Buying Notes From Lenders In **DISTRESS!**

by John Schaub

In the thirty-plus years I have been buying real estate and notes the past few years have presented the most opportunities for buying notes at huge discounts.

Owners of real estate are not the only ones in distress these days. Lenders, both private parties and institutional, own notes secured by mortgages and trust deeds which are non-performing. By non-performing, I mean the borrowers have quit making their payments.

In normal times when loan defaults are few, and optimism about property appreciation abounds, lenders often try to profit from defaulted notes.

They foreclose and try to resell at a profit, often successfully.

The climate is different today. Most institutional lenders are scrambling to make a profit and already own an inventory of real estate they have foreclosed. This real estate produces no income, compared to the loan they used to hold which paid them interest. Likewise, many private investors are not receiving the payments they anticipated.

Most Foreclosures Are Not Opportunities

Many are properties you would not want to own, no matter how cheap they are. I talked with a lender who made many high interest rate loans on houses in older, downtown areas. Making high interest rate loans to people who cannot afford to repay them is bad business in my book, but that's another subject.

Eventually, he foreclosed and has been unable to sell the properties at any price. They are now boarded up (condemned by the city) and he will probably lose everything because of the past due property taxes he is not willing to pay: An expensive seminar.

I only look at houses or notes *secured by houses in neighborhoods I know and like.* If I buy a note or a house, I need to **know the real value** and that I can **resell it or rent it at a profit**.

Don't let greed override your common sense. Don't buy a note at a ninety percent discount if it is secured by something you don't want to own. It is far better to make a smaller, but sure, profit than to take an expensive "seminar."

Looking At Both Sides

If you plan to take advantage of the many opportunities available today from lenders, it is important that you understand how the lender views his situation.

As both a buyer and owner of a number of notes secured by houses in my town, and a buyer of distressed paper and property, I have experience on both sides of this situation. In fact, I have more experience than I need as a mortgagee (noteholder). Even when you understand what is happening to you as a mortgagee, it is still not a comfortable experience when a borrower stops making payments.

It is unlike the experience as a landlord, because the remedies available to the landlord are more swift and certain, and the tenant has less to lose. The loss of a security deposit on a rental home is not the same as losing equity in *your home.*

In addition, the courts and our legal system offer more time and protection to the homeowner. A filing of bankruptcy will further extend the time a borrower has to repay the debt or forfeit the security.

The foreclosure process is also more expensive in terms of out-of-pocket costs and time. First-time investors in small notes are often wiped out when they cannot afford to pay the costs of foreclosure and carrying the underlying mortgages on the property they have for security.

When you are an investor in paper, you should have a cash reserve at all times that would allow you to make the payments on any loans senior to yours (recorded before your note) and attorney's fees, trustee's fees and court costs. If you do not, when a borrower fails to pay you, you will be in a weak position.

A rule I follow as a buyer of notes secured by houses is this:

Never buy a note secured by a house unless you would like to own that house.

If you are the holder of a note secured by a property you don't want to own, you will make costly concessions

instead of taking title to the property. When you don't mind taking title, then you will not give up any of your profit.

Another rule when buying a note:

Never loan more against a house than you are willing to pay for the house.

Many lenders today are receiving the real estate they accepted as collateral in lieu of payments. In effect, they bought the real estate for the amount of the loan, plus their cost in recovering the collateral. Often, this was not a good buy and they will be forced to sell for less than they have "invested" in the property.

Identifying Opportunities

Not all lenders are in weak positions. You only want to make offers to those who are.

A common mistake made by buyers of real estate is to make offers to the wrong people. Most of my offers are accepted (after some negotiation) because I only make offers to sellers who really need to sell.

From the previous discussion of what to do and what to avoid as a lender, you can begin to form a profile of a lender who would be anxious to sell to you at a discount. Before contacting lenders or advertising for them, know what you are seeking:

1. Lenders who have loaned too much money against a property.

2. Lenders who have loaned against property which they are afraid of owning.

3. Lenders who cannot afford to foreclose.

4. Lenders who do not want to foreclose because of public perception or a personal relationship with the borrower.

5. Lenders who are desperate for cash and willing to sell loans they now own to get cash.

6. Lenders who have foreclosed and don't want the property.

You can deal with a lender successfully in any of these positions.

You can buy loans that are performing (payments are current) at a discount when the lender needs cash or discovers that many of his loans are going bad.

When the loan goes into default, then you can buy loans that the lender does not want to foreclose, because of the relationship with the borrower or the financial considerations.

Finally, after a lender has foreclosed, you can buy the property directly from the lender. In the other circumstances mentioned above, you are not buying the property, but the debt secured by the property. You would be stepping into the lender's shoes.

Locating Lenders Who Want To Do Business

It is probably fair to assume that if your town is experiencing a weak real estate market, most of the local lenders would be willing to make you a good deal on their problem loans and REO (real estate owned) properties. You can simply call the bank and make an appointment to speak with the officer in charge of the REO department.

I have found that it is better to find one property they own and then approach them with an offer or inquiry on that one. You then have more credibility than if you just walk in off the street. After you discuss the one property then you can ask about other similar properties they might have.

Most lenders list their properties with local real estate brokers. By flipping through an MLS book or by doing a computer search for all properties owned by an institution, or by simply asking a broker if he has any bank-owned property listed, you can find your first one.

Another way I find houses is looking for abandoned properties in neighborhoods where I now own property. My friend Warren Harding taught me one of his trade secrets for finding property years ago. He told me never to drive the same streets to work or anywhere. Try to drive down a new street every day and sometimes you will see something you have never seen before, like an abandoned house. That advice has found me many abandoned houses. Thanks, Warren!

When you find the abandoned house, you need to find the owner or the lender. Often the owner is no where to be found and the lender is the one to go see. Don't look in the mailbox for mail, like past due loan notices addressed to the owner: that may be against the law.

Do talk to the neighbors. Find one even if you have to walk several houses down the street. They will typically have a story to tell and may be able to give you some leads. The neighbors have a personal interest in having the house repaired and occupied. An empty house attracts the wrong people.

Finding The Lender When There Are No Clues

When all you have is a house address, it's still not hard to run down a lender. Go to your local tax assessor's office and, with the address in hand, you should be able to determine the legal description of the property. Don't be shy about asking for help, but do be nice.

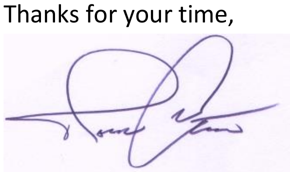
Using a cross-reference directory you should be able to identify the owner. Then simply look up the owner and the property in the public records (where all deed, mortgages and trust deeds are recorded). You will find the deed where the owner took title, which will give you the names of the owner(s) and typically recorded next will be the mortgage or trust deed.

You can usually find other debts against the property and judgments against the owner by doing a name search. Most public records can be searched by names and legal descriptions. If you don't understand how deeds and debt instruments are recorded and can be searched in your town, take an afternoon and go down to the court house. Ask for help and research your name (or one of your friends) to see how the system works.

John Schaub has been investing in paper and real estate full-time for over 30 years. He has taught highly-regarded seminars on real estate and paper since 1976 and is the author of many excellent guides and tape courses.

I hope you found this information useful and if you are interested in buying or selling a note please contact me.

Thanks for your time,



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