well ahead of almost all other investments.

Third, add in the fact that the overhead for the business is minimal and you can see why those profit margins can be maintained. All you really need is a phone, a mailbox and occasional access to a fax machine, although a computer is now becoming an essential for doing business in general. Undoubtedly, the private mortgage business is one of the best home-based businesses imaginable. The only real expense — even when you are a full-time, full-blown private mortgage professional — is for marketing. And even that can be minimized when you know what you are doing — again, a function of training.

If you're like most of the inspired entrepreneur types whom I talk to about the private mortgage business, you've gotten a handle on the big picture. Now you are ready for the details. In the next few chapters, I will tell you how to find mortgages for sale, how to discount and purchase them so you can safely make money and how to work with note buyers. I will discuss what documents are required, some of the legal aspects and how to close a deal.

My goal here is to show you everything I can about the private mortgage business in this type of quick-read primer. I already know this is one of the best home-based, no-capital-investment, low-overhead businesses around. So, my intention is to clarify these concepts for you and enable you to make a decision about the private mortgage business on your own.

Chapter Four — A Case Study

At this point, I think you can see how it is possible to make money in the private mortgage business. Now, let's walk through an example step-by-step and discuss the specifics.

The Smiths own their house free and clear. It has served them well while they raised their children, but now the kids are gone and the Smiths want to downsize — move someplace smaller and less maintenance-intensive.

The Joneses are interested in purchasing the Smith's house and they have saved about a third of the money they need for a down payment. The Smiths agree to hold the mortgage on their home. This means that instead of going to the bank for a loan on the remainder of the money (the traditional financing route), the Joneses will make their mortgage payments directly to the Smiths. What's the advantage of this type of arrangement?

Well, from buyer Jones' point of view, they save money by not having to pay points or fees. The Smiths save because they have less closing costs. The time it takes to research and close the deal is drastically reduced for both parties. The two couples sit down and make agreements among themselves, work out the terms and decide on a fair interest rate and how much the monthly payments will be.

The Smiths don't get a large chunk of money like they would have if they had gone the traditional bank-financing route, but they get something that is much better in the long run — a monthly income stream at twice the interest rate they would have received had they taken the large chunk of money and invested it in a CD or another traditional investment vehicle.

But let's say the Smiths change their minds a year later. The mortgage arrangement is going just fine but the couple needs a sum of money to pay for their daughter's wedding (or son's college education or a trip to Australia). They decide to sell the cash flow from their mortgage when they see an ad in a local newspaper:

WE PAY CASH FOR
SELLER-FINANCED MORTGAGES
CALL TOM AT 671-2222

The Smiths call Tom, who asks them questions about their mortgage — questions about the property value, the area where the property is located, the Joneses' credit credentials, anything that will give him information and assurances about the viability of the investment. He discusses what the Smiths expect to receive for their mortgage and explains the "time value" of money. The Smiths are made to understand that over time and with inflation, the amount of money they can get for the mortgage today may well be worth more than the payments they would receive over the next 30 years. They also end up realizing that they can get cash for their remaining payments without having to borrow money, so they agree to work with Tom.

Tom has done his homework with the Smiths. He understands their motivation to sell. By doing this, he has the information he needs to structure the deal properly.

There are still a few details to be worked out on Tom's side, and he needs to properly structure the purchase before he gives the Smiths a return phone call.

So, Tom calls ABC Funding, a company that buys mortgage notes, also known as an institutional private mortgage buyer. Tom passes all the information he has gathered about the mortgage on to ABC Funding. When ABC has all the information they need, they work with Tom to structure the purchase properly and quote a price to Tom — the price they will be willing to pay for the Smiths' note based on the structure they devise. Tom takes ABC's information home with him. He subtracts the amount of profit he wants from the deal, and then he has a good idea of what he will offer. Tom will cut the deal based on the original offer from the institutional buyer. In other words, he has the institutional buyer's offer in hand before he goes back to the mortgage seller to structure the deal.

At that point, Tom will contact the Smiths to buy the note from them and assign the contract to ABC Funding, the institutional buyer. He never actually buys the note; he only assigns the contract to a buyer.

Tom's fee, as the private mortgage broker, is the difference between the price the Smiths have agreed to sell for and what ABC is willing to give them. The broker's fee covers a wide range. It can be as low as $100 or can be as high as $20,000, and possibly even more.

The beauty of Tom's position is that he doesn't make any commitments until he has assurances from both sides — the buyer and the seller. Tom is in a perfect position to make safe, profitable deals.

Chapter Five — Finding Sellers

In the private mortgage business, a great deal of your time will be spent searching for sellers or note holders. Sellers are the key to success in this business. It's not that difficult; it just takes time and know-how. In that respect, mortgage notes have much in common with all other commodities: It is easier to find eager buyers ready to make a profit than it is to find interested sellers. The slowest part of working in the private mortgage business then is searching for and locating acceptable sellers.

One place to look for privately held mortgages is in the county records offices. Every mortgage taken out by a bank or an individual is recorded on the public record for anybody to look at for whatever purpose they have in mind.

There are volumes and volumes of mortgages filed chronologically. As you review the lists, you'll see that each mortgage lists the name and address of both the mortgagor and the mortgagee. Logically, since most mortgages are financed by lending institutions, you will find that the majority of the mortgages found in the county records are usually with banks and savings and loan associations. But what you are looking for are other mortgagors — those not listed as Second National Bank but as James Butler and Susan Cronin. In other words, you want to find individuals who are holding mortgages.

Make no mistake, wading through volumes of mortgages can be time-consuming and tedious. But, there are shortcuts. For example, many county records offices have what is called the Trustor Index or Mortgagor Index, which lists in a single column all the mortgages in alphabetical order. Also noted is the mortgagee and the book and page number where the mortgage is recorded. Using the index can help cut down on the time it takes to find potential note sellers. There are plenty of sound ways to locate the names of people who might very well become clients for your private mortgage business. The names and leads are all there. All you have to do is learn the steps.

What do you do with these prospect names when you get them? You contact them, either by telephone or by mail. You explain to them that you are willing to pay them cash for their mortgage. Their initial reaction may be one of disbelief. Remember, most of these people have no idea they can sell their mortgage to another individual for cash through a relatively easy process. Many of them are under the mistaken notion that for no particular reason they have to hold on to the note until the last payment is collected. And still others know they can sell their note, but believe they would be required to discount it too heavily in order to sell.

If you present your ideas in an uncomplicated, straightforward manner, selling usually becomes a very attractive option. Everybody can use a windfall of money — and you're offering a big one that replaces what they may consider a never-ending, monotonous collection process. To some people, it's like suddenly winning a jackpot. In fact, you're both hitting the jackpot.

It All Comes Down to Marketing

As I've already said, searching for sellers is a very large part of becoming successful in the private mortgage business. The county records offices, libraries and reference books are just a few of the many tangible sources for collecting the names of people who may be willing (indeed, sometimes waiting) to sell their mortgage to you. Marketing is an important tool for your private mortgage business. The goal is to put your name out there in the marketplace without having to spend any more money than necessary.

Marketing Options in the Private Mortgage Business

Direct Mail
Telephone
Professional Networking
Business Cards
Cable Advertising
Computer Bulletin Boards
Online Services/Internet
Group Meetings
Outdoor Advertising
Classified and Display Ads

The following are some marketing vehicles and additional prospect lead sources that you will want to consider:

Direct Mail — A well-planned and creative letter or flyer can go a long way. The correspondence you send to prospective sellers makes a lasting first impression. Your mailing must be personal but professional, and clever enough to stand out from the junk mail they might be receiving that day. The purpose of direct mail is to get the communication process started.

Telephone — Contacting note holders by telephone can be extremely effective. You know they have received your message and you can adjust your presentation to their particular circumstances as your conversation develops. You may consider creating a strategy that combines telephone calls with direct mail.

Professional Networking — Contacts among certain industries can generate referrals. They key idea here is to make contacts among professionals in the industries that deal with potential mortgage sellers. Some professionals you might consider establishing relationships with are real estate developers and brokers, mortgage brokers, attorneys, CPAs, financial planners and tax preparers.

Business Cards — Your business card is a powerful marketing tool — but only if it gets out of your pocket and into the hands of prospective clients. Distribute them liberally, give them to everyone you meet, leave them behind at restaurants and on bulletin boards to increase your chances of finding note holders. That's the name of the game.

Cable Advertising — With hundreds of channels available, cable advertising is a way to get word of your service to thousands of prospective note holders.

Computer Bulletin Boards/Online Services/Internet — If you have a computer and a modem, you may want to consider the information superhighway as your path to success in the private mortgage industry.

Group Meetings — As an expert on the subject of private mortgages, you can be a welcome speaker at many business gatherings and club meetings. You won't collect a fee for the speaking engagement, but you can take away something more valuable. By effectively educating a group of people about your services and the industry, you will most likely leave the meeting with a fresh list of leads and networking possibilities.

Outdoor Advertising — If you keep your message simple, a well-placed billboard can pay off. Billboards are rented based on the numbers of cars that drive by each day. Stay away from the expensive 100,000 cars a day; your rental fee will probably be too much. Instead, go for the middle ground in terms of exposure. And keep your message simple, both in terms of what it says and the artwork: a straightforward question, "Do you have a mortgage to sell?" with a phone number, in an easy-to-read typeface, white letters on a red background. Note: Steer clear of the really, really inexpensive "dog boards" that no one sees at all. Always drive by the potential location and check it out for yourself.

Classified and Display Ads — As one of the best uses of advertising money, classified and small display advertising can make your phone ring with calls from potential note sellers. Again, keep it simple, keep it inexpensive and track your response to make sure that you are placing the best ads in the best places.

There are countless other ways to market your business. They all have pros and cons. And you do need to be trained to use them. But the point is simply this: The sellers are there. And so long as you're marketing, you can find them.

Chapter Six — Why People Sell Their Notes

It's important for you to understand the motives of people who sell their notes. They are, after all, your livelihood. The better you understand their reasons, the better you can service their needs.

People sell their notes to get cash, and there are many reasons they need cash. Sometimes it's as simple as the desire for a new luxury car, boat or vacation. Sometimes they want to start their own business, send a child to college or add on to the house. Some people need the cash to settle estates or divorces or to pay off debts, especially credit card debts. At credit card interest rates, selling a cash flow stream to pay off these debts in one lump sum is a sound idea. Some people want the cash to invest in other financial vehicles, or in other real estate. For some, it's as uncomplicated as just wanting to enjoy life now.

In certain circumstances, you may run across note holders who didn't really want to carry the note in the first place. Property owners who are having a difficult time selling their property may end up holding the note because it is the only way their buyer can qualify for the mortgage.

People also sell notes for peace of mind. Selling their note means they don't have to worry about the payor going bankrupt or abandoning the property, no worry of default or foreclosure, and no worry of destruction or devaluation of property. In some respects, selling a note can also bring simplicity to their lives. They no longer have federal and state tax reporting requirements to comply with and no monthly collection hassles.

It is important for you to understand the seller's motivation because it helps assess the value of the note. Every note has some level of value, but certain notes are more valuable than others. By clearly understanding the reasons a seller has to sell a note, you can serve them and the buyer better.

Chapter Seven — The Business of Numbers

Tables, ratios, evaluations and appraisals — there's no getting around it. When you operate in the world of finance and investment, you've got to work with numbers. If you're comfortable with figures, you've got it made. If not, don't get nervous. A good business calculator, combined with some basic understanding of the standard computations, will give you the necessary skills.

It is important to understand the relationship between the buyer and the broker. The business of numbers is primarily relevant to the buyer. However, these same numbers are relevant to the broker because the broker has to understand what is relevant to the buyer. The best way to learn what is relevant is to understand what the numbers mean.

In this chapter, I'm going to give you an overall glimpse of the basic formulas and computations needed. This book is to help you evaluate whether becoming a private mortgage broker is within your reach, so this overview only touches on the things you will eventually need to learn to do this business.

When it comes to choosing a note, the buyer uses these numbers to evaluate his risk and yield. Understanding their meaning and where they originate will help you to speak the buyer's language. The following are some of the techniques of offering quotes and some of the evaluations used to measure a mortgage.

Loan-to-Value Ratio

Loan-to-Value (LTV) is a ratio that weighs the outstanding balance of a loan against the security or collateral pledged by the debtor. The purpose of figuring an LTV ratio is to determine how secure a loan is. The LTV is found by using a simple formula:

$$\text{LTV Ratio} = \frac{\text{Balance of Financing on Property}}{\text{Market Value or Sales Price}} \text{ X } 100\%$$

For the purposes of this formula, the remaining balance of any financing on the property is any debt that was created and still exists that uses the property for collateral.

For example, if there is a first mortgage with a remaining balance of $25,000 on a house and a second mortgage with a balance of $40,000 still due, the total remaining balance would be $65,000.

The appraised or market value of the property is used as opposed to the actual sales price because we are only concerned with how much the property can be sold for in the event of a foreclosure. Actual sales prices are not an accurate indicator of how much the property could be sold for at auction — unless, of course, the sales price is lower than the appraisal.

The LTV ratio is calculated to ensure that the investor can be assured of getting his money back in the event of a foreclosure. If the debtor defaults on payments and the creditor is forced to foreclose, the creditor must be able to resell the property for enough to cover the balance of the loan as well as any accrued interest. Since the property may no longer appraise for what it did when the original loan was made, and since the mortgage buyer may sell the property at a discount to get rid of it, mortgage buyers are rarely willing to accept a mortgage balance equal to 100% of the value of the property. The risk that the mortgage buyer will foreclose on the property and not be able to get all his money back is simply too high. In short, the higher the LTV, the greater the risk.

Investment-to-Value Ratio

In order to determine a mortgage buyer's risk in the event of foreclosure, you must be concerned with two things. First, the buyer must be able to get his money out of the deal. Second, you must be concerned with the amount of superior liens, since all superior liens would be satisfied before yours in the event of a foreclosure.

In order to determine your risk in this situation, you would use the Investment-to-Value (ITV) formula. ITV is the sum of the principal balance of all liens senior to yours plus the amount of money you have invested in your mortgage, divided by the value of the property.

This type of numeric evaluation is needed in the final steps of completing a deal.

Money Has a Changing Value

The concept of money today versus money tomorrow has its roots in the economic concepts of the value of money. If you are given the choice of receiving $100 today or $100 next year, the obvious choice is today, for these reasons:

1. $100 today can be invested and made "to grow into" a larger amount next year. Waiting until next year to receive your $100 deprives you of the ability to make money from the money.
2. Inflation will also make the delayed payment less attractive (in this instance where the payments are the same amount). Inflation "eats away" at the value or buying power of money. When inflation is high, people want to spend their $100 right away because they will not be able to buy as much with that same $100 a year later.
3. And besides, if you have $100 coming to you, wouldn't you rather have it to enjoy now, rather than 365 days from now?

There are five basic financial functions used in calculating the changing value of money. As you review these items, focus on the general concepts that they illustrate. It will be easier to apply them to specific situations later.

1) **The future value of money** — You have $1,000 deposited in the bank today. What will be the value of that money in five years? Given that you are earning 5% interest, you can expect to have $1,276.28 in five years.

The important thing to note is that the $1,000 does not earn 5% every year — only the first year. The second year you earn 5% on the original $1,000 *and* on the interest that you earned in the first year, and so on.

Year 1 $1,000.00 + 5% interest on $1,000.00 = $1,050.00
Year 2 $1,050.00 + 5% interest on $1,050.00 = $1,102.50
Year 3 $1,102.50 + 5% interest on $1,102.50 = $1,157.63
Year 4 $1,157.63 + 5% interest on $1,157.63 = $1,215.51
Year 5 $1,215.51 + 5% interest on $1,215.51 = $1,276.28

The future value of money takes into account the interest that you would earn if you had the money. It does not take into consideration the changes in value because of inflation.

2) **The present value of money** — This is calculated in the exact opposite way of future value. Keep in mind that future value is how much you *will* have, given how much you have *today*. The present value of money is actually much more pertinent to the subject of buying and brokering private mortgages. For example, a mortgage note matures in five years and the payment is a lump sum at that time of $1,276.28. How much money would you pay *today* in order to buy that payment in the future?

Well, if you expected to earn an interest rate (or yield) of 5% compounded annually (not very much!) then you would pay $1,000 to buy that future payment of $1,276.28.

In calculating the future value of money, we compounded the interest. To calculate the present value of a payment that we will receive at a future date, we discount the amount — it is the exact opposite of future value!

3) **Interest rate** — This is basically the "rent" you pay to use someone else's money. Now, if the money is yours and someone else is using it, then interest is what you earn for letting them use the money.

Interest can be figured in several ways. Annual interest compounded monthly is simply the yearly rate (say, 12%) divided by the number of months. It means that a 12% annual rate would be divided by 12 months, and would actually give you a 1% monthly interest.

$$\frac{\text{Yearly Rate}}{\text{\# of Months}} = \begin{array}{c}\text{Annual Interest}\\ \text{Compounded Monthly}\end{array}$$

After determining the monthly interest rate, it's easy to compute the future value of the principal. With financial equations, it's always assumed that interest will be reinvested at the same interest rate and thus compounded. That's why 12% of $100 is $12 but the interest earned over a year with monthly compounding at 12% is $12.68.

4) **Discount to yield** (or the discount rate) — This is very similar to interest and the concepts are actually identical. As we just mentioned, the interest rate is used to convert a present value to a future value. The discount rate is used to convert a future value to a present value.

5) **The rate of return** (or the yield) — This uses the same formulas as the interest. Therefore, your rate of return or yield is the same as the interest rate, using whatever compounding period is being applied. A required rate of return is self-defining: If an investor requires a 12% rate of return and knows the future value of something (say, a mortgage balloon payment), he uses a 12% discount rate in order to find how much he would pay for that investment. (And, not coincidentally, he also yields 12%.)

Investors require a certain rate of return for an investment. The base figure is the return the investor would like to receive if there were no inflation, no chance of default, or any other kind of risk. In effect, it is the return the investor wants in a world that is perfect and static.

However, as we know, the world is quite imperfect and investors have to figure that when calculating the rate of return they need on their investment. The more the risk, the more the required payoff — or rate of return. In the private mortgage business, certain risks such as expected inflation, default, liquidity premium and any balloon maturity premium are taken into consideration when the investor looks at what he wants in a rate of return.

A Bird in the Hand

The time value of money means that money is worth more today than it will be tomorrow. This is important to understand because the buyer needs to put a price tag on how much he is willing to pay in today's dollars for the right to receive the same amount of money sometime in the future. And the buyer needs to take into consideration whether that dollar is coming in tomorrow, next year or 20 years from now. These considerations (all based on financial calculations) determine how much value the mortgage note has at the present time.

Understanding the time value of money will help mortgage sellers understand why it is that they are not receiving the principal balance of the note. Why? Because they are not actually selling the principal balance of the note.

Most people think when they are selling a note, they are selling the actual principal balance. Let's say the principal balance is $53,000. They want to find out how much you will give them for this $53,000 note. However, the real consideration is not the balance, but how many payments remain on the note. This, not the principal, is what is analyzed in terms of time-value considerations and it is the remaining payments, not the balance, that are being bought.

All of these financial calculations appear complicated until you work with them. After a while, they become second nature, especially after you become proficient at using a basic financial calculator. With just a few simple key strokes, you can sort complicated cash flow streams into present value, future value, the amount of each payment, the number of payments and the yield rate.

Chapter Eight — Working with Buyers

Now you know how to find sellers and you know the reasons why they might want to sell their mortgages. You have seen some of the calculations and criteria used to assess the value of the mortgage. So how do you find the buyers?

Finding buyers is the easiest part of the private mortgage business. Working with them in a way that results in completed note deals is a little more of a challenge. If you have found a quality mortgage at a good price — and you do your homework with the seller — buyers will always be there for you.

Until you start buying and selling your own notes and building your own portfolio, you will deal almost exclusively with institutional note buyers. These companies, often referred to as funding sources, are interested in working with trained, professional brokers who understand what types of notes the company is looking to buy.

How do you find funding sources and note buyers to work with? The primary source should be through your training. At the Association of Private Mortgage Professionals, any certified mortgage broker can receive a comprehensive book listing all the funding sources, their preferences regarding notes and how they would like to be approached.

The process of dealing with institutional note buyers is actually very similar to the approach that you should take with note sellers. As you start working with a note seller, you have to find out what they want — what kind of notes they are looking for under what parameters — before you can structure the deal in a way that appeals to them.

So before approaching a buyer, you'll need to make a few practical evaluations yourself. For example, a buyer is going to want to know the creditworthiness of the mortgagor and the appraised value of the property. Gather as much information as possible, including all pertinent documents, from the seller.

The facts you obtain in advance will prove to the buyer that you are a serious and credible broker. Plus, your research will help the buyer know how to best structure the deal for smooth processing. Most importantly, though, by understanding as much as possible about the transaction, you can better serve the seller and the buyer. In the long run, your reputation as a thorough and professional broker can only help your business grow.

Your interaction with a note buyer or funding source requires that same type of information upfront. What does the buyer want in a note? Check your directory.

Chapter Nine — Building on a Solid Base

Cash is the choice maker. Without it you have few choices. With it, you have more. And the more cash you have, the more choices you have. No wonder they say cash is king — at least in matters of finance.

In the financial world, the value of an investment is determined by examining the amount and form of the return you get. Cash as a return on your investment — which is exactly what you get when you buy mortgage notes — is the most liquid form of return. In other words, it doesn't get any better than that!

As a broker of mortgage notes, you will soon learn that the note buyer is going to make more money than you will. That's because the note buyer is the one with the cash. As you broker more and more notes, you will find yourself in the position of being the "one with the cash."

This is ultimately the way you would want your new business and career to develop. Start out as a broker of mortgage notes. As a broker, you will earn fees for your work — in many cases much more money than you have made doing anything else. As you grow in your career, you will be exposed to an even better way to make money — buying the notes yourself. Great! Buy the note, but then, of course, you will want to sell it. Why? Well, because you only have so much money, and you want to make more. You buy the note for yield and then you sell it to someone else, usually an institutional buyer.

This is called "flipping" the note. You buy the note for yield. Say it pays over a 20-year period of time, and your yield is 15%. If you flip that note immediately, then you capture your profit — the discount — all at one time (and you would, of course, reinvest that money toward the purchase of more notes). So you make even more profit by buying and then reselling. The more you do that, the more money you will make.

So, to recap, let's look at the process step by step. First, you broker notes and make commissions. You don't need to use your own money. After you broker notes for a while, then you start buying them yourself. Your yield, or profit, is realized when you sell the notes or "flip" them to note buyers. When you first start buying notes, you want to sell them right away so you can make more money and buy more notes. As your career matures — and your instincts get sharper — you will find that note buying is earning you more money for the time you spend working. Simply put, you are making more money per hour.

As your income increases, your activities will switch from buying and selling to buying and holding. Then the big change occurs. Now, instead of finding and buying notes, you are making an income off of your portfolio. You have built a portfolio for yourself that takes care of you and eventually replaces your labor. You have gone from laboring as a broker to true investing as a portfolio buyer. When you purchase a mortgage note and keep it in your own personal investment portfolio, you are creating a situation where you will regularly collect checks without doing anything more.

I believe that this is the true beauty of the private mortgage business. You can broker notes if you have no cash at all. So, broker first. Make some money. Buy and sell from your own portfolio. Make more money. And then buy and hold for your own portfolio. That's when you can make real money.

Chapter Ten — Negotiating the Deal: The Offer and the Acceptance

You've found the seller and talked with him or her about the specifics of selling the note. You have verified the initial information and now you are ready to do business. Whether you are brokering or buying the note for your own portfolio, much of making good deals is using good negotiating tactics.

Keeping track of the information and verifying everything you are told is essential. You'll want to keep some kind of a mortgage worksheet with you wherever you go. When you're talking to a prospective seller, speak with confidence. Remember, you're the one with or representing the money. Always get the seller's phone number as your first order of business so you can continue negotiations. Remember, he's more likely to sell to someone he's comfortable with, who is polite, professional and patient. And patience is key since some of the very best deals can take up to several months to close.

Request copies of the note, the deed of trust or the mortgage and closing statements. Do this before you contact a note buyer. Having this information when you first go out for quotes from the note buyers is essential to being taken seriously and responded to in a short amount of time. Why? Because it shows that you are in control of the situation and that you have a real potential note seller. It illustrates that you have explained the process and that the note seller is interested in selling the note. Credit information on the payor can also help expedite the situation *and* get the best possible quote on the note.

There's no magic formula for calculating an offering price. Your most important task in offering a quote is to gather as much information as possible on the full range of circumstances involved. The more you know about the seller's motivation to sell his note, the better you will be able to structure the deal to satisfy him. His reason for selling and how much money he wants to pocket gives you indications as to whether you will offer to buy all of the payments or some of the payments.

The numbers and calculations we have already discussed, and the circumstances in terms of the creditworthiness of the payor, the value of the property, etc., will ultimately determine the yield. This will help you calculate your offering price.

As a broker, your job is to facilitate a sale between a note holder who wants to sell or is exploring selling and a strong institutional buyer who has the cash for either all or part of his remaining note payments. (Of course, you may be the buyer yourself, but the same type of information research — due diligence — is necessary.) It is up to the mortgage broker to facilitate this transaction. The more familiar you are with the numbers and the circumstances, the better your chances are of making a solid profit from the transaction.

Splitting Assets

You will offer either full or partial purchase of the note, based on what you know about the seller's needs and reasons for selling. In certain circumstances you can offer a partial first, but you also will be making an offer on the full note.

If a seller still won't accept your offer on the full purchase after you explain the time value of money and the fact that his mortgage is amortized and he'll never get the full price of the remaining payments, then make an offer on a partial purchase. These types of negotiating tactics are simple enough to learn.

Chances are the nonresponsive seller just hasn't heard the type of deal he needs. Maybe he doesn't need *all* the money, but *part* of it is appealing to him. Asking "How much cash do you really need?" is a simple way to get the information you need in order to make an offer that will appeal.

The ability to change the deal — for instance, offering to buy some of the payments, or just the balloon portion — is the true beauty of the private mortgage business. There is almost always a way to structure a deal, and there is always a way to make that deal profitable for everyone involved.

As you learn more about the private mortgage business you will recognize that the details and nuances of the deal-making process actually drive up the profit.

The more you know about structuring possibilities, the more profitable you can be. While experience is an excellent teacher, you will benefit in deal structuring and negotiating training early on in your private mortgage career.

Know Where You Are Going

When you approach sellers, you should always have a strategy in mind. Even before you offer a quote, know where you are going and where you want to end up.

Guideline #1: Know in advance whether you want to broker the note, hold it in your own portfolio or resell it. Know what kind of yield or profit you are looking to earn. Know whether you want to focus on commercial property or residential property, and whether you prefer to purchase a full or partial mortgage. Knowing where you want to end up gives you the power to direct the negotiation to your advantage.

Guideline #2: Know what the obstacles will be. How low an offer will you be making to the seller? What is the time frame? Is all the documentation available? Are there any liens on the property? Get all the facts.

Guideline #3: Justify the figure before you quote a price. This will soften the seller's disappointment and help him understand your quote.

Guideline #4: Be flexible in your negotiating. Knowledge makes this possible. And flexibility raises the chances of actually closing a deal and maintaining your rapport with the seller.

Guideline #5: One of the best advantages you offer is speed. If you are efficient, it is quite possible to close within two weeks after receiving all the critical documents.

Chapter Eleven — The Upside of the Downside: What Happens if a Note Goes Delinquent?

Real estate is the only investment in the world where you can recoup your money when someone stops paying you. The very reason you have a mortgage and a promissory note in real estate transactions is so you can reclaim your money when something goes wrong with the payment process.

There's even a benefit from it: When you foreclose on a property, you actually speed up the period of time in which that mortgage money is paid to you.

Normally, you wouldn't foreclose on somebody just because they didn't make their payment last month. If, however, after three or four months and many broken promises, your mortgagor still has not made his payments, you would turn the matter over to your lawyer. Not only can a lawyer do a much better job, but the attorney's fees will eventually be returned to you in the final foreclosure proceeds.

The mortgage documents state that if the mortgagor defaults on the note, the mortgagee has the right to request the house be sold at auction and the proceeds used to satisfy the note. In addition to the principal balance outstanding, the mortgagee has a claim to accrued interest on the payments in default (accruing at the highest rate allowed by law), court and legal costs, any mortgage payments required to keep superior mortgages current during the proceedings, and any other expenses that would not have been accrued had the foreclosure not taken place.

To protect the mortgagor from abuses, foreclosure on a property is a legal action and can result from a judgment. This allows the mortgagor to tell his side of the story and defend any claims he may have.

The actual foreclosure process is different depending on whether the property is located in a judicial state or a nonjudicial state. In judicial states, the mortgagee goes to court. In nonjudicial states, the mortgagee (or trust holder) complies with the state procedure.

Either way, the holder of the mortgage ends up with legal title to the property. And to you, as a note buyer, or to the note buyer you brokered the note to, that is all that matters.

How Can You Profit from Delinquent Notes?

In the world of private mortgage business, bad is sometimes better. For one thing, there is an almost endless supply of delinquent notes. For another, buying and selling (or keeping) a delinquent mortgage is often much more lucrative than dealing in regular mortgages.

But beware: Delinquent mortgages are not for the faint of heart. If, however, you are intelligent, willing to do your homework and have the patience to play it safe at every stage, this may be the path for you. A delinquent mortgage note can be a source of significant earning power for you, especially if you look for mortgages that have been in default for as long as possible.

For example, you find a 15%, interest-only mortgage with a $28,000 balance that is two years in default. The mortgagee is sick and tired of fighting the legal battle of trying to get the payments in default and doesn't want the headache of foreclosing on the property.

In fact, the mortgagee would be delighted if they could just get the remaining principal on the note: $28,000 — or even discount it by as much as 50% to $14,000. So you buy the mortgage for that price, making sure all rights of the mortgage are assigned to you (including the associated accrued interest). That very same day you begin foreclosure proceedings, which may take up to a year to complete, but usually much less.

At the foreclosure settlement, you, as the holder of the mortgage, are entitled to receive the original principal ($28,000) plus all accrued interest and expenses. This can be received in cash by the mortgagee at the time of the foreclosure auction. When you bought the mortgage, the payments were already two years delinquent. This means that six months after you paid $14,000 for the mortgage, you are entitled to receive $43,790.43 in cash. That's over a **300%** return.

There are other options when you purchase a delinquent mortgage. As in the example above, you can foreclose immediately. The advantage of this is you usually recover all of your investment as well as the legal costs of the foreclosure and you receive your money in cash. And if the sale of the property doesn't fully reimburse you, you are entitled to go after other assets of the delinquent mortgagor. And, though this is usually not the goal, foreclosing a property can be a less expensive way of gaining title to property.

Another option is to receive a deed in lieu of foreclosure. The advantage to the mortgagor is that since he is going to lose the property anyway, he is able to get out of the property without the huge credit implications of a foreclosure.

By receiving the deed, the advantages to the mortgagee are twofold. First, this is a very inexpensive way of getting into property. Second, the procedure of switching title is simple and quick.

The decision to buy delinquent notes comes with many options. As I said above, you can buy the delinquent property and foreclose on it, or you can take the property back. Many people will be willing to turn their property over to you rather than risk damaging their creditworthiness.

There is an additional option and advantage to buying a delinquent note, aside from the profit, of course. Instead of pursing the possession of the real estate, you can renegotiate the terms of the note. For example, you could take a promissory note that is payable over a two-year period but is in default right now and simply restructure it for lower monthly payments over a longer period of time.

Since you have received the mortgage at a discount, having revised the payment schedule by making it more affordable for the property owner, your yield will skyrocket. It can go from what would have been a 13% yield to a 30% yield because you've restructured it at no more than a 9% or 10% interest rate to the property owner. Restructuring becomes an effective strategy for dealing with delinquent notes.

Another thing you can do is to encourage the payors to put the deed in escrow and substitute your name for theirs. In exchange, you give them a one-year option to buy back the property at a prescribed price. In a year's time, if they can't do that, the property automatically becomes yours. The nice thing about the plan is that either way, both of you win.

There are many other possibilities. That's one of the nice things about buying mortgages. The process is so flexible that you can use creativity to structure the best possible deals. It's not only lucrative, but it's fun and fulfilling.

Just make sure you know the property from every angle, since you may end up owning it for a while. Search for any back taxes that may be owed and only buy delinquent mortgages at a steep discount to make it worth your while.

Chapter Twelve — Some Legal Ramifications

There is a two-step process to bringing brokered deals to a close. First, you must convince the note holder to sell the note. This is actually done early in the process. The final stage of the process follows all the negotiation and occurs when the buyer closes the deal. When you close a deal, both parties sign all the documents required to transfer the mortgage. It is at this closing that the mortgage is conveyed to the mortgage buyer and the check is turned over to the seller of the mortgage. This transaction takes place at an attorney's office, at a title company or through the mail.

Both attorneys and title companies will be experienced in real estate and familiar with the procedures and documents. They can hold funds in escrow, notarize and record documents, and distribute money.

Obviously, when a deal of this magnitude takes place, it is best to protect yourself legally. Because of the amount of money involved and the complexity of the deal, it is important to make sure the legal relationship you have with the institutional buyer suits your purposes. Finding good, reliable people to be involved greatly reduces your risk.

Documentation is another way to protect yourself. If you have well-planned, airtight documents, you can prevent bad deals from happening and you have what is necessary to protect yourself in the event of a legal dispute.

Partial Sales. Owning a mortgage with a second party establishes a legal relationship. When you deal with partial sales, there are more questions to be answered and the parameters of the transaction become more complex. For example: What happens if the other party wants to sell his portion of the mortgage? Do you get first right of refusal? Can the other party obligate your portion of the mortgage in some way without your consent? It helps to know the kind of issues that might be considered and how to resolve them to your advantage. But of course, that's why training is important for prospective private mortgage brokers.

Beware of partnerships. Many people fail to understand that a partnership can be legally established without a contract or paperwork. Whenever two people work together, a "partnership" is employed. There are ramifications of this relationship and often it is only in court where the full impact of the relationship is discovered. As an attorney, I don't recommend using partnerships with co-owners of notes. They create serious securities implications. Are you prepared to hold the greater fiduciary responsibility, have your past scrutinized and have each deal you make be in the interest of both parties — even though there is nothing in writing? Differing expectations frequently lead to trouble. And often the only way to dissolve the partnership is to sell everything and split the cash.

Joint ventures, on the other hand, can be a good idea. This is a much "cleaner" partnership put together for a specific reason. Its objectives are few and narrowly defined. And even better, the objectives and the relationship are both stated through a formal contract.

Disclosure. You are required to disclose anything that may be relevant and material to the deal to the institutional investor and, even more importantly, a noninstitutional buyer. If a mortgage goes sour after a sale and the buyer gets angry, he can claim lack of disclosure.

This is why gathering all the necessary documents is important and why you need to disclose everything. Proper disclosure of all relevant and material factors rarely blows a deal.

Good, ethical business sense and concern for your investor and your own protection will usually keep you well away from trouble.

Licensing. While you'll need the necessary business licenses from the state, county or city government in order to operate, I believe having a mortgage broker's license or a real estate license can actually be a disadvantage for three reasons:

(1) Licensees are assumed to have a fiduciary responsibility.

(2) Licensees are assumed to have a higher "standard of care." Supposedly, you gained a higher level of expertise when you earned your license and should know more about mortgages and real estate than if you had not earned your license.

(3) It is just another legal target which can be attacked.

The securities issue. I often am asked the question: Doesn't a mortgage constitute a security within the context of the SEC and Blue Sky laws? My answer: maybe. There are all kinds of terms and definitions and legal ramifications that will apply to your private mortgage business, and securities are only one. In this case, you can buy notes secured by mortgages for your own personal account without any implications. You must be the principal in the deal if you choose to co-own or deal in partials. The law comes into play when you split payments with an institutional investor or buyer. Make sure you learn all the nuances of these laws to protect yourself, your business and your income.

Chapter Thirteen — What Legal Form Should Your Business Take?

Choosing which way to organize your business to take the most advantage of your money can be tricky. There are pros and cons to each avenue. There are tax advantages to operating as a business as opposed to deriving your income from investment activities. There is the issue of retirement accounts and licensure to take into consideration. It is your responsibility to get the training you need to learn the specifics of these issues so you can protect yourself and earn as much from your business as possible.

If you are investing in mortgage notes for your own portfolio, you are acting as an individual and need not concern yourself with forming another legal entity with which to do business. Acting as a private individual does make things much simpler. If you are acting as a mortgage broker you, again, don't need to be incorporated.

But if you are buying and selling mortgages as a business, the legal form you choose is very important. I wholeheartedly recommend that you choose the corporation as the legal form of your business.

As with any business, there are six potential liabilities any self-employed individual faces.

(1) **General Institutional Debt.** You could incur a general business debt if you borrow money from an institution.

(2) **Secured Liabilities.** A secured liability is a debt secured by something else of equivalent or greater value. This means that if the business defaults on a debt, the institution can seize that asset.

(3) **Casualty Risk.** There is always the danger, though very, very low, that someone will injure themselves when involved in an activity related to the business. The only protection against this is to have sufficient insurance. This risk is rarely relevant to brokerage businesses.

(4) **Unsecured Liabilities.** Unsecured debt is any debt that does not provide for some form of collateral. As a corporation, the stockholders and officers are protected against a creditor seizing personal assets to satisfy a debt.

(5) **Internal Revenue Service.** Nothing will protect you from the IRS — at least as far as payroll tax is concerned.

(6) **Contract or Contingent Liability.** This is created by damage caused as a result of your action. Protection from contractual or contingent liabilities is probably the best reason to incorporate.

But, as I said earlier, these are similar to the legal dangers inherent in any business you establish. Each business has its own unique set of dangers. Most of these can be avoided with training and thoughtful consideration of the options before you.

Chapter Fourteen — Now Is the Time

It takes determination to build a thriving private mortgage business. The notes are out there; you have to have the fortitude to go out and find them, sell the note holder and close the deal.

But in case you need more evidence, consider these statistics. Mortgages and foreclosures have historically been a popular way to earn a fortune. The current total of dollar volume of privately held mortgages in the United States is approximately $226 billion.

If even only 1% of that volume were transacted per year, it would represent over $2 billion for an industry with fewer than 10,000 professionals nationwide. One in every 500 Americans is a millionaire and most of them earned that status by seizing an opportunity when they saw it.

As you consider the private mortgage industry, keep in mind that it offers all the advantages of a home-based business and can help you achieve your self-employment goals. The private mortgage business requires low overhead and low startup costs, and puts you in the position to make all the decisions from marketing to determining how many hours you work to closing the deal.

You get the chance to exercise your creativity and challenge yourself to bring in better and better deals. You can build your own portfolio of investments.

You are in control. And this is the beauty of self-employment. You know what potential and drive you possess, and you alone have the freedom to tap into these valuable resources and begin to make money on your own terms. Let the private mortgage business bring you closer to your long-range goal of complete financial independence.

Chapter Fifteen — Getting Trained

This primer has presented the basic principles of the private mortgage industry to you. In carefully reading each chapter, you have touched on the fundamentals of virtually every aspect of this business. How you choose to use this knowledge is now entirely up to you.

Hopefully you will use the information covered throughout this book to determine what role you want to play in the private mortgage industry.

Unfortunately, I could not use this format to present all of the information needed to completely prepare you for self-employment in this field. I know that without being able to walk you through every necessary calculation and document, without having an opportunity to introduce you to key industry contacts and provide all the training that goes into certification in this field, you would just end up wasting a lot of time spinning your wheels to get started.

Thorough training is available to help teach you the business, fill in the gaps and fully explain the legal and marketing aspects that have only been touched on in this book. You can apply the basics taught in this book and build on them in training to become an expert. Gaining professional training on how to run your own private mortgage business can be financially and personally rewarding.

The National Mortgage Investors Institute (NMII) leads the industry in training adults to become private mortgage brokers. In fact, some have estimated that NMII has trained about 70% of the trained professionals in the field at the present time. If you are interested in becoming a Certified Mortgage Investor and gaining the tools necessary to excel in this industry, I encourage you to contact an NMII Student Counselor at 1-800-543-1211 to receive more information on training in this exciting industry.

I look forward to having you join us in the industry. Good luck.

Glossary of Terms

Abstract of Title: A condensed but full summary of all materials, such as conveyances, deeds, liens, easements, encumbrances, marriages, divorces, deaths, wills and so forth, that affect, in any manner, title to a specific parcel of real estate.

Acceleration Clause: A clause in contracts for payment of money wherein the time for payment of the balance of the debt is advanced and becomes due and payable upon the occurrence of a specified event, such as failure to pay interest or principal when due, sale or assignment of the property, or the placing of an encumbrance on the property.

All-Inclusive Trust Deed (AITD): In trust deed states, the AITD is the trust deed equivalent of a wrap mortgage. See "Wraparound."

ALTA Policy: A particular kind of title insurance policy that insures the beneficiary against the widest scope of possibilities.

Amortization: The gradual, systematic payment of a debt, such as a mortgage and note, by installment payments of the principal and accrued interest at stated periods for a definite time, at the expiration of which the debt will be liquidated.

Assignee: The person to whom an asset is being assigned and, therefore, obtaining rights to the asset.

Assignment: A transfer by an assignor to another, the assignee of rights, such as an assignment of contract or an assignment of mortgage.

Assignment Consideration: For any contract to be binding, there must be consideration, *i.e.*, something of value surrendered, offered by both parties. In the case of an assignment, the consideration offered by the assignor is the asset being assigned, and the consideration offered by the assignee is the spread or profit the CMI (assignor) wishes to make.

Assignor: The person assigning an asset and therefore forfeiting rights to that asset.

Assumption of Mortgage: The taking of title to property wherein the grantee expressly assumes personal liability for the payment of an existing mortgage against the property and also becomes a co-guarantor for payment of the mortgage note.

Balloon: The principal amount representing the remaining balance that is due and owing in its entirety at a point in time less than would otherwise be required under the amortization period creating the payment schedule. For example, a $100,000 mortgage amortized at 10% over 30 years would have payments of $877.57. If the terms required a balloon at the end of five years, the balance of the mortgage at that time will be $96,579.32 and that will be the balloon amount. The payor will be required to pay the entire balloon amount at that time. Note: A balloon payment terminates the note obligation, distinguished from a principal payment, which only reduces the balance even if it is in excess of regular monthly payments.

Beneficiary: The person or entity receiving the benefit of something. Very often used in terms of insurance where the beneficiary receives any benefits paid. The beneficiary in a trust deed transaction is the institution lending money through the purchase of bonds to purchasers of real estate. Title to the real property is placed in trust for the benefit of the lending institution to secure repayment of the debt.

Business Note: A promissory note given in exchange for the assets of a business. Used the same way a purchase money note is used for a real estate sale.

Chattel Mortgage: A mortgage used to secure the assets of a business or assets other than real estate. Mostly used in the sale of businesses.

Closing Statement: When real estate is bought and sold, there are usually a number of expenses involved. A closing statement is an accounting of all monies involved in the transaction and to whom and by whom it was paid.

Cloud on Title: A proceeding or instrument such as a deed, deed of trust, mortgage, judgment, or other lien which would impair title to the land.

Deed in Lieu of Foreclosure: A deed in lieu of foreclosure is a conveyance of title to real estate. As can be gleaned from the title, the conveyance is executed in lieu of having the mortgage foreclose on the property. The sole consideration on the mortgagee's part is the agreement not to foreclose on the property. This allows the mortgagor to maintain a clean credit record.

Default: The omission or failure to perform or fulfill a legal duty, obligation or promise. For our purposes, most likely used in the context of payments that are in default.

Deficiency Judgment: A personal judgment against any person liable for the debt secured by a mortgage or deed of trust and being the amount remaining due to the mortgagee or beneficiary after foreclosure.

Easement: The legal right a person has in the limited use or enjoyment of real property of another. It is considered an interest in real property.

Encumbrance: Any claim, lien, charge, liability, encroachment, easement, etc., attaching to real property which may cause the title to be clouded and may affect the value of the property.

Equity: The value or interest an owner has in real property over and above any mortgage indebtedness or other liens against the property.

Escalator Clause: The clause in a mortgage allowing the lender to adjust the interest rate based upon the occurrence of a certain event.

Escrow: The system by which money, documents, personal property or real property are held in trust for others by a disinterested third party until the terms and conditions of the escrow instructions made by the parties to the escrow are completed or otherwise terminated.

Estoppel Letter: An estoppel is a bar or impediment which precludes allegation or denial of a certain fact or group of facts. An estoppel letter is a notarized document upon which facts are sworn to by a party. The purpose of the letter is to prevent, or estop, the same party from later claiming facts contrary to those sworn to on the estoppel letter.

Fee Simple: Sole possession of title to a property.

Foreclosure: A legal proceeding in court to enforce payment of a debt secured by a mortgage that is in default by sale of the property under court order.

Grant Deed: A warranty deed in trust deed states. See "Warranty Deed."

Hypothecate: To pledge a thing without delivering the title or possession of it to the pledgee.

Investment-to-Value Ratio: A measure of how secure a mortgage holder's position is and how likely he is to be able to recoup all of his money in the event of a foreclosure. The ratio is found by adding the amount of money the mortgage holder/investor has invested in the mortgage (not the balance of the mortgage) to any senior liens existing on the property, and then dividing that sum by the current value of the property. A higher ratio indicates a riskier investment.

Junior Mortgage: A lien that is subsequent to the claims of the holder of a prior mortgage. Also called an inferior mortgage or lien.

Land Contract: A form of real estate purchase in which the buyer makes installment payments toward the purchase over time and has use of the property but does not receive title to the property until it is paid for in full. In some states, the buyer does not accrue any equity such that if there is a default, the buyer is evicted without compensation of any kind. In other states, the buyer does build up equity and a foreclosure is required to regain control of the property. (Also referred to as "land sales contract," "agreement for deed," "contract for deed.")

Land Sales Contract: See "Land Contract."

Lease Holder: Possession of lease rights to a property.

Legal Description: A description of a parcel of land sufficient to identify the property.

Letter of Credit: A guarantee issued by an entity guaranteeing a creditor satisfaction of a debt created by another party should that party fail to satisfy the debt itself. Most often issued by banks and other large lending institutions to guarantee payment for goods or real estate purchased on credit. Used extensively in foreign transactions.

Lien: A hold or claim which one person has upon the property of another as a security for some debt or charge.

Life Estate Holder: Transferring title of property to another party after death but maintaining title to the property while alive.

Lis Pendens: A notice of lis pendens is placed in public records as a warning to all who may be interested that the title to a particular piece of real estate is in dispute.

Loan-to-Value Ratio: A measure of how heavily mortgaged a property is and how likely the owner is to default on these debts. The ratio is found by dividing the total balance of all existing liens on the property by the current value of the property. A higher ratio indicates a riskier investment.

Market Value: The price at which a ready, willing and informed seller would buy, neither party being under any pressure to act. The price the property would command in the market.

Mechanic's Lien: A claim created by statutory law in most states, existing in favor of mechanics or other persons who have performed work on furnished materials in and for the erection or repair of a building. A mechanic's lien attaches to the land as well as the building.

Mortgage: A pledge of real property for the security of a debt. A contract by which specific property is hypothecated for the performance of an act without the necessity of a change of possessions.

Mortgage Deed: Same as a mortgage.

Mortgage Note: A negotiable promissory note secured by a mortgage on specific real estate. It is the legal and negotiable evidence of the debt created by the sale of a property on credit and is a written promise to repay. It states the rate of interest, repayment schedule and other terms associated with the debt and its repayment.

Mortgagee: The lending party under the terms of a mortgage. The lender of money or the creditor and the owner (holder) of the mortgage.

Mortgagor: The borrowing party who pledges property as collateral. The owner of the real estate and the borrower or debtor.

Negative Amortization: An amortization schedule in which the scheduled payments do not cover the interest due under the terms of the note. Thus, not only is the principal not paid down at all, but that interest, which is due under the terms of the note but not paid because of the structure of the amortization table, is added to the principal balance and accrues interest. The principal balance, therefore, gets larger and larger until it either balloons or the amortization table changes the payment to at least include the interest due on a periodic basis.

Novation: The substation of a second party's obligations in place of the obligations of the original party. The original mortgagor's personal liability with the lender may be transferred to the second mortgagor under a mortgage assumption.

No-Warranty Deed: A deed that, when transferred, merely assigns any rights to title that the assignor has to another party. Does not include any guaranty of possession of title.

Partial: (Also a partial purchase) Any part of the payment stream that is less than the full amount due under the terms of the mortgage note. A partial purchase is the purchase of this portion of the payment streams.

Payor: The person scheduled to make payments under the terms of a contract.

Payee: The person scheduled to receive payments under the terms of a contract.

Payment Stream: The scheduled periodic payments under the terms of a note. As a general rule, it includes all periodic payments except the final balloon payment.

Prepayment Penalty: A penalty for the payment of a debt before it becomes due.

Promissory Note: The document stating a promise to pay the debt. The actual promise that someone makes to pay a certain amount of money at a certain interest rate over a certain period.

Purchase Money Mortgage: A mortgage given to the seller to secure in whole or in part the purchase price of real property.

Purchase Money Note: The note created at the sale of a property and secured by a purchase money mortgage.

Quit Claim Deed: A no-warranty deed in mortgage deed states.

Real Estate Contract: A contract for the purchase or sale of real property, which may or may not include personal property. The Statute of Frauds dictates that, to be enforceable, any contract for the purchase or sale of real estate must be in writing.

Recording: The placing on the public records of the county in which the property is located any instrument that affects the title of that property.

Satisfaction: The discharge of an obligation by paying a party what is due to him, as on a mortgage.

Seasoned: Seasoning relates to the length of time payments have been made on a mortgage note. A mortgage and note are seasoned if many payments have been received in a timely manner. Buyers will have their own ideas as to how many payments make for a seasoned mortgage, but a year's worth is fairly well-seasoned. In that time, the payor will have established his/her financial ability to make the payments on a consistent basis.

Second Mortgage: A subordinate or junior mortgage to a first mortgage.

Seller Carry-Back Mortgage: A mortgage held by the seller of a property and created as a result of the seller of the property financing a portion of that sale.

Servicing: The collection of payments of interest and principal, and trust fund items such as fire insurance, taxes, etc., on a note by the borrower in accordance with the terms of the note. Servicing by the lender also consists of operational procedures covering accounting, bookkeeping, insurance, tax records, loan payment follow-up, delinquent loan follow-up and loan analysis.

Sheriff's Sale: A sale of property, conducted by a sheriff or sheriff's deputy, in virtue of his authority as an officer holding process. Usually used in reference to the real estate sold as a result of a foreclosure judgment.

Simple Deed: A no-warranty deed in trust deed states. See "No-Warranty Deed."

Subordination: The act of a creditor acknowledging in writing that the debt due to him by a debtor shall be inferior to the debt due to another creditor by the same debtor.

Tail: The payment stream and/or balloon payment of a mortgage subsequent to another party's right and interest in that mortgage. Usually the back half of the payment stream when another party has purchased the front half.

Term: The period of duration of a note, acceptance, time draft, bill of exchange or bond, synonymous with tenor and usance.

Title Commitment: A commitment on the part of the insurer, once a title search has been conducted, to provide the proposed insured with a title insurance policy at closing.

Title Insurance: Title insurance can benefit either a mortgagor or a mortgagee. Should the beneficiary suffer any damages due to clouded or false title to real estate, title insurance will recompense the damaged party to the extent of the damages, usually to the extent of money owed or already paid.

Title Policy: An insurance policy, usually issued by the company conducting the title search, that insures a party against loss due to a defective title. Title policies can be issued to both the property owner (owner's title policy) and the lender (lender's or mortgagee's title policy).

Title Search: Research conducted in public records from the distant past to the present to ensure that title to a property has passed cleanly, legally and without dispute from owner to owner. A title search also uncovers any existing liens on the property and any other claims third parties may have to the property researched.

Trustee: The trustee in a trust deed state is an entity holding title to property in trust for the benefit of a lending institution as security for the repayment of the bonds sold by the trustor in order to purchase the real estate in question.

Trustor: In a trust deed state, the trustor is the purchaser of real property financed, in whole or in part, through a promissory note issued to a beneficiary lending institute or seller. The property purchased is placed in trust until the debt is satisfied.

Trust Deed: In some states, as well as in the District of Columbia, a trust deed or deed of trust is a security resembling a mortgage, being a conveyance of lands to trustees to secure the payment of a debt, with a power of sale upon default, and upon a trust to apply the net proceeds to paying the debt and to turn over the surplus to the grantor. Also referred to as a T.D.

Unseasoned: A mortgage and note that has had few, if any, payments due and received. An unseasoned note and mortgage will not have had enough time to establish the ability of the payor to actually make the payments on a consistent basis.

Warranty Deed: A deed to property in mortgage deed states that includes a confirmation by the grantor that they have sole title to the property and will guaranty that.

Wraparound: A mortgage loan in which a lender places a new mortgage on a parcel of real estate which already has an existing mortgage. The lender's new mortgage is in a secondary or subordinate position to the existing first mortgage. The new mortgage wraps around the existing first mortgage and includes both the unpaid principal balance of the first mortgage and whatever amount the lender advances on the wraparound mortgage to the borrower above the first mortgage.

Index