

Expand Your Business with Note-Buying

Knowing six exit strategies can help clients maximize their returns

The concept of note-buying isn't quite as old as lending itself, but it's close.

A promissory note is a promise to pay with specific terms. These include the amount of debt, the length of time in which the loan will be repaid and the rate of interest. A real estate note is written as a binding contract between a lender and a borrower on a real estate transaction.

Note-buying is the process by which the owner of a note looks to sell his interest in that note. It can be sold either for its existing balance or at a discount.

Mortgage brokers should be familiar with this process, as mortgage loan origination is the process of creating the note. Brokers can expand their business to include note-buying and can match buyers with sellers for a fee. Although notes can be bought and sold directly by buyers and sellers, they also can be arranged through note brokers.

Note-owners can sell a note for full face value or liquidate by discount. What they choose may depend on a note's payment history, an increase or decrease in property values, or simply their need for cash. What was once a behind-the-scenes trade between investors has now caught media attention, with large lending institutions selling off billions of dollars worth of non-performing notes.

Events in the past three years have caused a significant increase in the buying and selling of commercial and residential notes. Brokers who participate in note-buying should be able to advise their clients on a variety of issues, including exit strategies to help them maximize their returns.

Let's say your client located nonperforming loans, completed due diligence

and bought the notes at a good discount. Now what?

The idea is to approach the highest-paying strategies first. Here are six exit strategies to get maximum capital return.

- 1. Sale:** A note can be sold to another investor, either at par (100 percent) or at a discount because of a drop in property value. This strategy works for investors that buy individually or in bulk. The most common practice is to modify the loan and resell it when it's back to performing status. Typically, notes are sold at a decent spread.
- 2. Owner refinance:** If it's possible for the borrower to find a hard-money lender or other source that can pay off the existing delinquent loan, a borrower can replace an older loan with a new loan offering better terms. In this case, borrowers may not need a payoff discount because of their equity position on the property. Loans that are seasoned and have been paid on time can often refinance with a Federal Housing Administration loan. This is a great strategy, especially if the note was purchased at a discount.
- 3. Short loan payoff:** This scenario occurs when a borrower and lender negotiate a payoff demand that is less than the current principal balance. Some borrowers who haven't made payments in months suddenly may find cash to pay off their loan at a good discount. This is a strong exit strategy when you bought the loan at a discount and want to cash out fast. The return on this exit strategy is usually high.
- 4. Owner short sale:** If a borrower lists a property for sale at less than the current loan amounts that encumber the

property, this is considered a short sale. This is similar to a short loan payoff. The difference is the borrower is selling the property and a new buyer is coming in with financing. Again, this could be a great exit strategy as long as you're in a first-lien position and selling for more than what you purchased the note for. If you are presented with an owner short sale, the note-owner shouldn't feel forced to sell. You still have the freedom to decline and continue with foreclosure. It all depends on the profit margin you want.

- 5. Sell at foreclosure sale:** Typically, the minimum bid is equal to the outstanding loan amount, the accrued interest and any fees associated with the foreclosure sale. The note-owner, however, can foreclose and make the opening bid at a foreclosure sale lower than the outstanding amount due and therefore attractive to third-party bidders. The point here is that you can still sell, make a profit at the courthouse and never physically have to take back the property. If someone buys, you are cashed out and don't need to deal with selling the real estate owned (REO) property.

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6. REO sale: This is the bottom-line exit strategy. If a property-owner is unable or unwilling to make the principal or interest payments, or modify the mortgage, then an REO sale becomes necessary. The note-owner can foreclose to get the title and sell the property as stipulated in the terms of the mortgage

contract. After the property is back in the note-owner's possession, she can either hold and rent, or sell the property to regain her investment.

Note-buying can be a lucrative investment for traditional real estate investors, private holding companies, individual-retirement-account investors and other

private investing entities. Brokers who get involved in note-buying can help their clients by knowing these six exit strategies. As trusted advisers, brokers also can help clients find the right specialty collection team to accomplish these strategies successfully and limit their clients' investment risk. ●