

## **Effective Use of Private Lenders Yields High Profits**

### Using the “Substitution of Collateral” Clause

By Jon R. Kubas

Using Private Lenders to acquire and rehab properties is a major part of our business plan. We borrow money from family members, friends, neighbors, Self-Directed IRA's, and many other sources. We explain to the lender that our program is kind of like a CD (Certificate of Deposit), where we borrow money for a fixed period of time, usually 3 to 5 years, and we pay interest only on a monthly basis. We secure the loan with a note and deed of trust on a specific property. We usually borrow 75% of the After Repair Value of the property. The greatest part of our loan program is that we use a “Substitution of Collateral” clause, which states if we sell the original property secured for their loan, we will “Substitute” another property to be security for the same loan, and keep on paying the lender on the terms of the original note. Following is the clause we add to our note and deed of trust:

***Maker shall have the right, at any time, to substitute for the deed of trust given to secure this note, a first lien deed of trust on real property in which Maker can demonstrate that his equity in such substitute collateral is at least as great as his current equity in the property securing this note in which event lender shall promptly execute a release of the deed of trust securing this note.***

For example, if we borrow \$50,000 and secure it with Property A by recording a first lien deed of trust against Property A, when we sell it the lender will need to execute a release of lien on Property A. We will then re-secure their note by executing a first lien deed of trust on Property B, thereby “Substituting the Collateral”, and continue making payments as if nothing changed. We need to provide evidence that the new property has at least the same equity position as the original property, and this is usually done with an appraisal. The new deed of trust will refer to the original note of \$50,000 and will have the new legal description of the new collateral. When we sell Property B, we do it again and substitute Property C, and so on. The great part is we know we have the use of the money for the 3 to 5 year term, and not just for the one original property. Without the Substitution of Collateral clause, the lender would get their money back after the original property sold. The lenders like it because they know their money is working for them at a fixed rate of interest for a specified period of time, and they don't have to worry about it going up or down. This clause works especially well when you get “no interest” Seller financing or at a very low interest rate like 4% or 5%. This is the kind of loan you don't want to pay off if you don't have to because you can't go out and borrow money at that rate from a normal lender. An added bonus to this clause is that if you have Seller financing and the Seller wants their money back early, you can usually get a discount on the payoff and get another payday. I recommend you request to add this clause to any of your private loans. Contact your attorney to provide the necessary documents and provide him/her with a copy of the above clause as an example.

*Jon R. Kubas and his wife Amy began buying investment property in 1984 and have been living and investing in Houston, Texas since 1990. Jon is Past-President of the Realty Investment Club of Houston (“RICH” Club from 1993-1997), and is also a licensed Texas Real Estate Broker and Texas Mortgage Broker. Jon and Amy are experts in real estate investing and finance, and have spoken many times to Real Estate Investment Associations on numerous topics, most recently teaching their home study course, “**Real Estate Wealth Systems: A Proven Cookie-Cutter System To Buying, Rehabbing, Selling, And Managing Single Family Houses**”. They buy all types of property and also provide loans to both real estate investors and homeowner-occupants. For all your real estate needs, whether you want to buy a property for yourself, want a wholesale deal, have a property you need to sell, a deal to wholesale to us, need a loan of any type, want to lend us your money, or any other item relating to real estate or real estate investing, call them in Houston at 281-397-6200, toll-free at 1-800-424-8903, or visit their website [www.westwindsgroup.com](http://www.westwindsgroup.com).*