Lighthouse
Harbor Inc.

Understanding Mortgage Note Investing:

What is a Mortgage Note?

An agreement that offers a mortgage as proof of the debt and defines the terms under which the mortgage is to be repaid.

Ex. John goes to the bank to take out a loan to buy a house. He gets a Mortgage for 100K. The 100K that the bank lends out is secured by the collateral of the house.

There is secured debt and unsecured debt. What is the difference?

Secured Debt
Debt backed or secured by collateral to reduce the risk associated with lending.

Ex. With a mortgage, your house is considered collateral towards the debt, because it is "attached," or "secured" to the property. If you default on repayment, the bank seizes your house, sells it and uses the proceeds to pay back the debt.

Unsecured Debt
In the case of unsecured debt, a lender loans money without the security that an underlying asset provides. For this reason, unsecured debt carries more risk for the lender, which in turn makes the loan more expensive. The more additional risk that a lender must take on, the higher the rate of interest a borrower must pay, making unsecured loans subject to higher rates.

Ex. Credit card debt is unsecured debt. Suzie has $5,000 in credit card debt. She stops paying her monthly bill. The credit card company can call her, send her to collections, mark up her credit score, but there is no collateral, like a house or a car, that they can take back and sell to recoup the $5,000 debt.

Lighthouse Harbor, Inc. invests <u>only</u> in debt secured by real estate.

There are two kinds of personal bankruptcy. What does each mean, and how does each affect the mortgages we buy?

The two most common forms of bankruptcy for individuals are referred to as chapter 7 and chapter 13 bankruptcies.

A chapter 7 bankruptcy is designed to "wipe out" unsecured debt and allow an individual to start over with a "clean" credit history. In the case of a chapter 7, unsecured debt – usually credit card debt - is wiped out. Credit card companies can attempt to collect, but you are no longer obligated to pay the debt.

A chapter 13 bankruptcy is designed to "reorganize debt" for a specific amount of time. The debtor understands their responsibility and has the ability to repay their debt. They get on a repayment plan that usually consists of a large monthly payment that is dived out to creditors in amounts decided by the courts.

In either case, secured debt remains attached to the property, even in the case where a bankruptcy has wiped out all unsecured debt.

Again, Lighthouse Harbor, Inc. invests <u>only</u> in debt secured by real estate.

What is a "1st position," or "senior" lien?

The first security interest (aka, mortgage) placed upon property at a time before other liens, which are called junior liens.

What is a "2nd position," or "junior" lien?

A junior lien is one that is subordinate in rank to another prior lien (aka, first mortgage). This means that the junior lien will be paid off only after the senior lien has been satisfied.

Ex. John takes out a first mortgage on his house for $100,000. Five years later, John takes out a second mortgage on his house worth $25,000. In this example the $100K loan is in "1st position," or a senior lien, compared to the $25K lien which is considered a 2nd lien or a "junior lien." Both liens (mortgages) are secured to the property.

Investing in Mortgage Notes

Through our company, Lighthouse Harbor Inc., and the relationships we have established with banks throughout the United States, investors have the opportunity invest in "distressed" or "charged off" mortgages that are secured to properties across the country. Lighthouse Harbor Inc. is able to purchase these mortgages at a large discount, creating an investment that is very secure and offers an excellent rate of return.

Let's use the previous example of John:

John buys a house for $100,000. He gets a first mortgage for $100,000. Five years later, John's house is now worth $150,000. He takes out a second mortgage for $25,000. Now, John has a first mortgage for $100,000 and a second mortgage for $25,000. His house is worth $150,000.

Another five years go by and John's house is now worth $200,000. Although he continues making payments on the first mortgage, he has stopped making payments on the second. After many months of failed attempts to collect payments on the second mortgage, the lender "charges off" the debt and sends it to Lighthouse Harbor, Inc. for potential purchase.

With back payments and interest-related penalties, John now owes close to $30,000 on his original $25,000 mortgage. Lighthouse Harbor, Inc. "crunches the numbers" and agrees to buy the second mortgage for $5,000. Although we bought the mortgage for $5,000, we are owed $30,000 (the full value of the debt). By buying at a discount we've just created $25,000 in profit. John decides to sell his house for $200,000. The first mortgage of $100,000 gets paid off, and then Lighthouse Harbor, Inc. gets paid its $30,000.

In the example just outlined, why would a bank sell a mortgage worth $30,000 for only $5,000? Since their debt is secured to the property, can't they just take the house back and recover the entire $30,000?

Yes, they can. But they don't want to. Banks are in the business of servicing home loans that "perform." Meaning, they make their money on the homeowner who make payments every month for the entire life of the loan. Banks aren't equipped to handle non-performing mortgages. For the banks and different lending institutions we work, their answer is simple: "why spend time and money on distressed (charged off) debt, when they can sell it to Lighthouse Harbor, Inc. at a discount, recoup a portion of their loss, and write the rest off?"

This becomes especially true for banks when the non-performing mortgage is in a junior, or "second lien" position.

Investing in REO's

*The term REO stands for "*Real Estate Owned"

An REO is a property owned by a lender - usually a bank - after an unsuccessful sale at a foreclosure auction.

Ex: John has a mortgage on his house for $100,000. He stops making payments and the bank initiates a foreclosure to recover their debt. No one bids to buy the property at the foreclosure sale and the bank takes the property back. The bank now owns the property (i.e.: they own the real estate), hence the term REO.

In the above example the bank no longer has a mortgage on the property, because they now own the property. To recoup their loss, the bank must now sell the REO. Before marketing the property the bank will need to do all necessary repairs, evict any tenants or squatters, hire a real estate agent, and finish any number of tasks to complete the sale. Once again, some banks are not equipped to handle this sort of work. They would rather sell the property at a discount, as-as, and get what they can get rather than have to sell the REO using a broker and incurring all of the expenses just outlined.

Lighthouse Harbor Inc.

Non-Performing Mortgage Returns

			(days)	*(includes repairs)*				
Address	***Purchase Date***	***Close Date***	***holding period***	***Basis of Note***	***Payoff of 1st Mtge****	***Proceeds***	***Client Profit***	***note***
### 43rd St Washougal, WA	4/19/2005	8/8/2005	111	$ 7,113		$ 63,910	$ 17,039	Paid off at foreclosure auction
### Hummel Dr, Boise, ID 83709	4/27/2005	9/21/2005	147	$ 8,406		$ 29,596	$ 6,357	Paid off at foreclosure auction
### 195th Ave NW, Elk River MN	12/7/2005	2/23/2006	78	$ 9,546		$ 30,812	$ 6,380	HO Sold Home
### NE 53rd Ave, Portland, OR 97218	8/22/2005	2/9/2006	171	$ 5,541		$ 33,123	$ 8,275	Paid off at foreclosure auction
### Longacre St SW, Beaverton, OR 97006	4/13/2005	12/6/2005	237	$ 3,250		$ 24,303	$ 6,316	HO Sold Home
### E Diamond Ave, Spokane, WA 99207	9/30/2005	4/28/2006	210	$ 55,250		$ 82,543	$ 8,188	REO Sale
### Franklin, Thornton, CO	10/22/2004	5/13/2005	203	$ 20,000	$ 174,866	$ 206,937	$ 3,621	1st mtge money out 137 days, foreclosure
### Douglas St, Winston Salem, NC	1/31/2006	3/9/2006	37	$ 11,050		$ 22,204	$ 3,346	REO Purchase and flip
### Primitive St, Durham, NC 27701	3/29/2006	5/3/2006	35	$ 1		$ 3,613	$ 1,084	REO Purchase and flip
### NE Meadows Dr, Vancouver, WA 98662	9/6/2005	5/15/2006	251	$ 5,713		$ 20,397	$ 4,405	Paid off at foreclosure auction
### Quinalt Dr., Oregon City, OR 97045	8/8/2005	9/20/2005	43	$ 18,926		$ 50,968	$ 9,612	HO Sold Home
### Bedivere Dr E, Spokane, WA 99218	11/30/2005	5/6/2006	157	$ 25,224		$ 42,542	$ 5,195	HO refinanced
### SW 157th Ave, Portland, OR 97236	9/16/2005	10/3/2005	17	$ 7,021		$ 33,354	$ 7,900	Paid off at foreclosure auction
### E 25th St, Winston Salem, NC	1/31/2006	2/21/2006	21	$ 10,000		$ 21,481	$ 3,444	REO Purchase and flip
				$ 187,041	$ 174,866			
			101	***Average Holding Period (days)***		***Profit***	***$ 91,162***	

Property Information Search

Homeowner(s): __

Address__ City East Stroudsburg Zip__

Prop Add __City East Stroudsburg Zip__

County__________ State PA

$ 220 - Market Value

Date Bought (mo/yr)__________

$ 131K - 1st - Int. %_____ Lender: Flagstar Bank Date 11/97

Payment 1474 on payment plan - current as of 8/06

Entry # ______

$ 22,593 2nd - Int. %_____ Lender: Green Tree Date 12/00

≈ 29,030

Payment 361 next due ~~4/05~~ 5/05

Entry # ______ offered on 10/10

$ 8,743 - 3rd Green Tree - next due 5/05

$______ - offered $ 10/11

$______ -

BPO ✓

Title ✓

BK ✓

Property Information

Prop Serial # _

Acres/Sq. Ft. .6/26136

Vacant / Occupied

Year Built______ Sq. Ft. 1900 Taxes Paid: (Y) / N

Mini Legal Desc. LOT SEC

Condition:______

Recorded Information

Notice of Foreclosure Foreclosure initiated by the 1st - H/O making payments

Communication with Property Owner

RESPA:______ Demand:______ Intro:______ Phone #__

Notes: __

BK Info: filed Chap 7 10/05, dschg 4/06