Trust Deed Investing

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Private Trust Deeds (Deeds of Trust) can provide high monthly income plus investment protection based on the value of the underlying real estate. **Advisor Financial Services (LLC), a Registered Investment Advisor,** has established contacts nationwide with a number of mortgage lenders, originators and mortgage brokers that make these real estate loan funding opportunities available as an investment choice. They can be used as investments for IRAs and qualified retirement plans, which is a great way to build your wealth on a tax deferred (traditional IRA) or tax free basis (Roth IRA). They can generate high monthly income during retirement. You could use the extra income they generate to spend, invest, pay bills, or buy more insurance protection.

What is a Trust Deed?

A Trust Deed investment is a loan, with real estate as collateral to protect you, the private lender. A borrower applies for a real estate loan with a loan originator, such as a mortgage lender or mortgage broker. The borrower promises to repay the loan amount plus interest, by making payments according to the terms of a note. The lender secures the promise to pay by using a mortgage or trust deed, with the real estate as collateral. If the borrower does not make the loan payments as agreed, the lender may foreclose on the real estate to recover all overdue payments, late fees and the balance due on the loan. The borrower loses the home, and forfeits any equity to the lender. In some cases, additional collateral or personal guarantees may also be used to provide further security and protection for the lender. Title insurance and property insurance are also used to protect the lender.

Who are the parties in a real estate loan?

There are three parties in a real estate loan. A **borrower** who wants to purchase, build, repair or improve real estate. The borrower applies for a real estate loan with a mortgage lender or mortgage broker (loan originator). The **loan originator** reviews the borrower's credit and equity in the real estate, obtains an independent appraisal of the real estate, and evaluates the potential risks and merit of the real estate deal. The loan originator contacts the final party, the lender **investor**, who provides the funds for the loan, and receives the loan payments.

Why should an investor be interested in funding these loans?

The borrowers are willing to make interest payments for a short period of time that are about 5% higher than the prime rate and to payoff the principal quickly. Currently, interest rates on these loans are 10% or more to the investor, and paid in monthly payments. In some cases, several months worth of interest are pre-paid at the loan closing, providing even more protection for the investor.

Why is a borrower with good credit willing to pay an interest rate of 10% or more when they could get a lower rate from another lender?

Some borrowers have good credit and might be able to get loans at lower rates. Other (sub-prime) borrowers may have lower credit scores or are building their credit history, and lower rates are not yet available to them.

Some borrowers with good credit are professional real estate investors, builders, developers, real estate agents or business owners where real estate is a key part of their business. They do not want to tie up their conventional lines of credit with short term deals when they only need the money for a brief period of time, or until they can arrange permanent financing. Getting the real estate deal done quickly is the highest priority. The interest rate is not their highest concern, because they do not expect to make payments for more than 6 to 36 months. Higher interest rates are simply a cost of doing business. The borrower wants to borrow the money based on their equity in the property. They may also need the funds quickly to close a good deal before the opportunity is gone. Many traditional mortgage lenders take too long for processing and approval. Some borrowers will pay a higher interest rate if they can get the needed funds quickly, in a few days, rather than waiting weeks or months.

How is a borrower's equity in the property determined?

The determination of equity begins with an independent appraisal of the property that will be used as security for the loan. The appraisal establishes the "Loan to Value" (LTV) ratio, which is simply the amount of the loan divided by the amount of the appraisal. For example, if the borrower wants to buy a house for $200,000, and borrow $140,000 to make the purchase, the loan to value ratio is 70% ($140,000/$200,000). In order to complete the home purchase, the borrower would need to have $60,000 to combine with the loan amount to buy the home. The $60,000 is the borrower's equity in the property, the difference between the loan and the appraised amount. If repair work will be done, some loans are made using an After Repair Value (ARV). New construction loans use an appraised value after construction and occupancy.

Can I use my IRA funds to invest in these loans?

Yes, but you must open a self-directed IRA account with a custodian that can properly administer this type of asset in your IRA. The custodian will provide record keeping and tax reporting for your IRA account, and will process transactions relating to the loan, such as wiring funds for loan closings and receiving monthly payments to deposit to your account. We have researched and compared many self-directed IRA custodians and can recommend an experienced company that we use for our clients.

Can I invest with my personal savings or investment funds?

Yes. Trust deeds pay interest rates much higher than bank CDs, bonds or money market funds. Investment returns of 10% or more are attracting investors that are tired or afraid of stock market and mutual fund risks, annuities or the headaches of being a landlord. If you invest your personal funds, you would receive monthly payments from the borrower until the loan is paid off. At loan payoff, you would receive the final interest payment, and the return of the balance of your principal.

How can Advisor Financial Services help me acquire Trust Deeds?

Advisor Financial Services is a fee-based Registered Investment Advisor firm. We have experience and have done time-consuming research, comparisons and analysis on many mortgage lenders and mortgage brokers that originate private loans for trust deed investments. We act as the advisor for our clients in finding, reviewing, and analyzing each transaction based on our screening criteria:

To reduce and manage risk, the real estate loans we normally use are:

1. First position lien Trust Deeds, no second or third mortgages.
2. Minimum borrower equity of 25%, (LTV, Loan to Value ratio no greater than 75%.)
3. Minimum interest rate to the investor of 8% or more, net of all fees.
4. Loan duration no longer than 6 months to 5 years (60 months).

We assist our investor clients with setting up an IRA at a self-directed IRA custodian. We find, review and evaluate loans for our clients, monitor loan payments, provide client support, and find new loans for reinvestment of the proceeds once the current loan is paid off. We find loans from across the country for greater selection and diversification. Clients may choose to be the sole lender in a deal, or may lend funds for part of a loan funded by several investors. Splitting investment funds across two or more trust deeds reduces risk through diversification.

Are mortgage pools or mortgage funds available?

We have information on some private mortgage/trust deed funds that are available to qualified or accredited investors. These funds can further reduce risk by diversification across many real estate loans, in different locations. If one borrower stops paying on a loan, monthly income would continue from the other borrowers. However, investors would own shares of the fund and the fund would own the trust deeds. The fund manager would select and manage the trust deed investments. The investor would need to decide if the fund was suitable for their situation.

What is the minimum investment amount required?

In most cases, the minimum investment amount required is $25,000. Some second position lien Trust Deeds are available with lower minimums, but the investment risk is higher. We can often find trust deeds paying a higher interest rate if you invest $50,000 or $100,000. Since we charge minimum fees for our services and charge declining fees for larger sized accounts, your investment return will be lower with a smaller account. Smaller accounts are more likely to return 8% or 9% after fees, while larger accounts are likely to return 10% and higher. This is still much higher than a bank CD, bond, money market fund or an annuity, although the risks with trust deed investments are also higher.

What are the fees to become a Trust Deed investor?

Our clients pay us a fee for our time, knowledge, research, analysis, client support and administration of their Trust Deed accounts. Our clients pay no fees to the loan originator (mortgage company or mortgage broker). The loan originator charges the borrower a higher origination fee than on a conventional loan. The borrower bears all costs of the loan including mortgage origination and loan-servicing fees.

Advisor Financial Services charges the client an annual fee according to our current fee schedule, typically 1% to 2%, depending on the size of your account. Our fees are competitive with similar services offered elsewhere, and are similar to the management fees charged by a mutual fund. IRA investors also pay account maintenance fees, to cover the costs of reporting and bookkeeping, and transaction fees for the purchase and payoff of each loan. We can recommend a self-directed IRA custodian with low fees.

Does Advisor Financial Services invest in trust deeds?

Jerry Lucas, Financial Advisor, founder and CEO of Advisor Financial Services (LLC), has been an investor in residential and commercial real estate and land in several different states for over 23 years. He also teaches seminars on property management for landlords and property managers. Over 3,000 students have attended his classes. He is also a trust deed investor. He may invest in some of the same loans that he recommends to clients. We only recommend loans that we consider suitable for you. You can decline a trust deed investment if you are not comfortable with it and we will look for another one for you.

What happens when a loan pays off?

You or your IRA get a big check for the last interest payment, and for the balance of the principal amount of the loan. The cash is not automatically re-invested in a new loan. There are new loans generally available for investment each month, depending on market conditions. We will find and review the available inventory of loans from our suppliers and make a recommendation for reinvestment of your funds. We should usually be able to find a new loan for you within 30 to 60 days. Your cash balance will earn interest while we are finding the next trust deed investment for you.

Can I see a sample of a loan that you have recommended to clients?

Yes, contact us and we will provide loan summaries of some transactions that we currently hold for our own account or client accounts.

How safe is my principal?

First Deeds of Trust are as safe as the real estate that secures the loan. There are no government guarantees. There is no FDIC or SIPC insurance. There is title insurance and property insurance on the real estate. We suggest that clients not invest in any loan if they would not feel comfortable owning the real estate that secures the loan. Ultimately, it is the value of the real estate that protects the principal. We seek to invest in areas where the real estate market is healthy and the outlook is favorable. Local economies and real estate market conditions change due to various factors. However, by using a conservative 70% Loan to Value ratio and short-term loans, there is a 30% equity cushion to protect your principal. It is very unlikely that real estate values would drop 30% in a short time period, barring some catastrophic event. In the stock market, individual stocks can often drop 30% or more very quickly.

There are three sources of principal recovery:

1. High Monthly Cash Flow - If the borrower is making monthly payments at an interest rate of 10%, then, after only 12 full monthly payments, the lender investor has received 10% of their initial investment in the loan in cash. The borrower is generally free to pay off the loan principal before the due date without penalty, but deals are often written so that the lender investor will receive at least 3 months of interest, even if the loan is repaid one day after the loan closing.

2. Refinance – Typically, these loans have a short-term, 6-month to 36 month duration. The borrower continues to make the monthly payments and then either sells the property or arranges permanent financing with a new lender at a lower interest rate. At the closing of the refinance or sale, the Deed of Trust loan is paid in full, and the investor is paid back.

3. Foreclosure - If the borrower stops making loan payments, the lender forecloses on the real estate to recover all past due payments, late fees, and the balance of the loan principal by selling the real estate. The borrower forfeits their equity in the property in the event of foreclosure. Investors may then sell or rent the property at a profit and may end up with a capital gain in addition to their interest payments received.

For more information, contact Jerry Lucas, Jerry_Lucas@msn.com.
Phone (719) 591-0433, Website: AdvisorFinancialServices.com
Advisor Financial Services (LLC), Registered Investment Advisor