What Makes A "Safe" Mortgage?
24 Expert Investors Respond

We asked two dozen of the veteran investors in the note business what makes a “safe” mortgage?

The answers are informative on several levels. First, of course, is the combined centuries of experience behind them. But also it is revealing to see how much of an impact the phenomenon of credit scoring has had on the industry. Those of you on the Note Boat 2000 will long remember the vigorous debate we had on that subject, with passionate defenders of credit scoring as the key safety net opposed by others just as passionate advocating equity in the property as the best way to protect an investor.

Whether you are primarily an investor or a broker, you’ll learn a great deal from these answers. Even those who broker everything and never invest themselves should know what their investors need to have in a note.

Here is the question:

“Of course there are no guarantees, but what in your opinion are the priority characteristics of a residential mortgage note that a private investor should look for in order to have as safe an investment as possible?”

"Do I want to own this property at this price?"

“What is a "safe" mortgage/deed of trust? Will I always have hair? Will the Yankees win another pennant? These questions are often asked among Kings and cabbages. But, as any King will tell you, things change. That nubile neighboring kingdom's daughter sometimes turns out to be MacBeth's mother.

Due diligence is a term much used in this business but often turns into nothing but filling in some investor's check list. Old time note buyers always ask the question, ‘if this deal goes sour, do I want to own this property at this price?’

The recent advent of major players in this market coming from a background of mortgage lending has fostered a dependence on credit scores that many times does not really address the underlying collateral's inherent ability to at least return the investor's original capital. This business is not about 95%-97% funding using a government-sponsored program where your personal funds are never at risk. The broker mentality instead of the business owner mentality just looks for the next deal as an employee looks for the next payday.

A "safe" mortgage/deed of trust is one in which your answer to my question of owing the property is a loud YES.” — B.H. Tilton, President, Cross Creek, Inc., Wasilla, Alaska

---

“It’s the Attitude of the Seller”

First, after many years of having people contact us, the attitude of the seller is felt more than any thing else. We like to think we can feel the honest intent of the seller.

Our buying seller-financed loans has mostly been in the rural and semi-rural areas of the whole United States. Sellers contact us rather than our first contacting them.

We have lost so little in our 30 years of note buying perhaps we do not check as closely as we should.

We like to have the proposed seller fax us a copy of the amortization schedule showing the date of payment received. On our inquiry sheet we send to the proposed seller, we ask for a complete description of the property and "what is the employment of the payor and how long on the job, does he pay by bank check or money order?" We feel this personal information assists us to make a desirable decision.

We ran into a "Slicker" this week. The man had a corporation and sold it to his employee for $150,000. The proposed seller then loaned himself $100,000. Now he contacted us from our ad and wanted us to bid on buying this loan. This is unusual, for our proposed sellers of business notes have been above board to our knowledge.

Also, my wife of nearly 64 years helps me make decisions. We talk over each proposed purchase we might make and we are guided by her decision. She "weighs and decides": How is his credit? Why does the seller want to sell? If it is near new, we might buy a portion. Is it a first? If it is a second, is the first more than twice the size of the second? If so, NO.

Actually we have no list of how to, or not to do. Each one to buy is analyzed on how the seller has made us feel. For example, the time a lady called us and we asked her why she wanted to sell such a good note and she said, "We want to get our daughter's teeth straightened." We answered ,"You sound like a good mother." And she said, "Well, I try." We bought the note and had a good profit.

There is no guarantee of a SAFE NOTE. If we as buyers slow down and weigh and decide rather than try to beat another to buying it, the odds are you have bought a safe note. — Dale Ketcham, private mortgage investor for 30 years, Leawood, Kansas

---

"It's The Note In Your Possession"

"A safe note is one you have in your possession. It has a reliable, cooperative, and creditworthy payor. It is secured by collateral worth significantly more than what you paid for it; which collateral is backed by title and fire/hazard insurance." — Lorelei Stevens, Wall Street Brokers, Inc., Seattle, Washington

---

"Strong LTV and Title Insurance"

"I believe that a strong loan-to-value and title insurance are the most important factors." — David Spector, Waring Investments, Inc., Clifton, New Jersey

---

"Safety only lies in the collateral value of the property."

I have seen too many people with a 700+ credit score go down the tubes, and a relatively high coupon rate hardly mitigates the risk of a high loan-to-value regardless of the creditworthiness of a borrower. It is only the relative value of the house that means anything, at least to me.

At the end of a very bad day, if I have to foreclose, will I at least get my principal back after expenses? If so, then my principal is safe from loss." — Stephen C. Marks, Net1 Capital Corp., Boca Raton, Florida

---

“Get To Know The Payor First”

As you say, there are no guarantees on a safe note. But from experience the facts that must be considered in my opinion, in order of importance, are:

1. Talking to the payor, and getting a feel for his or purchase. Do they have plans for improving the property? Beyond normal "buyer's remorse" do they seem satisfied with their purchase. In short, as Mike Meeker says, "Does this dog hunt?" (Beats me, but that’s what he says.)

2. Credit score. I value the credit score over loan- to-value. Over 600 FICO is great. I also verify employment myself.

3. Loan-to-value: This is, in my own purchases mitigated by #1 above. If it looks like a good deal, I will go up to 90% LTV. Especially when I am comfortable with the payors and the property. Especially true if the area they are buying in is improving.

4. In my case I have had great success buying Realtor commission notes at a 30% yield. But I do the due diligence described above, and only buy the payment stream, never the balloon payment. These are risky, yet the yield outweighs my risk, I think. I've never lost one.” — Jon Richards, President, NoteWorthy Investments

---

“Most Important Is Credit, Then Equity”

When investing in mortgages I would say the most important component is credit followed by equity.

With a high credit score you rarely ever chase the payment and there are few headaches. Equity would be my second component because the more the borrower has something to lose the more pressure is on them to make payments.

However, in the world of owner-held mortgages, most notes were created because there was a problem with credit, little or no equity in the property or property is not so desirable to own. This is really the challenge to the note buyer. The most desirable notes rarely are bought at high yields so we are all pressured to buy B-C loans that have inherent perceived credit or collateral issues because they are simply more profitable.

When buying the less than perfect note, you need to keep your investment less than 55% of the appraised value and you most be strong on collection. The payor has to feel you are not afraid to own the property and that you welcome owning the property. If you can convey that message, the payor will have no cards against you. It is when the payor knows you are afraid to foreclose or do not choose to own the property that the payor holds you hostage.” — Joseph M. Pepitone, President, R&P Capital Resources, Inc

---

“It’s The Due Diligence”

In my opinion, it's the note broker's or investor's due diligence which makes a good note.

The investor/broker needs a sixth sense whether to move ahead or cancel out. A good investor or broker has an in-depth check list to which he strictly adheres. All items on the list are investigated, and either approved or disapproved. No short cuts are taken.

The investor should operate like an airline pilot. The pilot, without fail, goes though every item on the preflight checklist prior to take off. He knows that there is no room for error because flying doesn't allow for errors. It's the same with buying a note.

When shortcuts are taken, problems arise. We all know about good credit, protective equity, and, if you had to foreclose, would you feel comfortable owning the property, etc. Quite a few note brokers have only one thing on their mind, the commission. Can you imagine how they'd react if they had to invest their own dollars in the note with the investor, like I do?— Dick Ballard, CCIM, President, Dick Ballard, Inc. Mortgage & Investment Brokers

---

“Have A Back-Up Plan & Max 65% ITV”

The "safe" mortgage is the one for which you have a back-up plan in the event the first choice (payment income) does not occur and everything else goes the wrong way.

About 20 years ago, when inflation was increasing property values faster than a speeding bullet, I showed real estate agents how they could sell property by "assumption" with seller carry back for the down payment and I would buy the second at 40% yield. I had never experienced a down market and my seconds became poor investments.

To me, a safe mortgage is an investment to value of 65% or less. (In Texas we can go higher because the foreclosure costs are less and time saved is six months.)

Most of our investments are less than 30% ITV because we buy partials almost exclusively.” — Tom Hennigan, President, EscroServ, Inc.

“The Lower the Investment-to-Value Ratio, the Safer the Mortgage”

An investor in mortgage notes in the secondary market has one objective...that is, to earn a targeted return on investment. Although in purchasing such notes we evaluate the seasoning, the down payment, the payor's credit scores and other elements, ultimately the most important factor is the value of the property relative to the amount owed.

Just because a borrower has paid promptly for a period of time or has good credit or put up a sizable down payment does not assure that he or she won't run into future cash flow problems and an inability to make required payments. As mutual fund operators always caution, "past performance may not be indicative of future results.”

However, if an investor holds paper with a low balance owing relative to the value of the property, the investor has a very high probability of "coming out whole" and realizing its targeted return either through receipt of the promised periodic payments, or, if for any reason the payments are not made, through realization of an equivalent amount through foreclosure on the property. The lower the investment-to- value ratio, the safer the mortgage.” — Rick Gordon, Director - Transactions, Florida Asset Financing Corp.

“How Much Will It Cost To Foreclose?”

Determining what makes a "safe" mortgage is all a matter of preference in what you are looking to experience. How much pleasure? How much risk?

We've purchased high-risk notes that have paid off early and made a handsome profit. We've purchased "safe" investments, and lost our asses.

However, with experience being the best teacher, what any private investor should look for must be measured by how much risk he/she is willing to endure in the event of the need to foreclose, either for non-payment of either the monthly payments, taxes or "waste" of the property. It as much depends upon who the investor is, their own characteristics, as what the secured property is, the creditworthiness of the payor, and the amount of equity and seasoning in the property.

All of the following comments overlay large brushstrokes in generalities, so please accept the concepts and not the specifics. For example, an aggressive, young, energetic, "I want to foreclose and fix the place up and sell it for a profit" kind of investor will purchase a higher risk note hoping that he/she can get the place back, and make a killing.

A more passive investor does not want the risk of loss and is looking for a note securing a property where the payor has good credit, perhaps some seasoning, definitely some substantial equity, and a property type and location that is in the mainstream. This is the case to minimize the risk that something will go wrong. And if it does, so that if they have to foreclose, there is something worthwhile to work with that, even if from a distance, can be fixed up relatively inexpensively, and resold in order to cover the financial exposure.

Personally, my major issue is determined by whether I think I'm going to get paid, and if I am not:

a) how much is it going to cost me to foreclose, i.e. is it an easy to foreclose state, such as a Deed of Trust state where it only takes a few months to get a property back, or am I secured on a Contract for Deed, that is to say, where I don't have to go to court to foreclose? If I have to go to court to foreclose, such as in New York, Florida, New Jersey, etc., I am less likely to personally buy the note. And the truth is I've had many successful purchases in these states. The question is, however, what my first considerations are, and that is always the first one.

b) What kind of property is it? This is mainly for the purposes of determining my risk upon resale.

c) How much equity is in the property so that if I have to foreclose, there is room to cover all my costs, legal and repair, time since having any payments, and the value that can be gained by expending these dollars? This also takes into account whether it is a 1st or 2nd, and if I will have to carry the 1st in the event of default, and whether it is worth it to do so.

d) Yes, I always look at credit scores. Very important. What I also look at in the credit scoring is how much debt there is on the credit cards and accounts versus the amount of credit available. Someone with good credit can be charged up to the max, which might be an accident waiting to happen.

e) Seasoning is not my type priority, except from the standpoint when any of the other factors above are weak.

f) My sense of smell, and history of eating a lot of terrible properties around the country, that apparently were underwritten properly, but went bad anyway. There is absolutely nothing more valuable than experience. — Judy Miller, President, SellerFinances.com

---

"Low Down Is The Best Predictor of Default"

There are four issues that come to mind when I think about the definition of a 'safe' note:

1. The FHA studied this issue about 10 years ago and discovered that low down payment was the best predictor of future default. Being experts in the world of low down payments, they should know. This is still true today, in my opinion.

2. A clean credit report has also been a good predictor based on our experience. More accurately, a bollixed-up credit report is a good predictor of future problems.

3. Some of our software users subscribe to the philosophy of only holding notes on properties they wouldn't mind taking back and renting or reselling. Foreclosure becomes a major part of their business plan. Although it is a sound tactic for valuable property, it doesn't really tie into what we want to do. As investors, we don't want to take property back because it is time consuming and unpredictable. Plus we acknowledge up front that we will be dealing with people who don't always honor their commitments.

4. We've never been able to quantify that firsts are safer than seconds, but of course you want to be sure that the Investment to Value (ITV) ratio makes sense when the first and the investment in the second are added together. More importantly though, and many people may not agree with me, the Loan to Value (LTV) ratio is a better predictor of safety. Although ITV protects your investment, LTV is the inverse of down payment and lets you know if you'll eventually foreclose. — John W. Moren, President, Princeton Investments, Ft. Collins, Colorado, and author of the NoteSmith software products. http://www.notesmith.com/

"My Number One Criteria For Purchasing Notes Is CREDIT"

Like many things, my opinion on what makes a "safe" mortgage has changed over the years with my experience.

When I was a loan officer for a commercial bank, years ago, I always looked to "capacity": the ability of the borrower to make the payments. That was the standard used by the bank and it seemed a good indicator.

Then I became a Contract Buyer for Metropolitan and changed my focus to equity. We didn't always have access to the payor's income information and after all, if someone had a lot to lose, they would be less likely to walk away. Well, that's what I used to argue to Underwriting, anyway.

Now that I buy for my own portfolio and have had sad experiences with payors who had both the capacity and the equity, I can tell you my number one criteria for purchasing a note is CREDIT. Not necessarily the score, although that can be helpful, but the report itself. People are in the habit of paying their bills, or they're not! Next would be a verified repayment history from the seller, but if I had to choose one thing, it would be credit. While I have a few notes I purchased with poor credit payors which are performing, they are a constant collection headache – always some excuse. Most of the notes I purchased with poor credit payors have defaulted. (A 25% yield is not as good as it sounds if you never receive a payment!)

And, of course, I always speak with the payor prior to purchasing the mortgage. If I can't reach them before I buy the note, I surely won't be able to locate them when they're in default.

So, I look to: 1) Credit; 2) Conversation with the payor; 3) Repayment History; 4) Seasoning; 5) Cash Equity; 6) Property type and location (i.e. how difficult would it be to resell); and 7) Repayment Ability. — Lynda Vaillancourt, President, Western Capital Investments

---

Metropolitan Underwriters Respond

The underwriters at Metropolitan have years of experience in this field, and sometimes it can be difficult to define a "safe" note since each investment has its own unique combination of risk factors. We have developed and utilize resources that deal with this very issue; however no resource is as valuable as the knowledge and combined experience of our underwriters. — Mark Donoghue, Vice President, Production, Metropolitan Mortgage & Securities Co., Inc.

The three "C's"...Collateral, Capacity, and Credit. In some instances, we may have constraints on the credit issue so marketability (demand/supply/alternative use) is becoming very important, especially in the commercial transactions. — John Widman & Earl Ruddach, Underwriters

The structure of the note itself should be sound: A note which negatively amortizes, or one which has a short-term balloon, might be less desirable than a straight amortizing, fixed rate note. — Scott Spence, Vice President, Underwriting

---

"The Seven Areas Of Due Diligence"

There is no absolute formula to ensure the performance of a note. There are seven (7) areas of due diligence that can help evaluate the performance when considering purchasing the note:

1. EQUITY - not only through the appraisal value, but the ITV or Investment To Value. I always run an ITV amortization schedule that runs concurrent to the original amortization schedule.

2. PAY HISTORY - collect as much history as possible and chart or graph how many days past the due date the payment is received. This sometimes reveals a potential problem. If the note is very new, then the equity factor is even more important.

3. CREDIT HISTORY - I have stopped looking at credit scores; what a joke! Instead, I like to analyze the old-fashioned way — I read the entire report and formulate my own internal credit rating.

4. JOB STABILITY - VERY IMPORTANT!!! How many changes of jobs or professions in the past few years can be most revealing.

5. DEBT RATIO - calculate as close as possible the Income-to-Payment ratio including taxes and insurance. The range should be 28% to 38% for hourly-waged blue-collar individuals. Professional individuals can have 32% to 40%. Then include rent, recurring debt, auto payments, etc. and the overall financial picture becomes a little more clear.

6. DOCUMENTATION — DEED OF TRUST, NOTE, TITLE POLICY and any other documents the payor has signed or bears his signatures. READ the NOTE and DEED OF TRUST. Make sure you can live with the terms and conditions the parties agreed upon. You might very well be surprised at what you find.

7. PROPERTY INSPECTION — How has the owner taken care of his property, which will become your investment?

Anyone can have a problem — lose a job, illness, death, etc. The objective is for the investor to recoup his investment and not lose on any one transaction. — Allen E. "Al" Myers, President, Private National Mortgage Association (Pennie Mae)

"The Weakest Element: The Appraisal"

The three basic tools we use to evaluate real estate notes are: (1) the credit of the borrower, (2) title insurance, and (3) an appraisal. Based on my experience, I think the weakest element of the evaluation process is the appraisal.

Credit is much easier now since "credit scores" are provided along with the actual report, although you still need to review the data. The score is a quick indicator whether to proceed or not.

Title insurance is usually pretty "cut and dried"— you can get good title or you can't. In some cases, you can correct title problems if they are minor.

Since most of our purchases are on out-of-town properties, the appraisal is the element I get most concerned about. We usually don't drive by the properties ourselves.

The appraisal is very subjective, and depends on the skill, education, experience, data base, and the honesty of the appraiser. We've all had experience with appraisers who will "get you the number." We give them as little financial data as possible because we want a "real" number from them. But, always remember, it is simply their "OPINION" of value.

The added precautions we sometimes take, in addition to the typical drive-by appraisal, are:

1. Request a BPO (Broker's Price Opinion) from a local, respected real estate broker. The cost is about $50 to $100 for us.

2. Have an appraiser we trust review the work of the original appraiser.

3. Order a new appraisal from another appraiser,

4. But, most importantly, READ the appraisal and understand it.

5. Whenever possible, get a full (inside) appraisal.

— Hank Harenberg, President, Capital Concepts, Inc.

"You Have To Be Able To Legally Foreclose In The Event Of Default"

What makes a safe mortgage?

First, what is a "perfect" or "ideal" mortgage? An ideal mortgage would have a payor with perfect credit or high credit scores. The mortgage would have easily marketable collateral (in case we had to take it back). The ideal mortgage would have great equity with perfect paperwork. And, the ideal mortgage would carry a "high" interest rate with a "short" payoff period.

In terms of safety, three of these factors (paperwork, type of collateral and equity position) dominate. First, the paperwork has to be correct; probably 20-25% of the mortgages that we buy come with faulty paperwork and sometimes require months to fix. Title work has to be the first step... as we have to be able to legally foreclose in the event of default.

When purchasing a mortgage, I ask myself, what is going to keep the payor in this deal (keep paying) in the event he has a financial hardship? That is why the type of collateral is the second important safety factor.

Remember, even payors with perfect credit can undergo financial hardship (loss of job, illness, injury, divorce, etc.). If our payor suddenly didn't have enough income to pay all his bills, and his mortgage payment to us was on his home, that payment would be probably be the last payment he would let go, since he needs some place to live.

However, if that mortgage payment were on a commercial property, land or a business, he could decide not to pay it and not affect his lifestyle. Also, in the event of a foreclosure, the single family home is the most marketable collateral (easiest to sell) as there are many more buyers for houses than there are for commercial properties, land or businesses.

The third important safety factor is the equity position. The more the payor has to lose by walking away from the mortgage, the more likely he is to find a way to make his mortgage payment... thereby ensuring that his problem doesn't become my problem. This is a VERY IMPORTANT factor. When I come across mortgages with a great equity position, it sets off an internal alarm that prompts me to look at the mortgage as a "keeper" in the company or in a personal IRA. — Kevin Clancy, President, American Funding Group, Inc.

"We Will Accept Lower Credit Scores If The Buyer Has A Seasoned, Timely Payment History"

American Equities, Inc. (AEI) has been able to establish longevity in the real estate receivables industry by following a thorough analysis program during the purchasing phase. We follow a careful analysis (similar to a bank) in considering the financial ability of the borrower as well as all the particulars regarding the property. Since we began operation in 1979, we have found our program quite successful, and our investment portfolio is of the highest quality.

Once a file is submitted to our office for processing, our staff initially evaluates the buyer's credit and payment history. We will accept lower credit scores if the buyer has a seasoned, timely payment history. We also purchase receivables simultaneously on a new sale of a property. In this case, we require that the buyer is providing a minimum of a 10% cash downpayment and an acceptable credit application.

Next, we consider the property. AEI will only invest in receivables where the investment will not exceed a total of 75% of the property value for single-family residences; 65% for commercial and improved land; 60% for unimproved land. We have also limited our exposure to a number of western states where we have carefully analyzed foreclosure laws and the strength of the economy. We evaluate the current value of the property determined by a "drive-by" market analysis and photographs.

Simultaneously, we also review the title to insure our company is in first position at closing with no delinquent property taxes (at times, we will also purchase some second position notes).

When we fund on the purchase of the receivable, we feel confident about the security of the investment package. This is critical to AEI's success as the final product is either placed in our portfolio or re-sold to our valued pool of investors.
— Bridget Bosch, President, American Equities, Inc.

"The Credit Score Is Number One"

First National grades the notes that it is considering for purchase based upon four criteria:

(1) the credit score of the purchaser (40%),

(2) equity the payor has in the property (30%),

(3) seasoning (20%), and

(4) the purchaser's pay history (10%).

We have internally tested our system on many occasions based on our history of holding thousands of seller-carrybacks to maturity. We have also had our rating system tested by Michigan State University statistical experts who have confirmed our scoring system, especially the reliance on credit score as a predictor of future collection headaches and foreclosure risks. Equity was also found to have been a very strong predictor of default and, as reflected in our weighting system, seasoning was found to be a surprisingly weak predictor of default.

In addition to our scoring system, First National has found it is also very important to understand the circumstances under which a given transaction was created. This is key. Professional creators of notes - such as rehabbers and land developers - are adept at showing equity or high credit in transactions where it would be most prudent to price as if high credit or high equity were not present. Professionals are slicker about "showing" equity on paper even when it doesn't exist in reality. Big down payments can be supplied by the broker, only to have occurred "outside of escrow" or to be returned to that broker in the form of payment for services such as setting up a mobile home or painting or doing other potentially overvalued improvements. The methods of showing equity in this type of transaction are endless, and a blind adherence to stated equity has gotten many note buyers in trouble.

In addition, many professionals will put a high-credit-score payor in a property as an investor and then have it occupied by a low-credit person. This high credit score is misleading in the sense that payor may in fact know very little about the property or its value and may have an understanding with the professional with regard to what happens if payments from the low-credit occupant are not made.

In sum, while credit and equity are the primary considerations for First National in predicting defaults, it is important to understand the unique pitfalls of a professionally-created note. — Frederick C. Foote, President First National Acceptance Company of North America

---

"A Safe Note Is One In Which Risk Is Balanced By Return"

What makes a safe mortgage? I think the answer to this question lies in the delicate balance between risk and return.

There is little doubt that a 10 year seasoned note on an owner occupied SFR at 50% LTV, with a 750 score payer is a safe note. However, a note like this would probably be bought by an investor at the lowest market yield available, perhaps 8 to 9%. Such an investor would probably feel "safe," with this low risk note. On the other hand, a business note buyer might feel safe at a 20% yield when buying a 2 year seasoned note on a strong business, where the 700 score payer put 50% down. Clearly these are different notes, yet both investors would feel "safe." In my opinion the reason they feel safe is that the return exceeds the perceived risk.

At Financial Resources, Inc. we buy real estate notes of all kinds, both seasoned and simultaneous closings. One of the riskiest notes in the industry that we buy is the 80/10/10 type second mortgage. We have approximately a 25-35% default rate, yet we keep on buying these. The only way we can do this, is by buying these notes for 30 to 35 cents on the dollar. We can then sit back and actually feel "safe" when we buy these high-risk notes.

Another example can be illustrated by pointing out that Financial Resources, Inc. also originates residential and commercial loans. We will make a 97% LTV loan to someone who has the ideal credit, income, and debt ratio at a current rate of 7.5% and have a "safe" loan. Likewise, we can make an 80% LTV loan to someone with weak credit, non-verifiable income, and a high debt ratio but at a rate of 11.5% and also have a "safe" loan.

Safety is like beauty in that it is all in the eye of the beholder. — Jeff Long, CPA, President Financial Resources, Inc.

"Credit Is The Most Important"

In my opinion the most important factor today is credit. Good credit in this market is the driving factor. It makes it possible to do marginal deals; high LTVs. If the economy falters all the rules change.

Obviously, the safest mortgage is a SFR residence with an LTV of 50% or less. If this were the only types of deals we would buy we could not stay in business. — Leon Steinberg, President Steinberg Capital

“Would We Be Happy Owning The Property For Our Investment?”

What makes a note almost fool-proof? Unfortunately, I have seen enough seemingly good notes go bad to realize that the completely fool-proof note investment system has yet to be discovered. There are certainly a few tried and true methods for identifying a good note investment including credit, equity, seasoning, property condition and pay history.

I wish I could buy notes secured by a single family owner-occupied residence with 650 plus credit scores, two years of seasoning and 25% equity on a well maintained home in an appreciating area at 12% yields all day long. In reality, we realize that this inventory of notes has dwindled and we are constantly faced with something less than ideal. Rather than deciding on what makes a note "safe" we are deciding what makes it "safe enough"!

For me it becomes a balancing of the scales to weigh the negative against the positive. If the credit is poor do we have a verifiable pay history and/or equity? If it is a simultaneous note with little down, can we confirm down payment, prior rental history and sufficient income? If the property needs work do we have a reliable payer with plans to make repairs? Am I familiar with the area?

You might purchase a note with one or two negatives when balanced against mostly positive. However, when the scale tips towards the negative, consider "a pass" or a low ITV, high-yield partial!

We invest in quite a few notes with credit scores below 600 and have found the purchaser interview a valuable tool for confirming employment, contact information, property satisfaction, and comfort with the monthly payment amount. We also like to obtain a verifiable payment history when credit is poor.

In the end it will come down to keeping your investment level at an amount you would be satisfied owning the property on the more riskier investments! —Tracy Z, President Diversified Investment Services, Inc.

“There Is A Difference Between A Safe Note And A Profitable One”

I've been enjoying the responses to John Moren's question, "What makes a safe note?" I do believe several responses have actually answered another question--that being "What makes a 'good' note investment, or what makes a 'profitable' note investment?"

The answer to John's question is easy. GOOD COLLATERAL. The other question that I think most responders are trying to answer is much more complex. I've had several 'safe note investments' that have not been as profitable as some of my more risky notes.

If we want a safe note that is relatively trouble free, then we need good collateral AND good credit. But everybody wants these 'no brainers', thus the price can be high enough to leave a modest return of 10 to 14 percent.

To really make any money, bring me a “marginal deal,” in my neighborhood, that the big boys don't want. —Terry Preuit, President Cash For Contracts, Inc.

“Number 1 Factors: Good LTV & ITV”

While investigation of credit and a good credit report is important, this is not the most dependable factor of reliability in determining a safe mortgage.

Change of circumstances such as the loss of a job, the end of a marriage, etc. can change a good payor's dependability.

In these times people are not that dependable.

Good LTV values and ITV ratios are the number one factors in determining the validity and safety of a deal. If a payor becomes undependable, your conservative LTV and ITV values are excellent insurance.

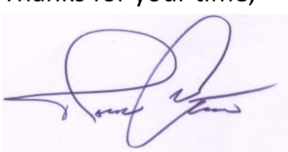
My LTV guidelines are:
Single family homes: Maximum 80%
Multi-family homes: Maximum 65%
Small commercial property: Maximum 65%
Raw Land: Maximum 50%
Improved Lots: Maximum: 60%
Farm Land: Maximum 50%

This may sound elementary, but these are my guidelines, and I sleep better at night doing this.

If I get a conservative ITV through a partial purchase along with a good LTV, that is even better. —Greg Wilson, President, Wilson Mortgage and Financial Solutions Company

I hope you found this information useful. If you are interested in buying or selling a note or have other questions, please contact me.

Thanks for your time,



T J Stewart, Founder & CEO
Ts6947@ymail.com
866-935-3100