

A Partial Note Purchase: One Way to Invest in Mortgage Loans

As I walk through these steps, please remember that my goal is to introduce you to these concepts and expand your understanding of what's possible in your portfolio. Please consult with a CPA, attorney, financial advisor, and IRA plan custodian before taking action and making any investments.

Baby Steps: Partial Loan Purchases

What if you're not ready to purchase a whole loan? Whether you're concerned about concentrating that much capital in a single investment or you simply don't have enough money to take such a big step, you might instead start by purchasing just part of a loan.

A *partial loan purchase* is a great way to test the mortgage loan investing model with a lower capital contribution while learning the fundamentals. A partial loan purchase contract has three parties: the seller, the buyer,

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and the borrower. Partial loan sales occur when a seller wants to raise capital from a mortgage loan investment, but doesn't want to sell an entire loan. Let's take a look at how it works.

Example

In Figure 8, showed you this loan I bought in California:

Purchase price	\$21,000.00
UPB (unpaid principal balance)	\$27,376.22
Monthly payment	\$351.84
Payments remaining	104
Yield	14.18%
Total collected over life of loan	\$36,591.36

If, after buying this loan, I found that I needed to raise \$10,000 and didn't want to sell the entire loan, I could sell a portion of the payments to another investor at an agreed-upon yield.

For example, let's say I am willing to give the purchaser a 9 percent yield. With our financial calculator, we can figure out how many payments I need to sell to the buyer to return a yield of 9 percent:

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N: number of payments	PMT: monthly payment	I/YR: desired yield	PV: purchase price
Unknown	\$351.84	9%	-\$10,000

Figure 1

By entering the data and then pressing the N key, you will get an answer of thirty-two. That means I need to sell the buyer a total of thirty-two payments to provide a 9 percent yield. Let's look at an actual amortization schedule to provide even more detail.

Partial purchase price	\$10,000
Monthly borrower payment	\$351.84
Buyer's yield	9%
Number of payments required to yield 9%	32
Total amount collected by buyer	\$11,258.88

Figure 2

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Compounding Period: Monthly

Nominal Annual Rate: 9.000%

Cash Flow Data - Loans and Payments

	Event	Date	Amount	Number	Period	End Date
1	Loan	07/14/2020	10,000.00	1		
2	Payment	08/14/2020	351.84	31	Monthly	02/14/2023
3	Payment	03/14/2023	381.49	1		

TValue Amortization Schedule - Normal, 365 Day Year

	Date	Payment	Interest	Principal	Balance
Loan	07/14/2020				10,000.00
1	08/14/2020	351.84	75.00	276.84	9,723.16
2	09/14/2020	351.84	72.92	278.92	9,444.24
3	10/14/2020	351.84	70.83	281.01	9,163.23
4	11/14/2020	351.84	68.72	283.12	8,880.11
5	12/14/2020	351.84	66.60	285.24	8,594.87
2020 Totals		1,759.20	354.07	1,405.13	
6	01/14/2021	351.84	64.46	287.38	8,307.49
7	02/14/2021	351.84	62.31	289.53	8,017.96
8	03/14/2021	351.84	60.13	291.71	7,726.25
9	04/14/2021	351.84	57.95	293.89	7,432.36
10	05/14/2021	351.84	55.74	296.10	7,136.26
11	06/14/2021	351.84	53.52	298.32	6,837.94
12	07/14/2021	351.84	51.28	300.56	6,537.38
13	08/14/2021	351.84	49.03	302.81	6,234.57
14	09/14/2021	351.84	46.76	305.08	5,929.49
15	10/14/2021	351.84	44.47	307.37	5,622.12
16	11/14/2021	351.84	42.17	309.67	5,312.45
17	12/14/2021	351.84	39.84	312.00	5,000.45
2021 Totals		4,222.08	627.66	3,594.42	
18	01/14/2022	351.84	37.50	314.34	4,686.11
19	02/14/2022	351.84	35.15	316.69	4,369.42
20	03/14/2022	351.84	32.77	319.07	4,050.35
21	04/14/2022	351.84	30.38	321.46	3,728.89
22	05/14/2022	351.84	27.97	323.87	3,405.02
23	06/14/2022	351.84	25.54	326.30	3,078.72
24	07/14/2022	351.84	23.09	328.75	2,749.97
25	08/14/2022	351.84	20.62	331.22	2,418.75

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	Date	Payment	Interest	Principal	Balance
	26 09/14/2022	351.84	18.14	333.70	2,085.05
	27 10/14/2022	351.84	15.64	336.20	1,748.85
	28 11/14/2022	351.84	13.12	338.72	1,410.13
	29 12/14/2022	351.84	10.58	341.26	1,068.87
	2022 Totals	4,222.08	290.50	3,931.58	
	30 01/14/2023	351.84	8.02	343.82	725.05
	31 02/14/2023	351.84	5.44	346.40	378.65
	32 03/14/2023	381.49	2.84	378.65	0.00
	2023 Totals	1,085.17	16.30	1,068.87	
	Grand Totals	11,288.53	1,288.53	10,000.00	

ANNUAL PERCENTAGE RATE	FINANCE CHARGE	Amount Financed	Total of Payments
The cost of your credit as a yearly rate.	The dollar amount the credit will cost you.	The amount of credit provided to you or on your behalf.	The amount you will have paid after you have made all payments as scheduled.
9.000%	\$1,288.53	\$10,000.00	\$11,288.53

Figure 3

Here's a simple breakdown of the process:

- The buyer wires the seller the \$10,000.
- The seller assigns the loan to the buyer and sets up the partial contract with the loan servicer so the next thirty-two payments of \$351.84 are paid directly to the buyer.
- The seller then has the \$10,000 they need for their investing purposes, and the buyer has a short, inexpensive introduction to mortgage loan investing with a 9 percent yield.
- After the thirty-two payments are made, the loan reverts back to the seller, who has the right to collect the remaining seventy-two payments.

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- If the loan is paid off early, all the payments received by the buyer are amortized along with the buyer's interest rate and the total amount the buyer invested to determine the refund due to the buyer. This is tracked by the loan servicer.

Partial loan purchases are a win for both parties: the seller gets a cash infusion and still gets to keep the tail end of the loan, and the buyer gets a solid yield on a lower-risk investment, since the seller isn't going to do anything, or allow anything, to jeopardize their investment in the remaining loan payments.

With that said, it's still important to do the same due diligence on a partial loan purchase as you would a full loan purchase. The difference with a partial is that there is no competitive bidding process. The seller will review all the data with you, explain all aspects of the loan purchase, and allow you to ask as many questions as you need to feel comfortable with the investment.

Partial Loan Purchases FAQ

Who owns the loan during the partial sale period?

The loan will be assigned to the buyer during the period that the buyer is collecting payments, and will be assigned back to the seller once the buyer receives their entitlement.

What happens if the borrower defaults during a partial?

Most partial loan sale contracts allow the seller to do one of the following in case of a borrower default:

- Buy back the loan.
- Continue to make the payments to the buyer.

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- Begin legal proceedings at the seller's expense.

Remember, the seller retains the right to many tail-end payments in the loan, so they have a vested interest in making sure the borrower keeps the loan current.

How is the loan serviced during the partial sale period?

Once the contract is signed and forwarded to the loan servicer, the loan is set up as a partial in the servicer's system. The servicer tracks the balance of the buyer's partial payment entitlement.

Which party pays the servicing fee?

The net monthly payment, after servicing, is used for the buyer yield calculations.

What paperwork is required?

The seller and buyer sign a contract that covers the partial loan purchase, which includes amortization schedules for both the buyer and the borrower, covering the number of payments sold.

What if the loan is paid off early?

All the payments the buyer already received would be entered into an amortization schedule, along with the buyer's interest rate and the total amount the buyer invested to determine the refund due to the buyer. The loan servicer tracks this data on a monthly basis and would distribute the correct amounts between the buyer and the seller.

What if the borrower makes irregular payments (pays more each month than they are required to)?

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Additional principal payments reduce the amount owed to the buyer, since the principal amount is paid back faster. The loan servicer tracks the amount due to the buyer each month during the partial contract.

What are the advantages of partial note purchases?

- Seller provides all due diligence for the buyer's review.
- Seller steps in and rectifies the situation if the borrower defaults.
- Buyer legally owns the loan during the partial.
- Capital commitment is reduced.
- Investment term is reduced.
- It's a relatively simple process with high yields and lowered capital needs, making it great for IRAs.

Feel free to contact me with any questions or for more information about mortgage loan investing.

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