

Q & A OWNER-FINANCED MORTGAGES

In response to the many questions we receive on this topic, we've prepared this general **Guide** (see Disclaimer below)*** to assist you in your decision-making. **After** reading through this entire Guide, please give us a call - if you have additional questions or need help in structuring your planned transaction.

Please note. We do not do any of the following:

Purchase mortgage notes:

- under \$ 50,000 balance amount;
- on manufactured homes, row homes, or properties with environmental (EPA) issues;
- “flip” transactions – where the property is not yet deeded in the seller’s name;
- “simultaneous closings” - where underlying liens must be paid at the time of property sale.

Here are the most frequently asked questions:

1. Should I sell my property with owner / seller financing?
2. How do I sell my property with owner / seller financing?
3. If I take back a mortgage, how much will you pay for it?

Before proceeding, it's important to first define the terms and to understand the process.

Typically, when someone sells a property, the ‘normal’ method is to have an institutional **mortgage lender** (a bank or mortgage company) provide the funds for the buyer. This is done through a **mortgage loan**, which consists of a **promissory note** secured by a **mortgage deed** or **deed of trust** on the property. The loan amount that's provided by the lender is based on a number of factors: type of property, credit of the buyer(s), use of the property, income to debt ratios, amount of down payment, etc. The lender analyzes all of this information to evaluate their risk in the transaction, to determine whether or not the buyer can repay the loan.

With owner-financing, the seller of the property **is the lender**, thus is subject to the same risks as would any mortgage lender – but without the tools and level of expertise to evaluate risk to the same degree; or to handle problems should they arise.

In many cases, the party providing the owner-financing wishes to “cash out” - by selling the mortgage loan to an **mortgage investor**, rather than just receiving the flow of monthly payments. The investor will in turn use those same (above) risk factors in determining whether or not they will buy the mortgage loan, and how much they will pay for it.

Important:

If the mortgage investor won't buy the mortgage loan, then the holder (you) can't cash out !

Q	<i>Should I sell my property with owner / seller financing?</i>
A.	You first need to compare the pros and cons of mortgage lender (bank) financing versus providing the financing yourself:

Bank financing:	
Pro:	You receive all of the money from the property sale.
	The lender takes all of the risk.
	Generally, will provide a larger mortgage loan than an investor will purchase
	Will pay off underlying liens / mortgages at time of funding.
Con:	Not all buyers will qualify under lender guidelines.
	The approval process may be time-consuming.
	Closing costs and or lender fees may be high
Owner financing	
Pro:	It may expand the market of potential buyers for your property.
	The approval / qualifying process will likely be somewhat easier.
Con:	You take all the risks, if the mortgage can't be sold.
	You will take a discount when you sell the owner-financed mortgage.

Q	<i>How do I sell my property with owner / seller financing?</i>
A.	As mentioned above, with owner-financing, you are the lender. Just as the banks do, you need to pre-qualify the potential buyer. In addition, you will be somewhat more involved in the overall structuring of the property sale transaction.
	Offering the property for sale:
1.	As a <u>first step</u> , you need to know the real value of the property you are selling. We strongly suggest having a full appraisal done, by a state-licensed appraiser. In considering purchasing the mortgage loan that you plan to sell, a mortgage investor (for the period of one year from the date of the property sale by you) will use the lesser of the sales price or the appraised value. For example, if the property appraises at \$ 100,000 and you sell it for \$ 90,000, the mortgage investor's price to you will be based on the lesser property value. Because you're providing owner financing, selling the property at full or very close to the appraised value is not unusual, and the appraisal you've obtained supports that value. To protect yourself against committing to provide financing for someone who turns out to be <u>not qualified</u> , you should consider stating in all your ads and subsequent Purchase contracts: "Seller may finance, subject to Seller approval" or similar wording suggested by your legal advisor.
2.	Qualifying the potential Buyer(s): As the lender, you need to know as much as possible about the Buyers in order to (a) determine whether they qualify as buyers; and (b) if so, for you to use this information as a basis in structuring the overall deal. Form 1003. Uniform Residential Mortgage Loan Application. You can download this free form off the internet; keywords "form 1003". The applicant should fill out all personal information - except for the details of the requested mortgage loan - and sign and date the Form. The information provided, among other things, tells you whether or not they have the down payment money.

Credit Report: Used in conjunction with the amount of the actual cash down payment, this is the single most important factor in determining the marketability and value of the owner-financed loan that you intend to sell. Simply asking, then getting the reply, “My credit’s very good, etc.” doesn’t work. All mortgage lenders and mortgage investors work with actual credit reports and credit scores, as should you. In general, and in today’s market, a credit score below 650 is not considered to be “good.”

Along with the completed Form 1003, you should require that the potential buyers provide you with a copy of their current credit report. They can obtain their report for free or at a nominal charge over the internet from a number of websites, including www.annualcreditreport.com, (tel: 877-322-8228); www.freecreditreportasap.com, www.experiandirect.com, www.experian.com

3 Structuring the Property Sale and Mortgage Financing:

One of the factors involved in analyzing risk is the **loan-to-value (LTV)**: the amount of the (new) mortgage balance divided by the value of the property; i.e., \$ 75,000 mortgage loan / \$ 100,000 sales price = 75% LTV. Acceptable LTV’s vary, depending on the type of property. A single family owner-occupied property will allow for a higher LTV than will a commercial property or a land-only property.

(a) Residential property (single family house)

Here is an example of a “typical” structuring (**10 / 80 / 10**) based on the property being sold at appraised value, and the buyers qualifying as to credit and cash position, etc.

Sales Price	\$ 100,000			
Cash Down***	10,000	10%		
1 st Mortgage	80,000	80%	LTV	term: 360 months, with 5 year balloon
2 nd Mortgage	10,000	10%	LTV	term: 360 months, with 5 year balloon

You would plan to sell the 1st mortgage loan for cash at some point in time after the property sale transaction is completed, expecting some discount from the face amount – depending on all factors of the deal (interest rate, etc). The interest rate on the 1st mortgage should be set at above current market interest rates, to make it attractive to the investor and to get you the best price for it. That mortgage should not have a prepayment penalty, thus allowing the buyers to possibly refinance at a lower rate in the future.

You may set the interest rate on the 2nd mortgage (which you will continue to hold) at whatever rate you can negotiate. The 2nd mortgage loan is very likely not saleable.

*** The Cash Down Payment must be verified by the title company at the time of closing. A 2nd mortgage in lieu of a cash down payment is **not** acceptable; i.e., you can’t use a 0 / 80 / 20 structure.

(b) Commercial property (various types)

Same as above, except use (**20 / 70 / 10**) structure; higher interest rate than for Residential.

(c) Land-Only property (various types)

Same as above, except use (**25 / 60 / 15**) structure;

Note: Variations of the above “structures” may be allowable on a case-by-case basis. Please contact us with the specifics of your deal.

Q	<i>If I take back a mortgage, how much will you pay for it?</i>
A.	For illustrative purposes, below is a sample Matrix showing many of the key factors that are taken into consideration in pricing a mortgage note. For each of the 6 <u>line</u> items (i.e., "Property Type", etc.), a number from 1 to 4 is placed in the box that applies. The <u>columns</u> are then totaled, with totals ranging from a low of 6 (best case) to a high of 22 (worst case).

input >>>	<input type="checkbox"/> 4	<input type="checkbox"/> 3	<input type="checkbox"/> 2	<input type="checkbox"/> 1	
Property Type	<input checked="" type="checkbox"/> 4 land only	<input checked="" type="checkbox"/> 3 commercial	<input checked="" type="checkbox"/> 2 2-4 units	<input checked="" type="checkbox"/> 1 house	
Credit Score *	<input checked="" type="checkbox"/> 4 600 +	<input checked="" type="checkbox"/> 3 650+	<input checked="" type="checkbox"/> 2 700+	<input checked="" type="checkbox"/> 1 750+	
Loan-to-Value **	<input checked="" type="checkbox"/> 4 90%	<input checked="" type="checkbox"/> 3 80%	<input checked="" type="checkbox"/> 2 70%	<input checked="" type="checkbox"/> 1 50%	
Interest Rate (vs. market) ***	<input type="checkbox"/>	<input checked="" type="checkbox"/> 3 below mkt.	<input checked="" type="checkbox"/> 2 at mkt.	<input checked="" type="checkbox"/> 1 above mkt.	
Property Use / Occupancy	<input type="checkbox"/>	<input checked="" type="checkbox"/> 3 vacant	<input checked="" type="checkbox"/> 2 rental	<input checked="" type="checkbox"/> 1 owner-occupied	
Seasoning (months)****	<input checked="" type="checkbox"/> 4 none	<input checked="" type="checkbox"/> 3 3 mos.	<input checked="" type="checkbox"/> 2 6 mos.	<input checked="" type="checkbox"/> 1 7 + mos.	

- * Credit Score: - Scores of at least 600 are required for newly-created mortgages.
- ** Loan-to-value (LTV): - Mortgage loan balance divided by actual property value.
- *** Interest Rate: - Actual rate compared to current market rates for a loan with similar term.
- **** Seasoning: - Number of months of payments made on the mortgage loan. Seasoning may offset a low credit score to some degree.

Shown below is an example of the risk factor scores (total of 13) with only one box filled in per line for each appropriate category. This is for a mortgage loan on a **single-family, owner-occupied home**, with an 80% LTV, a credit score of 700+, an interest rate at current market; with no seasoning.

input >>>	<input type="checkbox"/> 4	<input type="checkbox"/> 3	<input type="checkbox"/> 2	<input type="checkbox"/> 1	
Property Type	<input type="checkbox"/> land only	<input type="checkbox"/> commercial	<input type="checkbox"/> 2-4 units	<input checked="" type="checkbox"/> 1 house	
Credit Score	<input type="checkbox"/> 600 +	<input type="checkbox"/> 650+	<input checked="" type="checkbox"/> 2 700+	<input type="checkbox"/> 750+	
Loan-to-Value	<input type="checkbox"/> 90%	<input checked="" type="checkbox"/> 3 80%	<input type="checkbox"/> 70%	<input type="checkbox"/> 50%	
Interest Rate (vs. market)	<input type="checkbox"/>	<input type="checkbox"/> below mkt.	<input checked="" type="checkbox"/> 2 at mkt.	<input type="checkbox"/> above mkt.	
Property Use / Occupancy	<input type="checkbox"/>	<input type="checkbox"/> vacant	<input type="checkbox"/> rental	<input checked="" type="checkbox"/> 1 owner-occupied	
Seasoning (months)	<input checked="" type="checkbox"/> 4 none	<input type="checkbox"/> 3 mos.	<input type="checkbox"/> 6 mos.	<input type="checkbox"/> 7 + mos.	
Column totals:	4	3	4	2	13

Other property configurations (such as a lower LTV 2-4 unit rental property) may result in higher overall scores; however, that mortgage loan may be just as “good” as the above example. It’s just analyzed differently.

The bottom line: Once the mortgage investor has done their analysis of the risk factors, the price that will be paid for the mortgage note **then** comes down to the lesser of:

- The maximum amount they wish to put into the specific deal; and
- The price they need to pay to obtain the yield that they desire.

Conclusion: Based on all of the above, it should be clear that all of the above “risk factor” information is needed to provide you with an accurate quote. Based on the above example, the price paid to you by the investor would likely be in the 85 to 90 cents on the dollar range. When you get to that stage, please contact us for a specific quote.

<i>Other</i>	
1	Commercial and /or Rental Property :
	Additional information will be required for full evaluation of these types of properties: Rent rolls, rental amount, operating statements, etc.
	Credit Information on Payor(s)
	On occasion, the Buyers may wish to purchase the property in corporate or company name. Unless that company is fairly major, and can be checked out as to credit, etc., it is strongly suggested that you try to obtain the personal guarantees of the key principals / signers. This can be done in two ways: (a) Having them sign a separate Guaranty Agreement; or (b) Having them sign the mortgage documents both as corporate signers <u>and</u> individually. That way, the mortgage investor can determine the individual credit scores, and you will receive a more accurate, and perhaps better, quote.
2	Simultaneous Closings:
	Most Investors are only interested in being in first position – they won’t purchase a second position mortgage – so any existing mortgage or lien must be paid off. As mentioned above, we <u>won’t</u> do a Simultaneous Closing (table funding) whereby the underlying mortgage(s) / lien(s) are paid off from the proceeds of the mortgage purchase transaction. However, see the next two sections, below.
3	Land Contracts (also known as Contracts for Deed)
	This is an alternative way of selling a property. When a property is sold using a Note and Mortgage (or Deed of Trust), title to the property is transferred to the new owner by a Warranty Deed . By using a Land Contract, deed ownership remains with (you) the Seller, and the Buyer only obtains deeded ownership of the property once they have fulfilled all of the terms of that Contract. By using the Land Contract, you may not have to pay off the underlying mortgages*** at the time of the property sale.
	Once the property sale is completed, we can purchase the Land Contract, paying off any existing mortgages from the proceeds to you. This is not considered to be a Simultaneous Closing. Please note that prior to our purchasing the Contract, it may have to be converted to a Note and Mortgage / Deed of Trust.
	***Check first with a local real estate attorney in your area, and also with the existing mortgage holder(s) regarding this, particularly as to any “due-on-sale” clauses in the existing mortgage(s).

Other - continued

4	Wrap-Around Mortgages :
	<p>This is another alternative way of selling a property. In this case, the property is sold using a Note and Mortgage (or Deed of Trust), and title to the property is transferred to the new owner by a Warranty Deed. Rather than paying off the underlying mortgage(s) at the time of the property sale, they remain in place *** with a newly-created mortgage “wrapping around” the underlying mortgages. That wraparound mortgage will <u>always</u> be in an amount larger than the sum of the balances of the underlying mortgages.</p> <p>Once the property sale is completed, we can purchase the Wraparound Mortgage, paying off any existing mortgages from the proceeds to you. This is not considered to be a Simultaneous Closing.</p> <p>***Check first with a local real estate attorney in your area, and also with the existing mortgage holder(s) regarding this, particularly as to any “due-on-sale” clauses in the existing mortgage(s).</p>

Additional Resources: (to view .pdf files,  Adobe Reader is needed. (free download) <http://www.adobe.com/products/acrobat/readstep2.html>

- **Property Sales Calculator:** see last page for a snapshot view. You can download a working copy of this in Excel, from our website: http://www.americanfunding.net/downloads/sales_calculator.xls
- **Form 1003 Uniform Residential Loan Application:** http://www.americanfunding.net/downloads/form_1003.pdf
- **Other Forms & Information** (sample notes, mortgages, contracts, etc). http://www.mortgage-investments.com/resources/frame_Free_resources.htm

We hope the above information has been helpful to you. As you can see, “Owner-financing” is not quite as simple as it’s sometimes made out to be. The key to using it successfully is to first obtain all of the necessary information – **before** committing yourself to being the lender. Then, based on the quote you receive from us, you can determine whether or not owner-financing is the best sales / financing vehicle for you to use.

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PROPERTY PURCHASE / SALE CALCULATOR

ACTUAL APPRAISED VALUE: **\$ 100,000**
 DESIRED SALE PRICE: **\$ 110,000**

SALES PRICE **\$100,000** 100%

10 % CASH DOWN PAYMENT \$ 10,000
80 % **SELLER-HELD 1ST MTG** \$ **80,000** **80% LTV**
10 % SELLER-HELD 2ND MTG \$ 10,000

100 TOTAL (SALES PRICE) **\$ 100,000** **100%**

RATE	TERM		Payments	Balloon Amount(s)
8.000	360	60 1ST MORTGAGE (P & I)	\$ 587.01	\$76,642.90
9.000	360	60 2nd MORTGAGE (P & I)	\$ 80.46	\$9,668.48
Totals			\$ 667.47	\$86,311.37

SELLER RECEIVES:

⇒ CASH DOWN PAYMENT \$ 10,000
CASH FROM MTGE SALE \$ 72,000 ***
 TOTAL CASH **\$ 82,000** 82.0% of Sales Price

PLUS:

2ND MORTGAGE \$ 10,000
 TOTAL TO SELLER **\$ 92,000** 92.0% of Sales Price

Based on: ⇒ **90** cents on dollar (*** subject to our actual Quote)