SFG

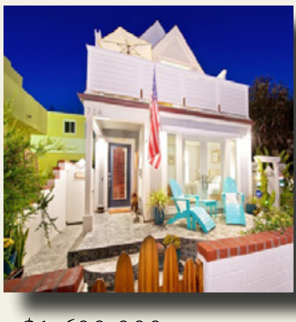
SEATTLE FUNDING GROUP LTD

THREE COMMON MISTAKES TO AVOID WHEN DEED OF TRUST INVESTING

By John Odegard President/Senior Partner, Seattle Funding Group

$2,400,000 - 4 Units
LTV: 60%
San Diego, CA

$5,500,000
3 separate properties
LTV: 65%
Seattle & Bellingham, WA



$1,600,000
LTV: 73%
Mission Beach, CA

$680,000
On Lake Washington
LTV: 65%
Seattle, WA

Mistake #1- Chasing Yield

Chasing yield is classic in all investment arenas and contributes to more losses than any other investment faux pas. Here's how it usually goes: The investor chases yield and rationalizes that the quality and risk is the same as a more conservative version of the investment, ignoring quality. For a while it seems to work, but then suddenly, the investor's previous returns are wiped out with one bad transaction, including a loss of some principle. This happens in stocks, bonds, real estate and even services like legal advice. One attorney bills less per hour than another but perhaps is less efficient, less experienced and less effective ultimately costing many times more than the more experienced attorney. The lesson is quit focusing on yield until you fully understand the risks involved. As soon as you are "wooed" by yield prior to risk assessment, your vision gets cloudy and your desire to "profit now" can over shadow sensible action. Of course you want a good yield, but not at the expense of your principle. A consistent and prudent 6% return is usually better than chasing 10%. A consistent and prudent 10% is usually better that chasing 15%, and so on. Let the higher returns come as a by product of wise investing, not yield chasing. It all comes down to quality and capital protection first, then appropriate yield.

Lesson: Think safety first, yield second.

Mistake #2- Under Estimating The Relevance Of The Securing Property's Marketability

This classic mistake is tied directly to deed of trust investing. The investor focuses on loan to value (LTV) and not depth of market for the securing property. As an investor, I would much rather invest at a 70% loan to value on a high demand property with plenty of financing options than 30% loan to value on an old special use building in a "B" grade location. Remember, easy in doesn't mean easy out. Usually this gets back to the investor not having enough choices of quality alternatives, so they chase yield all the way to Green Bay, Wisconsin, or Kalamazoo, Michigan. Ask yourself a couple questions first:

1) Is there a sufficient buyer pool, wanting the property, should it be offered for sale somewhere close to the appraised value? If not, it could take years to get back to cash. Especially in a slow market.

2) Is there a history of adequate financing available for the securing property type, at reasonably attractive rates? If not, you will be that lender for quite some time. Today more than ever, deed of trust investors must know their borrowers exit options, including the availability of new financing for prospective buyers. It's best to stay with highly marketable properties that attract large buyer pools. Getting back to cash in a reasonable time, can be very important.

Lesson: Think quality first, yield second.

Mistake #3- Underestimating The Importance Of A Quality Borrower

Over the years, it has been common for private money lenders to discount the value of a quality borrower, focusing entirely on the collateral. While it is agreed that in asset based lending, "collateral is king" and should be thoroughly analyzed, there is more to successful underwriting than just collateral analysis. The borrower's impact on the success or failure of the loan should not be discounted- especially on performance based loans like construction or income property. If the success of the loan requires the borrower to wisely manage cash flow, tenants, or complete construction- you must upgrade your credit tolerance considerably. After years of experience, we've seen this reality proven out numerous times. Good credit borrowers have something to protect, especially during tough markets. Good credit borrowers generally solve problems and make smart decisions. Bad credit borrowers do the opposite. Yes collateral remains the primary piece to a successful deed of trust investment. But in most cases, bad credit borrowers negatively impacting the securing property's value by making poor and self serving decisions, and add considerable time to the process of foreclosure. Time is money. Limit your exposure to poor character borrowers and over the long haul, your yield will improve, and so will your enjoyment of investing.

Lesson: Borrower quality matters, and should be at least 30-40% of your analysis, even with excellent collateral.

$1,550,000
LTV: 60%
Park City, UT

Final Word

The last several years provided an economic rising tide in the real estate markets, which have likely masked many investment mistakes deed of trust investors have made. In 2008 and 2009, as the truth in underwriting was unveiled, there was nowhere to hide. If your underwriting was sloppy in 2005-2007, you lost money in 2008-2010. If your underwriting had major flaws, you lost a lot of money, perhaps a majority of it. As Warren Buffet quipped, "you never know who's been swimming naked until the tide goes out". So many in the real estate lending industry were swimming naked from 2003-2007. Later, those investments were exposed. I believe many private lenders are swimming naked again by pushing leverage levels and quickly "surface underwriting" (not fully diagnosing the risks involved), driven by a motive for volume and quick profits.

$2,800,000 - 25 Units
LTV: 57%
Cathedral City (Palm Springs), CA

At Seattle Funding Group, we have been involved in successfully underwriting more than a billion dollars in deed of trust investments and more than 2000 transactions, since 1988. Today we are one of the most proven companies of our kind on the west coast. Over the years we have learned what works and what doesn't- in all markets. We have written our top twelve lessons in deed of trust investing and will be making it available to investors upon request. The lessons discussed here are three of the twelve. If investor's adhere to these twelve lessons when investing in deeds of trust, we believe they will better keep their principle secure, consistently make strong returns, and enjoy the peace of mind deed of trust investing can provide... especially today. SFG

$1,575,000
LTV: 65%
Maui, HI

Mr. Odegard, President and Founder (1988) of SFG, LTD as well as a founding principal (1992) and manager of the SFG Family of Income Funds–one of the west coast's long standing private mortgage investment pools. He has been a speaker on local and national media regarding Real Estate investing and finance on numerous occasions and has been a key principle in hundreds of successful deed of trust and real estate investment transactions over the last twenty years. He is the co-author of the "News of Interest" investor newsletter circulated to more than a thousand SFG investors across the United States, over the last 23 years. John has testified as an expert on real estate and related matters at the request of the largest law firm in the Pacific Northwest, and is a recognized leader in the field of asset based lending and mortgage fund management.

$1,575,000
LTV: 54%
Anaheim, CA

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