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, theses 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.

> *"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."*

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.

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.

> *"We often save properties and loans from foreclosure action."*

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.

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.