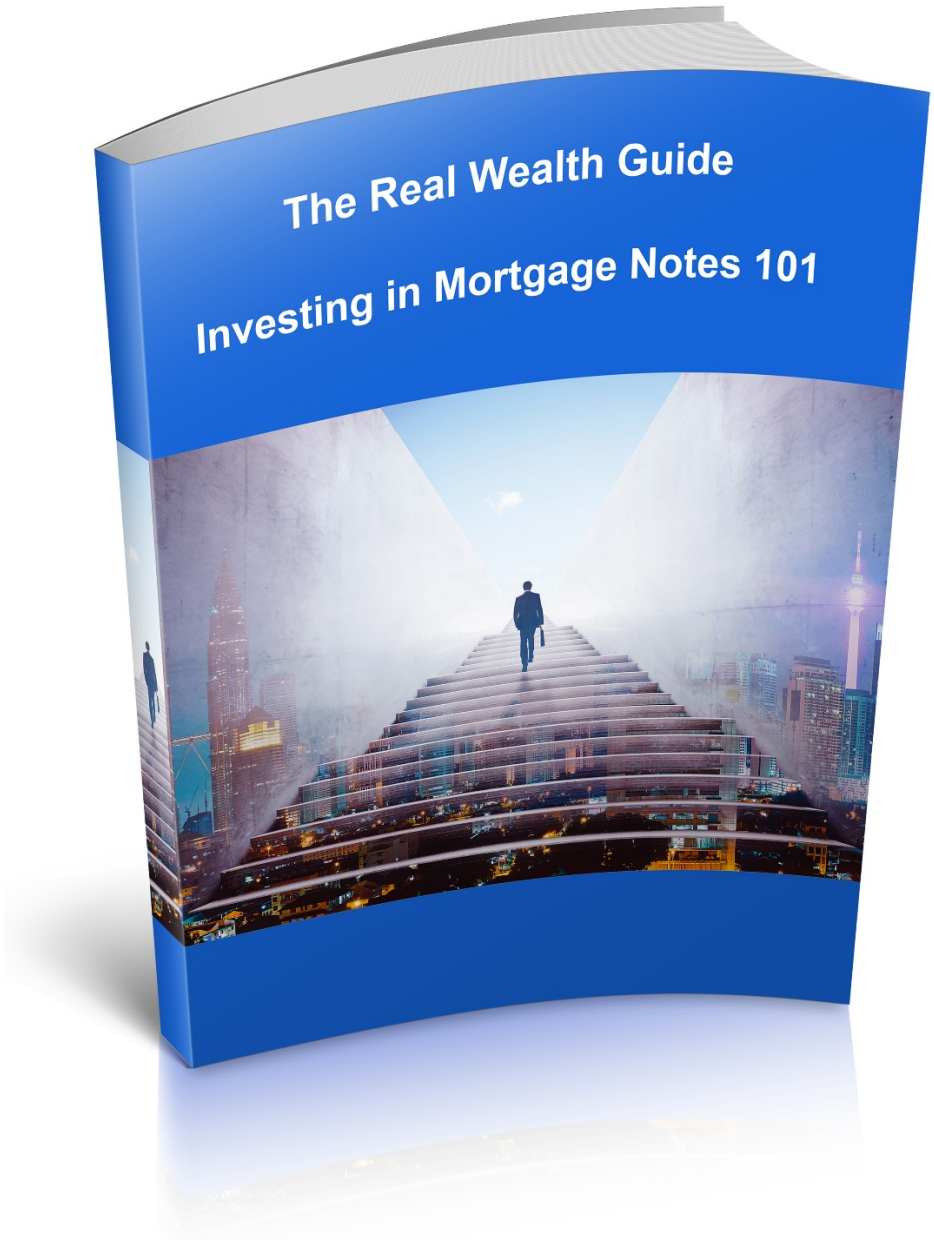

THE REAL WEALTH GUIDE: INVESTING IN MORTGAGE NOTES

Creating Consistent, Passive Returns for Financial Security:

Make Work Optional

Real Wealth Doctor
Make Work Optional

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Creative Real Estate Investing in a Post COVID-19 World

As the global COVID-19 pandemic subsides investors are left asking:

- What now?
- Where do we invest?
- Where will the best opportunities be?

It should go without saying that each situation is unique and no one is in possession of all the answers. However, there are many indicators we can examine that provide guidance. In doing so you may find that this could surprisingly be a great time to invest.

Warren Buffet is widely quoted for saying;

"Widespread fear is your friend as an investor because it serves up bargain purchases."

And Baron Rothschild said to "buy when there is blood in the streets."

Since the American stock market crash of 1929 and Great Depression, the US has experienced 14 recessions and expansions. While we cannot time the market, we can devise programs that create reserves for market downturns. These will enable us to comfortably survive the storms and provide enough cash to capitalize on emerging opportunities when they arise. Quoting Buffet again;

"The best chance to deploy capital is when things are going down."

Simply put, we shouldn't fear market corrections and down cycles. We should anticipate and embrace them because they can create our best opportunities. At Real Wealth Doctor we focus on investing in performing notes and believe there will be numerous opportunities, albeit perhaps with "scratches and dents", due to the pandemic that will still be solid investments. We've added the following criteria to our underwriting and feel that these are good basic rules to follow for any real estate investment you might consider.

Look for historically strong markets

How strong was the market's job and population growth before the Pandemic? Were they strong? Weak? Generally speaking, population growth will follow job opportunities. If work is available people will migrate there. For example, Oakland, California developed into a major city due to the growth of the shipping industry during WW II. San Jose, CA and the surrounding cities, as well as Seattle developed largely due to the availability of cheap land and the tech industry.
How affordable is the area's housing? Some Midwest cities have growing job markets and housing is a quarter or less expensive than many coastal cities. What is the potential for future growth? Many markets we've researched were negatively affected by the loss of major manufacturing. However, they are being revived by what have become to be known as "STEM jobs": science, math, engineering, and technology. As you may be aware, many of these jobs can be done from home or in small towns and don't require large infrastructure requirements. In addition to the major hubs like San Francisco or Seattle, STEM jobs are increasing in cities like Ann Arbor, Michigan and Raleigh, North Carolina.

Avoid areas that were hit hard and will have long recoveries

While every city will experience significant revenue loss due to reduced tax and other sources of income, some will have longer term negative effects. Cities like Las Vegas, NV and Honolulu, HI that are dependent on the tourist industry will be slow to recover due to people's unwillingness to congregate in in public places. They probably won't begin recovering until a COVID vaccine is discovered and widely available. But areas impacted by the oil and related industries will be the slowest to recover. This not only includes cities in the vicinity of the Permian Basin oil reserves but any city heavily dependent on oil or mining. According to the Bureau of Economic Analysis cities in Texas, Oklahoma, Colorado and Louisiana will suffer the most but cities such as Duluth, Minnesota and Bakersfield, CA where oil/gas extraction and mining account for 12 to 14% of their economies will also be heavily impacted.

Follow the Jobs

Although many service jobs were halted by the Pandemic and may never return, large portions of the economy were unaffected and many actually thrived during the lock down. The tech and shipping industries and various delivery companies such as Amazon soared. So, any areas where distribution centers are being built or tech is growing should be solid bets. Streaming services, online gambling, online gaming, and telehealth should also experience significant lasting growth. Looking for cities for concentrations in those industries could also be wise.

Other areas to look at are those having dominant industries that will accelerate due to factors pertaining to the COVID and future pandemics. Some scholars are predicting that the number of worldwide pandemics will accelerate until worldwide rampant deforestation is halted. This is due to the fact that many viruses that thrive in those environments are compatible with resident animal species but are toxic to humans. Accelerated eradication of those environments exposes humans to increasing numbers of viruses that will continue to cause plagues. The industries that will be striving to keep pace with the increasingly changing needs of social distancing will be robotics, banking and finance, pharmaceutical and insurance companies. Cities such as Bloomington, IL, Des Moines, IA, Jacksonville, FL, Sioux Falls, SD and others have large back office facilities in these cities and will necessarily grow to meet future demands.

Follow Population Growth

As previously mentioned, population often follows the availability of jobs. Some job sectors like tech never slowed down and continue to grow. However, many such as the restaurant industry may never recover. According to the Bureau of Labor Statistics some of the most significant job growth nationally will be in tech related companies but also robotics, data science for many industries, customer support, shipping, home health care, nursing and assisted living facilities, and power and communication line construction. As you may have noticed, many of these positions can be in facilities that are being built in smaller suburban cities. The cities around Atlanta, GA and Washington DC are good examples.

One other factor that’s important to note is that the pandemic has revealed one of the weaknesses of globalization. Each nation must have the capacity to produce a portion of their own essential products. The inability of a country to produce such items renders it vulnerable to producing countries and their willingness to export the goods when needed. Witness China’s reluctance to ship N95 masks to the US and other countries when shortages occurred. Companies will start to move portions of their supply chains back into the US. The weaknesses of a country’s essential products being produced solely by foreign suppliers has been exposed. Thus, any areas that already have limited capacity to provide these products might be good bets.

Consider Investing in Mortgage Notes

Whatever you decide, remember that cash flow is your friend. Hoarding cash for long periods waiting for “the next big opportunity” is a money losing proposition. However, constant cash flow can be your life blood. Mortgage Notes are an excellent source of

cash flow. Well underwritten, low loan to value notes in well located areas like those mentioned above can be an excellent supplement to “day job” income, smoothing any peaks and valleys you may experience. Or, they may be your road to creating your future financial security. Financial success is created over the long term, not overnight. If you were furloughed or your practice income suffered during the pandemic think of how different your experience could have been if you had a constant source of cash flow.

If you would like **more information on investing in notes…**
visit us at RealWealthDoctor.com or Schedule a call

You Can Invest in Mortgage Notes!

Many people think of a mortgage as a vehicle for buying a home and may not realize the extraordinary investment potential in buying mortgage notes. Investing in mortgage notes is a SIMPLE, secure way to diversify your portfolio and increase cash flow, offering reliable returns without the effort of other real estate investments.

Easy, asset-backed, passive income? If you think it sounds too good to be true, you are not alone. Many people approach mortgage note investing with caution when they first learn of it. After all, if it was as good as it sounds, wouldn't everyone be talking about it?

Not necessarily. As the saying goes: **money talks**, but *wealth whispers*.

Who should consider investing in mortgage notes? If you are looking to diversify your portfolio and generate passive income with real estate investments but do not want the hassle of flipping and renting, buying mortgage notes may be just what you are looking for.

Even if you're new to the world of buying and selling mortgage notes, you may already be familiar with the concept a mortgage and note. However, it is helpful to define these terms, and others associated with investing in notes and mortgages, in context.

What is a mortgage?

A mortgage is a secured loan that uses real estate as collateral. Most home buyers do not have the liquid assets needed to buy a home outright and need a loan to supplement their down payment. Mortgage lenders (typically, but not always, banks)

fund the purchase for approved borrowers who then repay the loan, with interest, over a period of 10 - 30 years. A mortgage attaches a lien against the property until the loan is repaid according to the terms laid out in the note.

What is a mortgage note?
Mortgage notes are not the same as a mortgage, though both secure a loan. When a borrower takes out a mortgage, the lender produces two documents: the mortgage (see above) and the mortgage note, which is also called a promissory note. The mortgage note can be seen as a “promise to pay” and lays out the terms and conditions of the loan.

What is mortgage note investing?
Investing in notes and mortgages is a wealth generating strategy that can provide consistent, long-term returns with predictable monthly payments to the investor. When you purchase mortgage notes, you are not buying property but, instead, rights to the mortgage and note and, therefore, the mortgage payments, the stream of income.

What is a mortgage note broker?
Often someone selling a home finances the buyer’s purchase and “takes back” a note. They serve the same function as a bank and are called the “note holder”. After several years they may decide to sell their note and use the proceeds for another purpose like paying for a child’s college tuition or buying a new car. They can sell the note to one of several exchanges established for that purpose. Note brokers purchase mortgage notes and may hold them for their own portfolio or resell them to interested buyers.

Investing in Mortgage Notes

For many, the world of mortgage note investing sounds enticing, but finding a way in can seem daunting. As you search the internet for resources and read advice from many of the big names in the landscape, you frequently find the same challenges again and again:

1) Complicated financial jargon that seems designed to fortify rather than remove the barrier to entry, so that only those with decades of experience can understand it and invest.

2) Advice that is big on hype but short on specifics. You do not want to only know how much money you can make or how much risk there is in mortgage note investments; **you want to understand how to do it.**

We have developed this guide to overcome these common obstacles, using the processes and standards we have developed at Real Wealth Doctor to provide step by step explanations and explore the risks and rewards of note investment.

If you're **considering mortgage note investment for the first time** and want to learn more than just the basics, explained in plain language, so you can make an educated, informed decision about your financial future; or you **have invested in notes already** and wish to reinvest some or all of your returns to generate even greater wealth, this guide is for you.

Who sells mortgage notes and why do they want to sell them?

The first question that comes to mind for nearly anyone interested in buying mortgage notes is: who sells them? When you buy mortgage notes, the seller will typically either be an individual or a large investment company. In both cases, the property seller has acted as the bank for a home buyer.

- **Individual Sellers.** When an individual originates a note, they often do so because of the long-term income it provides them. However, another key benefit of mortgage notes is the ease with which they can be liquidated. If a note holder finds that they need a large sum of money to pay for a purchase or an unexpected personal expense, or they simply wish to reinvest their funds elsewhere, they can sell the note and transfer ownership to a new buyer.

  If you are considering selling a mortgage note or wish to learn more about selling mortgage notes, you can read more here.

- **Investment Companies.** Large investment firms usually sell their notes because they need to return investors capital.

- **Banks, credit unions, and other lending institutions** also sell mortgage notes. While not impossible, finding performing or re-performing notes that you can buy directly from the originating lender is often too cumbersome and involved a task for those who are not running an investment firm or buying and selling notes full time.

  Many financial "gurus" sell high priced courses and books claiming to teach you how to buy notes directly from the bank in your spare time. In reality, they are typically focused on buying non-performing notes (notes on which the borrowers are no longer paying) and your results will hinge greatly on not just your ability to find them, but also the number of hours and dollars you can invest to buy a sufficient number notes to buffer the risk and actually see returns. This approach to buying notes comes with high risk as well as high levels of involvement for the investor.

  For those interested in **secure, long term, truly passive income**, an approach that includes only non-performing mortgage notes misses nearly every mark. To recoup your initial investment, let alone profit, you may need to foreclose on and flip the property. While some level of risk is expected and even welcome for many investors, this approach espoused by the "gurus" often glosses over the hard work and potential losses that bridge the gap between high risk and high reward.

Why should I work with a mortgage note broker?

Finding sellers and analyzing notes is often a large enough hurdle to send interested investors off in search of more familiar assets, such as hard real estate. Working with a mortgage note broker can remove that seemingly large hurdle by giving investors a

knowledgeable partner who can help them navigate the process and manage their investment, payments, and even help mitigate risks.

When we partner with new investors at Real Wealth Doctor, we find they often ask a set of similar questions. We have identified those we are asked most frequently and provided answers below.

Where are the properties?

When you buy a mortgage note, you are not buying property. Instead, you are **buying an income stream.** When the borrower makes monthly payments on their mortgage loan, you will receive the payments.

This payment structure is not unlike the income you receive from rent payments when you own a rental property. However, unlike investing in rental properties, investing in mortgage notes does not saddle you with the administrative and maintenance costs that come with becoming a landlord.

This is because you do not become a landlord when you buy mortgage notes, you become “the bank.” Maintenance and upkeep of the property remains the responsibility of the borrower. Your responsibility as a note owner is simply to receive payments.

Nevertheless, the location and condition of the property securing the note is important to consider, as is the borrower’s ability to repay the loan. These factors will help to shed light on how much risk is associated with a given note and help to determine if it is the right investment for you.

Although we buy notes in almost every state, most of the notes we buy are located in **clean, safe, working class neighborhoods** in the Midwest and Southeast, in areas that have diverse sources of employment, low home prices, and high rents. Buying notes in these areas increases the likelihood that borrowers will be able to continually make their mortgage payments, and provide multiple exit strategies in the unlikely event that the borrower is not able to meet their mortgage obligations.

Who are the borrowers?

They are working class people like millions of other Americans. They work in factories, stores, warehouses, hospitals, schools and many other places. These borrowers were approved for a home mortgage and have a demonstrated ability to repay the loan according to its terms.

When purchasing mortgage notes, we do our due diligence and analyze the FMV (fair market value) of the property, review title reports, review the borrower's payment history and credit reports, and take other steps to assess the value of each note as well as its risk. Because of this comprehensive analysis, we are able to project the likely earnings we can expect for the life of the note. And because mortgage notes are backed by tangible property, notes offer **an added degree of security** not typically available when purchasing stocks, bonds, and other paper securities.

How much do people usually invest in mortgage notes?

Most of our mortgage note investments range from $40,000 to $70,000 per note. The cost will vary based on several factors, including the age of the note, payment history, location, loan-to-value ratio, and more. These "small balance notes" afford the investor opportunities for greater diversification ("don't put all of your eggs in one basket"), and currently carry higher yields than most institutional grade notes. When we buy a note, we first complete a note analysis to evaluate a note's performance and assess its current market value.

Whether you buy mortgage notes through a mortgage note broker or seek out and broker your own deals, there are certain factors you should always consider to gain a complete picture about the health of a note and the returns it is likely to yield. For a more in-depth study of how to assess a mortgage note and understand the return on your investment (ROI), read Investopedia's article on ROI HERE.

How long does the investment last?

Investing in mortgage notes is not a get rich quick scheme, and brokers who say otherwise, unfortunately, do not have investors' best interests in mind. These are long-term investments typically lasting 10 to 28 years. Many loans will be paid off early, while others will run for the entire term. Before buying a note, you should be able to estimate the number of payments that remain on the loan and the amount of each payment, so you can explore various scenarios wherein a borrower may pay off their loan early.

What yield should I expect?

Most performing notes have returns in the 5-8% range, with nonperforming notes yielding higher returns. Your return will depend somewhat on the level of risk you are comfortable with and how actively you want to manage your investment. A higher stated return often comes with a higher degree of risk. As the holder of the mortgage note, the borrower's payments are deposited into your account on a monthly basis. You receive returns on a monthly basis.

Depending on your investment goals, you may want to direct these payments to an account that gives you immediate access to them or to a retirement or investment account. Each of these options can impact the tax implications of your mortgage note returns. Some can even provide tax free returns.

What are the Risks of Buying Mortgage Notes?

Buying notes offers a lot of security for investors. If you invest in stock, you are subject to the market's variability with no safety net. When the market drops, your investment may lose value.

All investment vehicles carry an element of risk, and mortgage notes are not immune to this. As with any asset, performing due diligence before you invest is a crucial

component of managing investment risk. For note investors, there are several ways to mitigate potential losses, some of which are detailed below.

Invest in notes with a broker you trust

A mortgage note broker's primary interest should be in the quality of the note and whether it fits your investment objectives. They should also be not just willing, but enthusiastic, to answer your questions and help educate you so that you can make an informed, responsible decision and invest in notes that align with your goals.

As mentioned above, if a broker positions mortgage note investments as a get rich quick scheme, you can safely conclude that they are looking after their own interests, not yours. Buying mortgage notes isn't a scheme at all—it is a way to diversify your portfolio with a reliable and secure wealth building strategy, a strategy that has been employed by insurance companies, for example, for years. A broker you can trust will be honest about your risk and returns and will tell you if they do not feel that it is the right investment for you.

When deciding which note broker to work with, ask them questions to understand how they find and evaluate the notes they buy and sell, and what you can expect from them as the note matures, such as:

- **What criteria do you assess when reviewing a mortgage note?**
    - When you partner with a broker to buy a mortgage note, it is important to know that they are doing due diligence in evaluating each prospect and presenting them honestly to potential buyers.

- **Do you have experience working with people whose financial goals are similar to mine?**
    - A broker's experience in the field can be assessed by their time in the industry, but a more relevant yardstick may be their experience with portfolios and goals similar to yours. Not only will experience with your situation help them to identify the best investments for you, but it will also ensure that you are not a "small fish in a big pond" that is not given attention until the bigger fish are fed.

- **What level of risk would you suggest for someone with my goals?**
    - No two investors are the same, and a mortgage note broker who leads all of their clients in the same direction will do many of their clients a disservice.

Before beginning a relationship with a broker, have a candid discussion about your goals and the level of risk you are comfortable with. As experts in their industry, your broker may suggest investments outside of the risk level you've described, but they should be able to explain their thinking, answer your questions, and ultimately help guide you, not pressure you, as you make a decision.

- **How will you assist me as my notes mature or until they are repaid?**
    - A broker who understands your goals and is familiar with your current investments is the ideal partner. Unlike brokers who treat each deal as a one and done sale, a broker who partners with you for the life of the note will be able to identify additional notes that you can re-invest your returns in to generate even greater wealth.

      Additionally, all investing comes with risk, and mortgage notes are not immune to this. A mortgage note broker who signals that they are available to assist you in the future should your note stop performing, either by offering guidance or concrete assistance, is also signaling that they are invested in more than just the sale—they are invested in a relationship, in your success, and they are offering a level of service that reflects this.

Make sure the borrower has made a substantial down payment or has equity in the property

Buyers who have made large down payments and those who have amassed significant equity in the property through long-term ownership have more to lose if they default on their mortgage. While there are no guarantees, these borrowers are statistically more likely to keep current on their loan payments and less likely to strategically default (a strategic default occurs when an borrower owes more on their home than the home's value and, finding themselves unable to make loan payments, walks away from the home.)

Buy mortgage notes with low loan-to-value ratios

What is loan to value ratio? Calculating the loan-to-value ratio (LTV) is a way to evaluate the risk on a secured investment. In the case of mortgage notes, the loan-to-value ratio is found by dividing the amount of the mortgage (the loan) by the value of the property securing it (value.) A mortgage note with a loan-to-value ratio of less than 60% is considered less risky than a note with an LTV of 90%, for example. If the borrower experiences an unexpected life event that causes them to default on the loan and they

are unable to become current again, a home with a lower LTV offers a higher likelihood of being sold quickly and possibly at a discount so the note holder can recoup their investment.

Research rent prices and determine if they are higher than the borrower's loan payments

Part of assessing the risk of any investment is identifying your options to recover what you can if the investment is not performing optimally. Nobody hopes to foreclose on a borrower, and many note holders will explore alternatives before taking this step. If it does come to pass, however, note buyers who have done their research may still be able to recoup the full value of their investment. Mortgages are secured by property which means, if no other solutions are available, the note holder may foreclose on the borrower and take ownership of the property. If rent prices in the area are higher than the borrower's mortgage payment, you can fall back on renting the property to ensure you receive a return on your investment.

Note Management

Does Real Wealth Doctor service my loan?

We employ licensed third-party loan servicing companies to service our loans. While the loan servicer will collect payments from the borrower and deposit the funds into your account, we recommend that all of our clients also check their account on occasion to ensure that payments are being deposited properly.

What happens if the borrower refinances or sells the property?

If the borrower on a note you hold refinances or sells their home before the loan's maturity date, the unpaid balance of your investment will be repaid when the sale closes. Another benefit to investing in notes is that a portion of your principal (the amount you invested) is returned with each payment you receive. It's not like investing in stock, where you hopefully get all of your money back plus a return when you sell the stock. Thus, your risk is further reduced since you consistently receive a portion of your investment each month.

What do I do if the borrower's payments are late, missing, or they stop making payments altogether?

In a perfect world, a performing or re-performing mortgage note would always continue to perform until it is paid in full. In reality, sometimes things go wrong. If a borrower is not making payments as agreed, the loan servicer will take the necessary steps to communicate with them and try to bring them back to current. This may include sending overdue payment notices and other notifications.

In these situations where a mortgage note is no longer providing consistent returns, Real Wealth Doctor will also assist you in taking steps to recover your investment, which may include may include forbearance or loan modification, or connecting you with a lawyer in the state where the property is located in order to foreclose on the loan. If you own only a portion of the note, we handle this aspect of the process entirely.

Conclusion

One of the most compelling draws for mortgage note investors is that notes are not shaped by market fluctuation in the same way as other investment vehicles, nor do they require the ongoing maintenance and upkeep of other real estate asset classes.
Once you have made your initial investment in a mortgage note, your money goes to work for you and provides **passive income that is truly passive**. As a note holder, you become "the bank." The borrowers mortgage payments are sent to you each month and will continue until the loan repayment is complete. For many investors, partnering with the right note broker and servicer is all that is needed to find, purchase, and manage their mortgage notes.

Investors who are looking for an investment alternative that will diversify their portfolio and offer consistent returns often find precisely what they are looking for in mortgage note investment. These secured assets are not without their risks, but these can often be mitigated while providing a more stable option than stocks that yields higher returns. The market is unpredictable and can wreak havoc on a portfolio that is not designed to withstand its whims. If you're looking for a more stable and predictable avenue to save for retirement or supplement your income, mortgage notes may be the investment you need to start growing your wealth. And make work optional.

Whether you are looking to buy mortgage notes, sell a mortgage note, structure seller financing, or just have questions and want to learn **more about investing in mortgage notes**…

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Marishka & Larry
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