

www.turnkeyinvesting.com

The TurnKey Investor's

“Subject To”

Mortgage

Handbook

*The Art & Science of Buying
Investment Property by
Taking Over Mortgages!*

Matthew S. Chan

Author of “TurnKey Investing with Lease-Options”

With Contributions by Wes Weaver

*Ascend Beyond Publishing
Columbus, Georgia*

The TurnKey Investor's "Subject To" Mortgage Handbook

The Art & Science of Buying Investment Property by Taking Over Mortgages!

Copyright © 2005 by Matthew S. Chan. All rights reserved.

No part of this book may be reproduced or transmitted in any form or by any means, electronic or mechanical, including photocopying, recording, or by any information storage and retrieval system without permission in writing from the publisher, except by a reviewer, who may quote and reprint brief passages in a review.

"TurnKey Investing" is a trademark of Intrepid Network Concepts, Inc.

Published by: Ascend Beyond Publishing
5435 Woodruff Farm Rd., #B-300
PMB 158
Columbus, GA 31907

www.ascendbeyond.com

ISBN: 0-9713947-4-1

Printed in the United States of America. First Edition.

First Printing: August 2005

Book Ordering Information

Visit www.turnkeyinvesting.com to order additional copies for private use or for resale. Quantity discounts are available. Special pricing for churches, schools, colleges, universities, and non-profit, charitable organizations.

Visit our website at www.turnkeyinvesting.com to find more information on books, educational materials, and courses on how to create safe and steady returns through real estate investments.

Dedication

To the people who have entrusted me ...

To the people who have invested with me ...

To the independent-minded investor ...

To the supporters of TurnKey Investing ...

I commit this book to them. Salute.

Matthew S. Chan

This publication is designed to provide competent and reliable information in regard to the subject matter covered. It is sold with the understanding that the author and publisher are not engaged in rendering legal, accounting or other professional advice. Laws and practices often vary from state to state and country to country. If legal advice or other expert assistance is required, the services of a competent professional should be sought. The author and publisher specifically disclaim any liability that is incurred from the use or application of the contents of this book.

Table of Contents

Introduction

..... 1

CHAPTER

1

The Beauty of "Subject to" Mortgages

Chapter 1	7
The Benefits	8
Summary	15

CHAPTER

2

The Fundamentals of "Subject to" Mortgages

Chapter 2	17
Components of a "Subject to" Mortgage Transaction	19
Mechanics of "Subject to" Mortgage Transaction Diagram	20
Legitimizing "Subject to" Mortgage Transactions	24
Urgent Sellers	25
Evaluating Potential Deals	26
Risks of "Subject to" Mortgage Transactions	26
Due Diligence	27
Closing the Deal	27
After the Closing	28
Ongoing Issues	28
TurnKey Investing Philosophy	29
Summary	29

CHAPTER

3

**Legitimizing “Subject to”
Mortgage Transactions**

Chapter 3 31
A Personal Story 33
No Man (or Woman) is an Island 34
Driving Force for this Chapter 35
Real Estate Attorneys 37
Real Estate License Study Manuals 39
Tax Books 40
General Real Estate Books 41
Settlement Statement 42
Settlement Statement Sample (HUD-1) . . . 43
Summary 44

CHAPTER

4

Finding the Urgent Seller

Chapter 4 45
Negotiation Dynamics are Changed 47
Circumstances Creating Urgent Sellers . . . 48
Finding the Urgent Seller 51
Winning Sellers Over 52
Focusing on Seller’s Benefits 55
Our Responses to Seller’s Concerns 59
Summary 64

CHAPTER

5

**Evaluating
Potential Deals**

Chapter 5 65
Seller Information Sheet 67
Monthly Payments 68
Real Equity 69
Potential Equity 70
Loan Arrearages 71
Vacancy Cost 75
Marketing Costs 75
Property Preparation Expenses 76
Homestead Exemption Status 76
Deal Evaluation Formulas 77
Making the Offer 79
Summary 80

CHAPTER

6

**The Risks of "Subject to"
Mortgage Transactions**

Chapter 6 81
Over-Leverage 83
Original Borrower Demands a Cash-Out 85
Lack of Professional Support 86
Seller Interference with Lender 88
Seller Interference with Property 89
Seller Wants the Property Back 89
Property Insurance 91
Doctrine of Implied Assumption 92
"Due-on-Sale" Clause 94

What does a Due-on-Sale Clause Look Like?	95
Why We Don't Worry About Due-On-Sale	98
Summary	104

CHAPTER

7

Due Diligence

Chapter 7	107
Lease-Option Criteria	109
Property Inspection.	110
Investment Returns & Profitability (The Numbers)	113
Seller	115
Release of Information Authorization	117
Lender	118
Loan Status	119
Foreclosure Attorney.	121
Title Check	122
Insurance	123
Summary	124

CHAPTER

8

Closing the Deal

Chapter 8	125
Closing Attorney	126
Title Insurance	127
Types of Closings	129
Land Trusts.	132
Closing Documents.	136
Get the Keys.	139
Summary	140

CHAPTER

9

After the Closing

Chapter 9 141
Get Legal Possession of the Property . . . 142
Foreclosure Attorney. 143
Lender 144
Property Preparation. 145
Other Methods of Profit. 147
Our File System 147
Replacing Insurance. 148
Summary 149

CHAPTER

10

Ongoing Issues

Chapter 10 151
Communication with the Seller 152
Times Change, Situations Change 153
Property Manager Role. 154
Address Changes & Lost Mail 155
Account Changes 156
Escrow Account 157
Property Insurance 158
International Readers 158
Summary 162

CHAPTER
11

**The TurnKey Investing
Philosophy**

Chapter 11 163
Our Strategy 164
Staying Focused 165
Our TurnKey Investing Philosophy 166
Summary 177

Conclusion

..... 179

Appendix

A - Sample Documents 183
B - Area Maps 187
C - Property Photos 191

Acknowledgements 197
About the Author 201
About the Contributor 205
About the Management Team 209
Recommended Resources 213

Bonus Book Excerpt:

TurnKey Investing with Lease-Options . . . 217

Introduction

In 1999, I decided that I wanted to acquire a “large” portfolio of investment property. Specifically, I wanted to buy single-family houses that produced monthly cash flow. I didn’t simply want to “dabble” in real estate like so many people do by only buying 1, 2, or 3 properties. Long-term, I want to buy 10, 20, 30 properties and more.

I knew building this property portfolio was not going to be an overnight venture. It was going to take time and lots of work over the course of several years.

The Dilemma

One of the major obstacles I saw in acquiring the portfolio size I wanted was my limited borrowing power. I knew it would not be difficult to qualify for a few loans through a mortgage broker on my own but I also realized that it would not take long for my credit to get tapped out.

When I began acquiring properties, I was a self-employed, independent contractor in the I.T. industry, not a W-2 wage earner. As you might expect, lenders much prefer a high-paid W-2 wage earner to a self-employed individual. I knew this going in.

I have always taken a proactive approach in any business I am in. I was not comfortable with the idea of being tapped out of financial resources first then trying to find a solution around it.

One rule I follow in business and investing is, “Get money when you don’t need it.” Conversely, the worst time to look for financing is when you are tapped out and desperately need it. It is a basic law of credit. When you have little or no debt, everyone wants to loan

you money and give credit. When you finally do take on lots of debt, lenders pull back on credit and get nervous about lending money.

A Working Solution

Like many beginning investors, I exclusively used my own cash and credit to buy my first few properties to get myself going. But I knew I would have to as quickly as possible find alternative ways to finance properties I wanted to buy.

I read and studied various methods of alternative financing and I realized if I wanted to bypass conventional lenders, I would have to utilize *seller-financing*. One seller-financing technique I learned, adapted, and used, is the “*subject to*” mortgage where we “take over” mortgages on an existing property. I refer to this form of seller-financing as an equivalent to “assuming a non-assumable loan.”

I must admit that while I initially understood the concept, I was a bit slow and clumsy in execution. The reason why I was slow and clumsy is so much of the success of using this technique is based on the ability to negotiate, educate, and create trust with the sellers.

The Start

I had a slow start in 1999 as I was simultaneously trying to buy property but having to travel frequently in my I.T. training business. By early 2000, I managed to acquire a few investment properties in the Atlanta area when I decided that I both wanted and needed to

relocate to a smaller city. The city I eventually relocated to was Columbus, Georgia, two hours southwest of Atlanta next to the Alabama border.

The Alliance

In early 2001, I settled in and got established enough in my new home city of Columbus to begin resuming property acquisitions. By the end of 2001, I would go on to acquire five more investment properties with “subject to” mortgage financing. It was during this time I met my current business partner, Wes Weaver (also the Lead Contributor of this book).

Wes watched with great interest how I, one by one, negotiated and executed “subject to” mortgages to acquire investment property and then created cash flow by lease-optioning them out.

Starting out as my apprentice, Wes eventually joined forces with me to create a management alliance we enjoy today. Together, we have gone on to become the “#1 Provider of Owner-Financed Homes in Columbus, Georgia & Phenix City, Alabama” where we specialize in lease-optioning property out to our tenant-buyers.

How we lease-option out properties we acquire is covered in the previous book, *“TurnKey Investing with Lease-Options”*.

The How-to Manual

This book discusses how Wes and I jointly acquire investment properties with “subject to” mortgages. Wes and I take a unique tag-team and synergistic approach

in our “subject to” mortgage transactions. Together, we carry more credibility and close more transactions than if we did them separately.

At the risk of being boastful, the book you have in your hands contains an incredible amount of little-known information never before seen in book format. And while there are other sources of “subject to” mortgage information which you can learn from, very few contain the in-depth research and the customized techniques described herein. I am confident that you will find distinctions not found elsewhere.

The Reasons for Writing this Book

This book was written for several reasons:

First, because we value our business reputation, we always look to maintain a high degree of credibility and legitimacy in what we do. “Subject to” mortgage transactions are often unknown or misunderstood. This manual serves as a definitive written source explaining how and why we do what we do.

Second, because we invite investment partners to work with us, this book allows us to more completely and efficiently describe and communicate what we do without all the fluff of a brochure.

Third, as our management team grows, this book serves as both an instructional and operational guide into what and how we do things. It is a more concise alternative to a full-scale Operations Manual.

Finally, this book was written for experienced investors who wish to expand their financial repertoire by utilizing the “subject to” mortgage as an additional financing technique to acquire property.

What to Keep in Mind

There are two important points I want you to keep in mind.

Despite how the “subject to” mortgage technique is advertised in seminar circles, we take a serious view on this subject. We consider this an advanced financing technique that can be incredibly powerful when utilized correctly. Or it can be financially catastrophic in foolish or ignorant hands. *This handbook was written for the experienced investor* and makes no effort to accommodate the beginning investor.

Our system constantly changes and evolves as we adapt to new circumstances, situations, rules, and market conditions. As such, we unhesitatingly make changes, updates, and revisions to our daily operations which, over the course of time, may outdate the information in this book.

In the meantime, I hope you find the information helpful. Thank you for reading this book.

Matthew S. Chan

CHAPTER

1

**The Beauty of
“Subject to”
Mortgages**

The idea of buying investment property without having to get a new loan is a very attractive idea. One way this occurs is that you take title to a property but leave your seller's existing loan in place. This particular method of acquiring property is the essence of a little-known technique of buying and financing property with a "*subject to*" mortgage, a form of seller-financing.

The Benefits

There are many benefits to buying property with the "subject to" mortgage technique, including:

- No Qualification Process
- Fast Closings
- No Loan Costs
- No Impact on Borrowing Power
- Negative Events Do Not Appear on Our Credit Report
- Profitably Buy Little or "No Equity" Properties
- Seller's Credit is Often Improved
- Lender Losses are Minimized

No Qualification Process

When we buy property with a “subject to” mortgage, we are not “asking permission” from a lender as to whether we can buy the property and qualify for a loan. Neither are we trying to formally “assume” the loan.

We are simply making alternative offers to sellers (who already went through a loan qualification process) for us to step in, take over their position, and begin making payments. In effect, we bypass the normally cumbersome loan qualification process.

Fast Closings

Because we are simply assuming the seller’s position with the loan, we are able to do quick closings. Often, all that is required for a closing on such properties is for us to do a title check, verify the loan status with the lender, and then set up an appointment with a real estate attorney (or title company) to complete the paperwork and close the deal. Typically, all these events can happen within a week.

We use this benefit in our negotiations with our sellers who may want to move out and on with their lives quickly.

No Loan Costs

Buying investment property typically requires getting new financing, which often means qualifying for a new loan. When a lender agrees to provide financing to a borrower, these loans and closing costs can add several thousand dollars to the purchase price of the

property. Such costs can include fees for appraisals, loan underwriting, attorneys, couriers, surveys, insurance, and inspections. The list of the fees to be paid for a new loan can be quite long.

Buying property with a "subject to" mortgage eliminates the loan fees and closing costs because they were already paid by the seller when they originally bought the property. The only exception to this no-fee approach is that when we close with our sellers, we pay our real estate attorney a fee to do our closings.

No Impact on Borrowing Power

A common challenge for many real estate investors is the amount of financing they can qualify for as their portfolio grows. With every new investment loan, an investor's borrowing power generally weakens. Ultimately, many investors will encounter a time when getting new investment properties with their own borrowing power becomes very difficult.

Buying properties with a "subject to" mortgage bypasses any impact on our credit reports and our borrowing power. The reason is that the loan continues to appear on the seller's credit report until we ultimately pay off and satisfy the loan. As such, there is not a credit limit to how many properties we can buy with a "subject to" mortgage.

"Ultimately, many investors will encounter a time when getting new investment properties with their own borrowing power becomes very difficult."

Negative Events Do Not Appear on Our Credit Report

I almost hesitate to bring this benefit up because this can be taken out of context, but I will do so in the interest of being complete. It is a benefit I hope no one -- including ourselves -- **ever** takes advantage of.

In the highly improbable event that we lost a property to foreclosure, our credit reports would not show any negative consequences. To a lesser degree, even late payments and other negative performance-related issues will not appear on our credit reports. If a foreclosure occurs, it will appear on the seller's credit report.

“Buying properties with a ‘subject to’ mortgage bypasses any impact on our credit reports and our borrowing power.”

At this point, I would like to emphatically point out that this benefit can only be used under financially or economically catastrophic events. Like life insurance, this is a benefit you hope to never use in your lifetime.

I do not in any way, shape, or form condone buying a property with a “subject to” mortgage if there is any question or concern about whether you can make the payments. This is especially true if you are buying from a seller who has marginal to excellent credit. Buying properties with a “subject to” mortgage is just as serious a business, if not more so, as buying property with your own credit. If you ruin your own credit, that is one thing – but ruining another person's credit is a burden being placed on someone else.

Yet if an economic catastrophe occurs, you can take some small comfort that your credit will not be ruined by the properties you bought with a "subject to" mortgage.

Profitably Buy Little or "No Equity" Properties

One of our favorite ways to separate ourselves from many buyers in our market is that we are able to profitably buy little or "no equity" properties. Typically, sellers with no equity in their property have a difficult time selling them. In our local area, it is quite common for many sellers who have owned their homes for three years or less to have little or no equity in their property. Clearly, we are nowhere near California cities or any of the other places where property appreciates very quickly.

When a seller wants to mortgage a property with little or no equity, very few real estate agents are willing to work with sellers of those properties because their sales commissions often

come from the proceeds of a sale. If there is little or no equity, the only way a real estate agent could be paid is if a seller is willing to pay the commission out of pocket. Needless to say, few sellers are inclined or are prepared to pay such a large sales commission themselves.

"If an economic catastrophe occurs, you can take some small comfort that your credit will not likely be ruined by the properties you bought with a 'subject to' mortgage."

As investors buying for profit, we would not normally get new financing to buy little or no equity properties. Because a new loan would add thousands of dollars to the purchase price (making it over-priced), it would make little sense to go through the trouble or costs to buy these types of properties.

However, buying with a “subject to” mortgage increases our willingness and the overall desirability of the property because it allows us to step into those properties with great ease, little out of pocket costs, and no loan qualification process.

Seller’s Credit is Often Improved

Often, we buy from sellers with a troubled payment record. They frequently have loan arrearages they cannot pay. In some situations, foreclosure is imminent. When we step in to buy these properties, we pay the arrearage and reinstate the loan.

Once we reinstate the loan, we begin to make regular monthly payments to the seller’s account. From the lender’s point of view, the account has “miraculously” improved. From the seller’s point of view, their troubled credit “magically” begins improving as their delinquent account and arrearage disappears and the account becomes and stays current. Over a 12-month period, having a mortgage loan that is current goes a long way to improving the seller’s credit score and borrowing power.

“Often, we buy from sellers with a troubled payment record.”

And as part of our negotiations, we often tell our sellers about this particular benefit. Not only do they sell their property quickly but also they get their credit scores and credit records improved because of it.

Lender Losses are Minimized

Lenders are helped by “subject to” mortgage transactions. By creatively utilizing this technique, we often save properties and loans from foreclosure action.

Foreclosure action is generally a very expensive process where many parties lose. The borrower would clearly vacate the property and suffer a foreclosure record. But the lender often takes business losses by paying fees on foreclosing and managing vacant properties that have little or no equity.

Additionally, when they do finally resell the properties, they often do not fully recover the monies they originally loaned out. These costs are passed on to future loan customers.

By doing our part to “save” the properties and the accompanying loans, lenders suffer fewer losses from foreclosure action. More importantly, they continue to have a performing account with ongoing loan payments.

“We often save properties and loans from foreclosure action.”

Summary

Buying and financing investment properties with a “subject to” mortgage has many benefits for the buyer, the seller, and the lender. A “subject to” mortgage is not a “magical pill” to solve all buyer, seller, or lender problems. However, it is an innovative and little-known financing technique that, when properly utilized, provides win-win situations to all parties.

CHAPTER

2

**The
Fundamentals
of “Subject to”
Mortgages**

There are various elements and concepts that you must understand in order to digest the mechanics of an entire “subject to” mortgage transaction.

Conceptually speaking, buying property with a “subject to” mortgage involves transferring title from a seller to a buyer while preserving the integrity and terms of the existing loan. In essence, you are buying the property “subject to” the terms of the existing loan.

The title changes hands, but the original loan stays in place. The original borrower retains formal liability on the loan. When this occurs, the seller has provided the buyer a form of “seller-financing” to make the deal happen.

There are several components and surrounding issues that you have to first understand before you engage in a “subject to” mortgage transaction.

Assuming a “Non-Assumable” Loan

The nature of a “subject to” mortgage is that we are in essence assuming a “non-assumable” loan. We do so without going through any qualification process, and the transaction is done without direct permission from the lender.

Components of a “Subject to” Mortgage Transaction

The major components of a “subject to” mortgage transaction are:

- Title
- Legal Possession
- Lender
- Loan
- Mortgage
- Seller / Borrower
- Buyer

Title

Every property has a legal entity that owns, controls, or holds the title to that property. That legal entity could be a corporation, partnership, trust, or individual. Having title is what gives you the right to control or own a property.

That title can be conveyed from one legal entity to another. Title is transferred and conveyed most often by a document called a Warranty Deed.

The essence of transferring title from one party to another involves the following steps.

- A new Warranty Deed is prepared (often by a real estate attorney).