FROM THE DESK OF... PETE SILVA!

Update On Real Estate™

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Highlights

- What you need to know about discounts and yields.
- What is your mortgage really costing you?
- How to get cash "fast" at closing.
- Find out how you can profit by helping your clients!

The Time-Value Of Money

*The hidden real estate paper market is exploding. For this reason, **Update On Real Estate™** will focus on this market for the next several months. It is our intention to keep you informed of the many ways in which you can assist your clients, while at the same time increase your income.*

—Time affects the value of money. It's the age-old addage that dollars today are worth more than dollars tomorrow. Grasping this important perspective goes a long way toward understanding the private paper marketplace. And it puts you in an excellent position to clarify certain financial decisions for your clients.

To understand this concept, think of the flow of dollars in terms of the old bromide - "A bird in the hand, is worth two in the bush!" The bird in hand is risk free. You know you won't go hungry. You also know that you won't have to spend any more time trying to catch your dinner!

$4 Billion A Year In Seller-Financing!

What about those two birds in the bush? They present a whole series of decisions. For example, do you have to let go of the bird you have in order to catch the two in the bush? Are there really two birds in the bush? Can you catch both? If you only catch one will it be a better bird than the one you already have, and so on.

The point is simple: All investments involve a certain amount of risk. You are giving up money you already have, for an anticipated future benefit that is

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Real Estate Corner — Simultaneous Closings

—You don't have to stretch the envelope to achieve creative solutions for real estate financing situations. An abundance of tried and true strategies are available. Most of the more successful arrangements involve the creation, exchange, and/or sale of private mortgages somewhere in the mix. Realtors with CCIM training, and agents specializing in exchanges, have been using these deal-making weapons for decades.

Being aware of these old deal-making techniques, and using them daily in your real estate

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greater. And, in deciding the worth of the expected additional benefit, you must evaluate risk of loss, depreciation, and opportunity cost.

Balancing these considerations is achieved through yield. The yield is your rate of return over a given period of time. Yield is used to judge the value of a particular investment in itself, as well as in comparison to competing investment opportunities.

The Time-Value of Money

Intrinsic to yield calculations is time. Why is that? Well, lots of things can happen over time, and nobody knows with absolute certainty what the future will bring. The longer you have to wait for your money, the greater the risk that you may not receive it or, at least, not all of it. Likewise, you are deprived of the use of your money for the investment period and the collateral risk of lost opportunity with respect to alternatives.

The relationship between time, risk, and value is a natural consequence. Two basic mathematical formulas bear this assumption out. Fortunately the math works the same whether you are in Tranquillity, New Jersey, or Bountiful, Utah. Even better, the formulas are plugged into simple financial calculators that are easy to use, inexpensive, and available anywhere.

The first formula is where we take $1 and invest it at a set rate of interest over a period of years. We will know exactly how much the future value will be at the end of that time.

The second formula is the reciprocal of the first. It tells us what a future value is worth when discounting the investment to its present value. Correlating the time-factor, yields are calculated as an annualized percentage rate.

For example, we have a $10,000 note with a 10% annual interest rate, all due in one year. The first formula tells us that the value of the note will be $11,000 in one year's time, a yield of 10%. In two year's time, the value will be $12,100. In three year's time, the value will be $13,310.

Conversely, the second formula tells us that $11,000, due in one year, is worth $10,000 today, when discounted to yield 10%. So, what should we pay today for $13,310 to be received in three years, discounted to earn 10% on our money? The second formula tells us $10,000 is the present value or purchase price of $13,310 due in three years, discounted to yield 10%.

Yield is figured in one of two ways. First compounding the future value as in example 1. Or second, discounting the present value as suggested in example 2. With either calculation

Notable - Rates

Discounted yield calculations are essential to the mortgage industry. Why? Because mortgage lenders are competing with other investments, such as the daily auction prices of 30-year Treasury bills, for the same investor money. To stay in the hunt, lenders use a "Yield Spread" formula, adjusting loan fees to compensate for the daily price changes in the financial markets.

In a mortgage situation, interest rate is not the same thing as yield. The actual rate you pay for a mortgage is based on two costs - interest rate and points (one point equals one percent of the loan amount). Points are where lenders make their profit. Points are also used to meet investor-yield requirements, by discounting future returns for present values.

For example, say the going rate for a 1st mortgage averages 7%, with two points in fees. The points make your actual cost for the loan 7.5%, while the investor earns 7%. A lender can offer you a 6.5% rate by giving the investor four points. With the extra points, your actual cost drops to 7%, and the investor still earns 7% on the loan - a higher yield than what the interest rate indicates.

Conversely, a 7.5% rate would cost no points. Your actual cost is 7.5%, because you paid no points. The investor is still earning 7%, but the yield is less than the interest rate because the investor paid a premium for the higher rate. The premium covers the lender’s profit.

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the value of money is directly related to the time when it is received.

Discounting

Here's a real-life scenario that demonstrates the importance of yield calculations.

Kerry Cash is looking at two competing $25,000 private mortgage notes to purchase and wants to receive a 14% return on his money.

Anita Dough's note is payable monthly over 15 years, with a balloon due in ten years. Iwanna Hall's note is payable monthly over 20 years. Both notes are earning interest at 10% and both are comparably risk-rated. Each seller wants 82 cents on the dollar for the notes or $20,445. Kerry wants to earn 14% on his investment. Which note would yield Kerry his desired return, Anita's note or Iwanna's note?

The payments on Anita's note total only $44,882, while Iwanna's note equals $57,902. However, when discounting present value to yield Kerry's desired 14% rate of return, the stream of payments for Anita's note equals $20,445 (82 cents on the dollar), while the discounted present value of Iwanna's note comes to only $19,401 (78 cents on the dollar). How does this occur? Iwanna's note will not be paid off for 20 years, whereas Anita's note is paid in ten years. This is the power of time when it relates to money. Therefore, Kerry would purchase Anita's note.

Knowledge is power! You can use your understanding of the time-value of money to give added value to your clients and grow your business. -- End.

Brainstorm – Attorney

Jack & Jill	Jack and Jill went up the hill to fetch a pail of water. When they got there, the well was dry – shortly thereafter, they decided to go their separate ways.
Home	First, they had to figure out how to divide the equity in their home, which appraised at $180,000. Deducting a mortgage balance of $122,400 left equity of $57,600. Jill's share was $28,800.
Note Created	Jack's attorney suggested that Jack give Jill a promissory note secured by the house. However, Jill wanted to cash out so she could go back to Happy Valley. Jack didn't want to sell the home, so he had to find another way to pay Jill her share of the equity.
The Problem	But, Jack had several problems. Most lenders would only refinance up to 75% LTV on a cash-out transaction. The refi would also cost $4,000, leaving Jack short $20,200 to pay off Jill. A second mortgage would work, but at 86% combined LTV, Jack faced $3,200 in loan costs and a 10% rate.
Debt-to-Income	Unfortunately, Jack couldn't qualify for either loan. He had changed careers ten months earlier, so he couldn't count that income, making his debt-to-income ratio too high.
Cash Now	Jill's attorney invited his note broker friend, Aesop, to meet with the couple. Aesop explained how selling the home would cost $12,000 in commissions and fees, indicating that their true equity was approx. $22,800 each. Aesop then showed them how to structure a second mortgage note between themselves, which could be quickly sold. This would give Jill her cash now and allow Jack to keep the home.
20-Year Note	They created a 20-year note for $31,000, payable at $299 per month at 10% interest, with a balloon payoff due in seven years. The note sold for $25,786. After closing costs of $700 and a $2,300 commission to Aesop, Jill netted out $22,786.
The Solution	The attorney found a solution for Jack and Jill…everybody got what he or she wanted, everybody came out better than otherwise, and they all lived happily ever after!

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activities will increase the volume of your sales, and build your referral base. The end result - more profits!

Simultaneous closings are a powerful tool that offer a great deal of flexibility and a notable advantage to the serious dealsmith. They can facilitate closings where traditional financing alternatives are not available. Using this maneuver, the Realtor creates an owner carryback purchase mortgage, while simultaneously working with a note broker to sell the note to an investor at the closing of the purchase transaction.

Several variations of the simultaneous closing technique have been used over the years. However, fueled by an upsurge in the development of mixed-use office/light industrial office parks, R & D facilities, and ministorage complexes throughout the country, there has been an explosion in simultaneous closings during the past five years.

The problem in the past was how to finance all the potential sales. A number of these projects are planned-unit developments, being built with the idea that small businesses can own their own spaces. But, over the past decade, limited options, onerous terms, and stringent qualifying criteria have made it difficult to obtain palatable long-term commercial real estate financing through traditional channels, particularly for loans under $500,000.

Next Issue

- A Piece of The Action - Partial Purchase Benefits
- Notable - Killing Your 401k
- Brainstorm - Mortgage Banker Strategies
- Real Estate Corner - Lease / Option Alternatives

The Solution

Simultaneous closings! More real estate agents are becoming familiar with this approach and aware of the advantages that such expanded thinking brings to their closing ratios. This deal-making technique has become a common solution in increasing sales volume for a variety of real property transactions.

Typically, the Seller or his Realtor will structure a seller carryback purchase money mortgage. By establishing a relationship with a note broker ahead of time, the agent can gain the basic knowledge necessary for structuring a note that is attractive to a note buyer, while creating a sale that meets both the Seller's and Buyer's needs. Once the Seller and Buyer have agreed to the terms of the note, a note buyer can provide a quote reflecting what s/he would pay for the note after closing.

The paperwork for evaluating a note purchase is similar to underwriting a traditional mortgage. The note broker needs copies of the purchase contract, a completed credit application, income documentation for the Payor, and a current appraisal. It has become common to use a basic credit application form rather than a loan application (1003) form, to insure that the parties are clear that the note purchase is NOT a loan transaction.

A commitment to purchase the newly created note at closing is then obtained from a note buyer, generally at a discount. From that point, the deal proceeds through escrow. Shortly after closing, the Seller's note is then sold to the investor, and the seller receives the cash in a second closing. In this manner, the Seller is able to get his equity much the same as he would with a typical financed closing.

Voila! The knowledgeable Realtor just injected new cash into a transaction where traditional financing didn't meet the need, and closed a deal that wouldn't have happened otherwise! Simultaneous closings can be used to fund a wide variety of purchases where a good credit buyer can't qualify for traditional financing.

See ya next quarter!

Personal Profile

Pete Silva is an expert in private real estate financing. He has counseled individuals and companies in structuring private paper transactions and turning private paper assets into cash.

Mr. Silva's specialties include: assisting other professionals with structuring quick sales of difficult properties for their clients, through the creation of notes which can be liquidated for cash at the close of escrow ("simultaneous closings"); disposing of existing notes to achieve cash liquidity for clients; and structuring transactions whereby private paper can be used in lieu of cash toward achieving investment or personal acquisition objectives.

With his guidance, Mr. Silva's professional associates have been able to help their clients sell properties that are difficult to sell. Additionally, he has helped buyers purchase properties who had difficulties qualifying. His techniques have also provided many note holders with the ability to achieve other objectives such as, resolving estate distributions, divorce settlements, and obtaining goods and services by the conversion of private paper assets to cash, or through barter.

If you wish to join the mailing list or subscribe to this publication, please use the contact information below.

Mr. Silva is available to assist you with the structuring, purchase, or sale of real estate notes. He can be reached at (800) 264-2649.