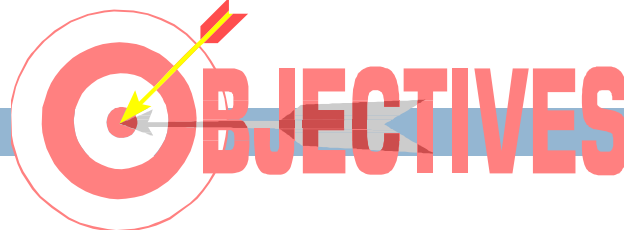




LESSON EIGHT

CREATIVE FINANCING APPROACHES

STUDENT LEARNING OUTCOMES (SLOs):



1. *Differentiate between traditional and creative financing techniques.*
2. *Offer reasons for using alternative or creative financing.*
3. *List five types of creative financing techniques.*
4. *Describe how junior financing can be creatively structured.*
5. *Point out the advantages and disadvantages for using installment sales over "straight" sales.*
6. *Explain the techniques used in exchanging.*
7. *Interpret the major provisions of the Seller Carryback Financing Disclosure (Civil Code Sections 2956-2967).*

I. Creative Financing

A. What is Creative Financing?

1. Non-traditional
2. Novel or unique
 - Solve finance problem
3. Demand
 - Traditional does not do the job
4. Limited by imagination
5. Bottom line
 - Meets buyer & seller desires
6. Some become mainstream

B. Why Creative Financing?

1. Competition
 - Constant demand in California
2. Capital requirements
 - Inflow of capital to California
3. Tight money
 - Shortage of funds
4. Alternatives

II. Techniques to solve Financing Dilemma

A. Creative Approaches

1. **Secondary** financing
2. All-inclusive trust deeds
3. Land contracts (Installment Sales Contract)
4. Lender participations
5. Sale-leasebacks
6. Share collateral
7. Open-end trust deed
8. Divided amortization schedules
9. Exchanging and trade-ins
10. Commercial loans
11. Stock equities
12. Piggyback loans
13. Seller **carry-back** first trust deed loan
14. Lease-options
15. Compensating balances
16. Long escrows

B. Instruments Used

1. Assignment of Note and Deed of Trust
2. **Installment** Note - Collateral Security Agreement
3. All-Inclusive Note and Trust Deed (A.I.T.D)
4. Long-Form Security Installment **Land Contract** with Power of Sale
5. Sale-Leaseback Agreement
6. Exchange Agreement

III. Secondary Financing

A. Seller Carry-Back Second

1. **Purchase** Money 2nd
2. Amount
3. Filling the void

B. Collateralized Junior T.D.

1. Pledge
2. Purpose
3. Receipt of **cash**
4. Example
5. Solving the problem
 - a. Control
 - b. Cash **flow**

C. Sale of Junior lien/loan

1. Purpose
2. Residual **interest**
3. Amount of **discount**
4. Example
5. Accomplished
 - a. Assignment of Trust Deed
 - b. Sources

III. D. Broker Participation

1. **Partnership**

2. Purpose

3. **Assignment**

4. Example



5. Mechanics of an Agreement

- a. Documents

- b. Contract

- c. **Assignment**

- d. Default

III.D. 5. E. Combination/Split Junior T.D.

1. Purpose
2. Splitting the **note**
3. Example
4. Advantages over a single junior loan
 - a. Sale of the note
 - b. Marketability
 - c. **Cash** relief readily available
 - d. Compromise



IV. All-Inclusive Trust Deed (AITD)

A. What is an All Inclusive Trust Deed

1. Definition: Purchase money lien that includes the existing **first** T.D. and secondary loan amount, given to the seller by the buyer.
2. Other names:
 - Wraparound
 - Overriding
 - Overlapping
 - Hold harmless
3. AITD used instead of **installment** sales contract

B. Characteristics of an AITD

1. “Subject to” -- subordinated to encumbrances
2. Provision that seller to pay off underlying loans with funds from buyer’s payment
3. **Seller-trustor** becomes seller-**beneficiary**. Buyer is trustor.
4. Title conveyed by deed and insurable **title** insurance
5. Default: seller must follow standard foreclosure procedure

IV. C. When is AITD used?

1. No alienation clause in the underlying note(s)
2. Existing financing **assumable**
3. Existing note has lock-in clause
4. Large project with limited partnerships
5. Underlying note has waiver of **acceleration** clause
6. Instead of installment sales contract/land contract
7. **Overpriced** property
8. Small down payment
9. Low interest rate on underlying loan
10. Buyer cannot qualify under normal sale
11. Substantial junior loan
12. Heavy **prepayment** penalty

IV. D. Example

IV. AITD

E. Benefits to Seller

1. Way to dispose of property without paying **prepayment** penalty
2. Existing financing assumable
3. Seller gets favorable terms
4. Seller gains net yield
5. Seller increases **effective** rate of return

F. Benefits to Buyer

1. Ability to buy property
2. Larger property using **leverage**
3. One monthly payment
4. **Flexibility** in structuring the loan
5. Buyer gets deed
6. Buyer has less costs
 - No points
 - No **assumption** fee
 - May be lower interest

IV. AITD



G. Contract and written note state use of collected funds apply on senior indebtedness

H. Current handling of AITD

1. Attractiveness of investment dependent on yield
2. Wraparound attractive for home seller
3. Non-assumable loans decrease demand
4. To benefit all parties, **record** the AITD

PROCEDURES IN SETTING UP AN ALL-INCLUSIVE DEED OF TRUST

1. ARRANGE TO RENEGOTIATE OR PAY OFF THE EXISTING LOANS THAT RESTRICT ALIENATION.
2. CONSTRUCT A REALISTIC PAYMENT SCHEDULE ON THE ALL-INCLUSIVE DEED OF TRUST TO COVER THE OUTSTANDING BALANCE(S), PERIODIC PAYMENT(S) AND BALLOON PAYMENT PROVISION(S) ON THE EXISTING LIEN(S).
3. DECIDE WHO IS TO PAY FOR THE COST OF SETTING UP AND ADMINISTERING THE COLLECTION PROCESS.
4. DETERMINE CONDITIONS GIVING RISE TO DEFAULT.
5. HAVE AN ATTORNEY DRAW UP THE REQUIRED AGREEMENTS AND DOCUMENTATION, USING PHRASEOLOGY ACCEPTABLE TO THE TITLE COMPANY THAT IS TO INSURE THE TRANSACTION AND ACT AS THE TRUSTEE UNDER THE ALL-INCLUSIVE DEED OF TRUST.

V. INSTALLMENT CONTRACT OF SALE

A. What is an Installment Sale

- **Buyer-vendee** receives possession, but not a deed. **Seller-vendor** retains title.
- 1. Other names
 - Land contract
 - Contract for deed
 - Contract to sell, Agreement to sell
 - Real Property Sales Contract
- 2. Unique Features
 - Seller does not give up fee title until conditions are met
 - Payment of 50% of price

B. When used

1. When no due-on-sale clause or alienation clause
2. Vendee has **small down payment**; vendor does not wish to give up legal title
3. Existing loans favorable to retain

V. INSTALLMENT CONTRACT OF SALE

C. Safeguard for DRE Licensee

1. **Full disclosure**
required under
“Creative Financing
Disclosure Act”
2. Execution of **disclosure
statement**
3. Consultation between
buyer/seller and real
estate **attorney**

D. Example

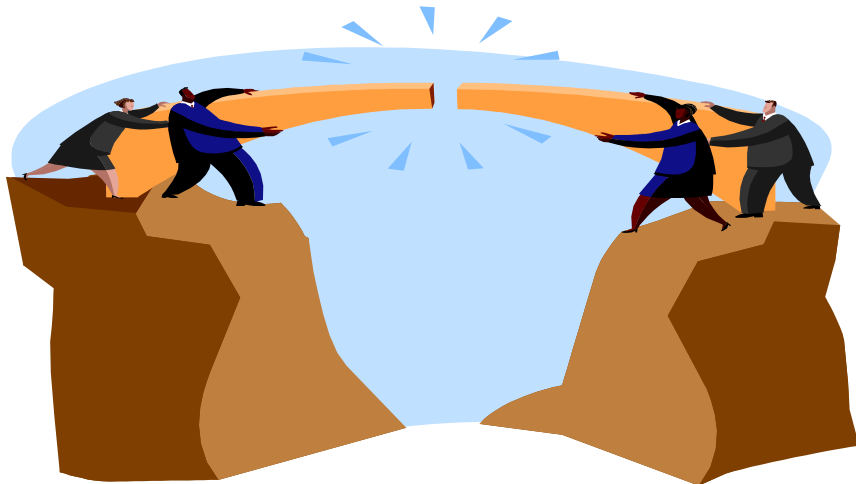
E. Mutual agreement

- Trustee to receive loan
payments from the
buyer
- Trustee to **disburse**
appropriate amount to
underlying lender
- Trustee to disburse
appropriate amount to
seller

VII. Divided Amortization Schedule

A. What is Amortization?

- Periodic **reduction** of unpaid principal loan **balance**
- Usually monthly installments



B. What is Divided Amortization?

1. Alternative
 - Repay in **equal** installments
 - Apply **interest**
 - Apply balance to **principal**
2. Usage
3. Repayment Schedule
4. Variation

VII. Divided Amortization Schedule

C. Annual Constant

1. Annual Constant is the sum of twelve monthly payment divided by the **loan** amount
 2. Monthly constant is on monthly basis
 3. Applied first to **interest**; balance to principal
- Total amount of loan (P & I) divided by number of years to determine the amount of equal payments.

D. How Annual Constant Used as Creative Financing Technique

1. Yield vs. Cash flow:
 - P & I portion of constant gives lender a particular **rate of return**
 - Borrowers get the **debt service** they desire
2. Example

VII. Divided Amortization Schedule



E. Other uses of annual constant

1. To determine the note **interest** rate.
2. To determine the existing loan **balance** at any point.
3. To determine the remaining **term** of a loan.
4. To determine how long it will take a loan with a specified loan amount to amortize.

VIII. Shared Equity Financing

A. What is Shared Equity?

- Financing that allows an investor to obtain tax benefits & help a home buyer who would not be able to afford to buy on their own.
- 1. Purpose: Help buyers during **high** interest rates & escalating prices
- 2. Variations: 2 or more parties pool resources to buy property-**partners** are resident owner and non-resident investor.

B. Who are the parties?

1. Resident owner can be **anyone**.
2. Non-resident owner is the **investor**



Shared Equity Financing

C. Advantages to Resident Owner

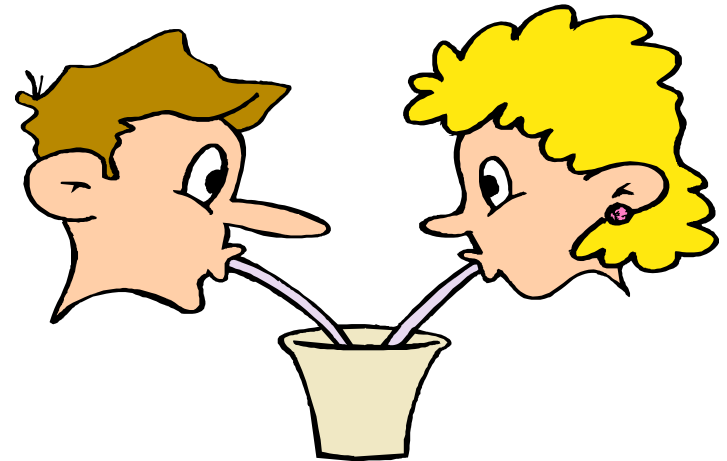
1. Getting into a property sooner, instead of having to wait until they have the **large** down payment that is required.
2. Equity build-up through loan payments and **appreciation**.
3. Easier qualifying because of participation by the co-mortgagor/investor.

D. Advantages to Non-Resident Owner-Investor

1. **Lower** interest rate because the property will be owner-occupied.
2. At least partial income tax deductions.
3. Little, if any, tenant problems.
4. **Share** in the appreciation of the property's equity.
5. Shifting of management and maintenance problems to the resident-owner.

VIII. E. Getting Started with Shared Equity Financing

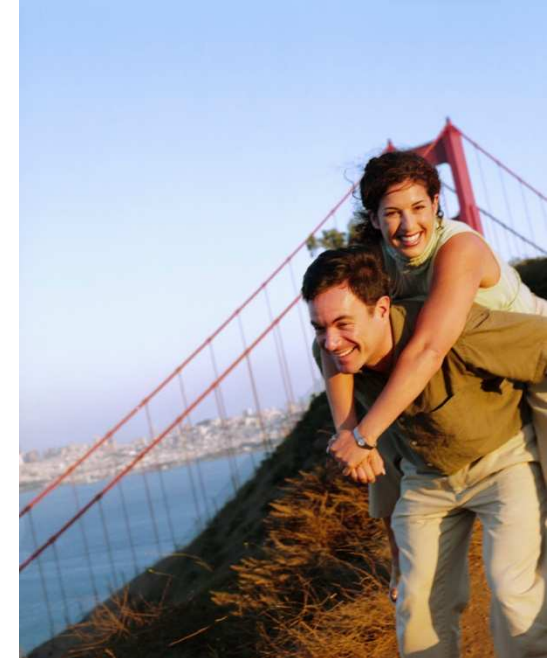
- Get competent advice from tax attorney or CPA
 - Owner occupied
 - % of ownership
 - Fair rental value
 - Duration of agreement
 - Relationship of the parties
 - Who pays for what
 - Who entitle to tax deductions



IX. SELLER CARRY-BACK FINANCING DISCLOSURE

Civil Code Sections 2956-2967

- The **arranger** of credit is responsible for the disclosures required to be given to the purchaser and vendor.
 - A. Introduction
 1. Alternative to traditional financing. Seller provides some or all of the financing
 2. **Disclosures**
 3. Application
 4. Extension of credit
 - a. Seller extends credit
 - b. Purchase includes title or lease with option
 5. Loan arranger



IX. A. 5. Loan Arranger of Credit



- a. Disclosure requirements imposed on the **arranger** of credit, including DRE licensee or attorney
- b. The language is directed at real estate licensees
- c. For more than one **arranger** of credit, the one who obtains the purchase offer from the buyer is the one who must make the disclosure
- d. The selling agent responsible for disclosure

IX. SELLER CARRY-BACK FINANCING DISCLOSURE

B. Timing the disclosure

1. Immediacy: as soon as **practicable**
2. Contingency: Any document signed prior to disclosure is **contingent** on buyers approval before execution of security document
3. Signatures: Buyer & seller sign receipt for disclosure statements & **arranger** of credit must sign.

C. What must be disclosed?

1. Identification
2. Description of terms of the note
3. Terms & conditions of recorded encumbrance
4. **Balloon** payment
5. Warning if refinancing required
6. **Negative** amortization
7. AITD
8. Collecting agent
9. Buyer data
10. Insurance
11. Default
12. Title **insurance** policy
13. Property taxes
14. Security documents
15. Cash proceeds
16. Requirement for other disclosures:
 - Federal Home Mortgage Disclosure Act
 - To avoid fraud, misrepresentation or deceit

X. Reprise

A. Other creative financing

B. Financing alternatives not included:

Bow tie

Piggyback loan

Buy-down loan

Profit participations

Commercial loan

Revenue sharing

Compensating balances

Sale-leaseback

Equity kickers

Share collateral

Lease options

Silent seconds

Long escrows

Stock equities

Open end trust deed

Zero interest loans