

NEWCO, LLC
BUSINESS PLAN

I. EXECUTIVE SUMMARY

The proposed company, Newco LLC, will be formed with the purpose of investing in promissory notes (Notes) secured by residential mortgages or deed of trusts. The primary investment strategy of Newco is to purchase defaulted Notes secured by second position mortgages. Newco may also purchase defaulted Notes secured by first position mortgages. Newco will contact the homeowners and negotiate a "resolution". There are multiple "resolutions" that will generate cash flow and profits for Newco.

- 1) Workout Agreement – Newco modifies the terms of the Note and the homeowner begins making monthly payments. Expected yearly cash flow is 40% to 55% of purchase price of Note.
- 2) Past Due Payments – Newco collects a percentage of the past due balance. After the payment is made, the homeowner pays down the unpaid principal balance on the Note. Past due payments can be more than the purchase price of Note, thus reducing the cost basis for an individual note to zero. In this example, all payments to pay down the unpaid principal balance are profits to Newco.
- 3) Discounted Payoff – Newco collects a one-time payment from the homeowner to payoff the Note and to satisfy the lien. Discounted payoff can range between 150% to 200% of the Note purchase price.
- 4) Foreclosure – Newco forecloses on the property and keeps the property as a rental or sells the property. Foreclosure from the second position requires that the first be paid or Newco receives the deed "subject to" the first, in which case Newco pays the first mortgage from rents collected.
- 5) Sale of Re-Performing Notes – After Newco negotiates a Workout Agreement with the homeowner, the Note is now classified as a re-performing Note, and can be sold on the secondary market. Expected sale price is 200% to 250% of purchase price of Note.
- 6) Cash-Outs – After a Workout Agreement is in place and the homeowner has been making monthly payments, Newco can receive a cash-out when the homeowner decides to refinance or sell the property. Newco is paid the balance on the Note. Newco can discount the balance due and still be several multiples of the purchase price.

II. THE OPPORTUNITY – Focus on Second Position Mortgage Notes

The market opportunity for this business developed during the last several years as the number of defaulted mortgages increased. Banks of all sizes have been actively selling off large pools of defaulted notes at substantial discounts. As a private investment company, Newco can provide creative solutions not offered by the banks. Newco will purchase the notes at significant discounts and pass some of the discount to the homeowners. A win-win solution is created where the homeowner can stay in their home with reduced payments, and Newco makes an above average return.

There is a high level of perceived risk in purchasing second position mortgages that Newco can reduce to make the reward and profit above average. Homeowners who are paying their first mortgage have “emotional equity” and are highly motivated to negotiate a workout on their second mortgage so they can stay in their home. Newco will purchase notes that can be up to three to four years delinquent and the homeowners are past their “difficulty,” which was usually one of four events: job loss, divorce, death of spouse, or illness. The homeowners are now able and willing to start paying again.

When Newco purchases non-performing notes, it makes direct contact with the homeowner to modify their existing loan via a workout agreement. The notes are now a performing asset and can be held for monthly income or sold through the secondary market to other note investors.

A pool of notes can generate exceptional cash flow within twelve months of the purchase. In addition to the monthly cash flow and profits from the sale of re-performing notes, there is a great opportunity to generate profits over the next three to ten years from cash-outs.

Traditional cash flow investments, such as bonds or newly originated mortgages, do not have the opportunity to create equity, and ultimately large profits.

Because Newco will buy notes at such a large discount to face value (typically an 85% discount) there is huge potential to generate profits when a homeowner sells their property or refinances.

Most homeowners will have the required equity and/or credit score to refinance or sell within three to ten years. The profit potential is the difference between the unpaid principal balance on the loan and Newco’s purchase price. Newco’s opportunity for cash-outs during the next three to ten years should increase as home values increase and the principal on the first mortgage is paid down.

This business is similar to investing in traditional residential real estate. However, instead of buying a house, rehabbing it, and then keeping the house as a rental for cash flow or flipping it for a one-time profit, Newco buys a note, or the “paper,” rehabs the note, keeps it for cash flow, or flips it for a one-time profit. The primary exit strategy is through the homeowner via a loan modification or workout agreement. The secondary exit strategy is through the house via foreclosure.

It’s a great business – we never need to worry about a contractor showing up or a call in the middle of the night because of a leaky toilet or roof.

III. DEFINITIONS

- 1) Promissory Note (Note) – the legal instrument signed by the homeowner detailing the terms of the loan, such as loan amount, interest rate, maturity date, and monthly payment.
- 2) Mortgage or Deed of Trust – provides the security interest of the lender (Newco) in the property. Mortgage instruments are typically used in judicial foreclosure states, and Deed of Trust instruments are typically used in non-judicial foreclosure states.
- 3) Judicial Foreclosure – foreclosure is processed through the courts.
- 4) Non-Judicial Foreclosure – foreclosure is processed through a trustee sale, and used when a power of sale clause exists in a mortgage or deed of trust. A "power of sale" clause is the clause in a deed of trust or mortgage, in which the borrower pre-authorizes the sale of property to pay off the balance on a loan in the event of their default.
- 5) Non-Performing Note / Defaulted Note / Defaulted Mortgage – homeowner is not current on their mortgage payments.
- 6) Workout Agreement – document created by Newco that details the loan modification. If a homeowner defaults on the Workout Agreement, then the original terms of the Note and Mortgage/Deed of Trust are enforced.
- 7) Re-Performing Note – a Note is considered re-performing when the homeowner is making payments per the terms of the Workout Agreement.
- 8) Collateral Documents – include the promissory note, mortgage/deed of trust, assignments, and allonges.
- 9) Assignment – legal document showing transfer of the mortgage from seller to Newco . Assignments are recorded by the local counties.
- 10) Allonge – legal document that provides the endorsement of the Note from seller to Newco.

IV. BUSINESS OPERATIONS

1) NOTE ACQUISITIONS

a) Purchase Process

Newco will purchase defaulted Notes from hedge funds and private investment companies. There are two types of purchases:

- i) Type 1:
Seller sends out a list of Notes to multiple buyers. Newco performs its due diligence and places a bid for the Notes. Seller contacts Newco if they are the winning bidder. The buy/sell agreement is executed. Newco wires money to seller. Seller sends original collateral documents.
- ii) Type 2:
Newco contacts seller and requests a pool of Notes for a specified purchase price. Newco can specify criteria such as location of property (by state), amount of equity, and status of first mortgage. Newco performs its due diligence. Newco can negotiate pricing, but pricing is usually firm. Newco can request to remove specific Notes that do not pass its due diligence and have the seller replace with new Notes. The buy/sell agreement is executed. Newco wires money to seller. Seller sends original collateral documents.

b) Collateral Documents

Electronic copies of the collateral documents are received from the seller as part of the due diligence process. The original collateral documents are mailed by the seller after payment is received. Newco will store the original collateral documents at a third party document storage company that specializes in legal documents.

c) Due Diligence

- i) Credit Report – review for status of first mortgage, other debt analysis, and bankruptcy history.
- ii) Equity - establish the fair market value (FMV) of property through analysis of comparable sales and then calculate equity. Formula is FMV less First Mortgage equals Equity to cover second.
- iii) Bankruptcy – review Pacer, which is the federal government's online system for court records.
- iv) Skip tracing – review personal information through private access databases.

d) Equity Criteria

Newco will purchase Notes with full equity, partial equity, and no equity. The majority of the purchases will have partial or no equity.

- i) Full Equity Notes - there will be enough equity in the value of the house after the first mortgage to cover the full unpaid principal balance on the second mortgage.

FMV = \$200,000

First Mortgage = \$150,000

Equity After First = \$50,000

Second Mortgage Unpaid Principal Balance = \$48,000

- ii) Partial Equity Notes – there will be enough equity in the value of the house after the first mortgage to cover the purchase price of the second mortgage.

FMV = \$160,000

First Mortgage = \$150,000

Equity After First = \$10,000

Second Mortgage Unpaid Principal Balance = \$33,000

Purchase Price of Second Mortgage = \$5,000

- iii) No Equity Notes – there will be no equity in the value of the house after the first mortgage to cover the cost of the second mortgage.

FMV = \$160,000

First Mortgage = \$170,000

Equity After First = (\$10,00)

Second Mortgage Unpaid Principal Balance = \$33,000

Purchase Price of Second Mortgage = \$5,000

2) WORKOUT OPERATIONS

The following procedures are followed to take a Note from non-performing to performing.

- a) **RESPA Letter** – Real Estate Settlement Procedures Act (RESPA) letter is sent to notify the homeowner that the servicing of their mortgage has been transferred to Newco.
- b) **TILA Letter** – Truth in Lending Act (TILA) letter is sent to notify the homeowner of the transfer of ownership of the note and mortgage/deed of trust.
- c) **NOP Letter** – Notice of Purchase (NOP) letter is sent to homeowner with copies of the Note and mortgage/deed of trust. The NOP letter details the current status of the mortgage, including past due amount and payoff amount.
- d) **Skip Tracing** – the process of trying to get contact information such as place of employment, unlisted phone numbers, relatives, etc.
- e) **Phone Campaign** – call every three days for first 10 days. If a message is left, it is very non-confrontational. “We are here to help resolve the accounting issues with your mortgage. Please call so we can review your options.”
- f) **Hand Written Letter Campaign** – send up to three hand written letters asking the homeowner to contact us so we can help.

- g) **Legal/Foreclosure** – if, after 16 days the homeowner does not contact Newco, then we will initiate foreclosure. The first step is to send a Demand Letter from a local attorney in the property's state. The foreclosure laws and timeline vary by state, but the next step is usually a Notice of Default which is recorded at the local county office and posted on the property. The main purpose of the foreclosure process is to scare the homeowner so they will finally call our workout department. Newco expects to foreclose on less than 15% of Notes purchased.
- h) **Workout Agreement** – after Newco has contacted the homeowner and negotiated a workout, a Workout Agreement is prepared and sent to the homeowner for signature and must be notarized.
- i) **Servicing for Re-Performing Notes** – after the Workout Agreement is finalized, Newco transfers the servicing of the mortgage to a third party servicing company that specializes in servicing for private mortgage investors. The new servicer sends out the monthly statements, collects the payments from the homeowner (preferably through ACH), wires the payment to Newco, and sends the year-end Form 1098 to homeowners for mortgage interest paid. The cost for third party servicing of re-performing Notes is \$15 per month per Note.
- j) **Defaulted Re-Performing Notes** – if a homeowner stops making payments per the terms of their Workout Agreement, Newco follows the same procedures listed above, including foreclosure.

3) SALE OF RE-PERFORMING NOTES

After a non-performing Note is converted to re-performing it can be sold on the secondary market.

a) Sale to a Related Party

If the sale of a re-performing Note is to a related party of JB LLC or JS LLC, then the sale price will be determined using a Present Value (PV) calculation. The PV calculation is based on the monthly homeowner payments, the number of remaining payments on the loan, and a discount rate of 25%. Balloon payments due from homeowners are not used in the PV calculation.

Present Value Examples:

- i) Sale Price = PV = \$11,905
Monthly homeowner payment=\$250
Term=235 months
Discount Rate=25%
Yearly Cash on Cash Yield = 25.2%
- ii) Sale Price = PV = \$14,390
Monthly homeowner payment=\$300
Term=355 months
Discount Rate=25%
Yearly Cash on Cash Yield = 25.0%

b) Sale to a Non-Related Party

The sale price of a re-performing note to a non-related party will be determined by the current pricing in the secondary market. The pricing is expected to be 200% to 400% of the purchase

price of the non-performing note.

c) Re-Performing Note Warranty

- i) Warranties are not required, but higher prices can be achieved with a warranty. It is also easier to sell lower quality performing notes with a warranty. The quality is determined by the amount of equity to cover the sale price of the re-performing note.
- ii) The Newco warranty will provide the purchaser with a replacement re-performing note if the original Note goes into default for more than six months. Newco will attempt to get the defaulted note re-performing again during the six month period. The value of the replacement note is equal to the original sale price less all homeowner payments received by the purchaser.

4) NOTE TRACKING

- a) Newco will utilize a software program developed by Zoho (www.zoho.com). This is a cloud based software system. The cost is \$20 per month per user.

5) ACCOUNTING AND RECORD KEEPING

- a) Newco will utilize Quickbooks or an equivalent accounting package.

V. RESPONSIBILITIES OF MEMBERS

- 1) The members of Newco LLC will be JB LLC and JS LLC.
- 2) JS LLC will be the Managing Member.

Item	JS LLC	JB LLC	
1) Note Acquisitions	Primary	Review	
2) Workout Operations	Primary	Review	
3) Sale of Re-Performing Notes	Primary	Review	
4) Note Tracking	Primary	Review	
5) Record Keeping	Primary	Review	
6) Cash Management	Primary	Review	

VI. CASH MANAGEMENT

- 1) JS LLC, as managing member, will be responsible for cash management and payments to trade vendors. Prior to any distributions to members, trade vendors will be paid. JS LLC will provide cash flow analysis to ensure there is adequate cash available to pay its vendors. The order and priority of cash payments will be as follows (from first priority to last priority):
 - a) Trade vendors.
 - b) Preferred Return (interest payments) to JB LLC and Management Fee to JS LLC.
 - i) The preferred return and management fee will have equal priority.
 - c) Distributions to Members (*see section VII*).

VII. DISTRIBUTIONS TO MEMBERS

- 1) Newco will make cash distributions to its members in the following order and priority (from first priority to last priority):
 - a) Tax Distributions
A pro rata tax distribution to holders of Class A and Class B Units, in an amount to pay their anticipated federal, state and local tax obligations attributable to Newco net income passed through to such holders.
 - i) Any Tax Distributions will be deemed an advance towards "Distribution of Excess Cash" listed in item "d" below.
 - b) Distribution of Cash from Previous Pools
After JB LLC's contribution for a specific pool of Notes is re-paid 100%, then the excess cash generated from the re-performing Notes from that specific pool will be distributed even if additional contributions are made to purchase additional Note pools. Distributions will be made to holders of Class A Units; XX% to JB LLC and XX% to JS LLC.
 - c) Return of Contribution to JB LLC, as holder of Class B Units, until JB LLC's contribution for purchase of a Note pool are returned in full and accrued interest thereupon paid; and
 - d) Distribution of Excess Cash to holders of Class A Units; XX% to JB LLC and XX% to JS LLC.

VIII. EXPENSES**1) Corporate Expenses Paid By Newco LLC****a) Management Fee**

\$XXX per note purchased is to be paid to JS LLC by Newco. Payments to be distributed equally over twelve months, starting from the purchase date of the pool of Notes.

b) Variable Note Expenses / Working Capital

Expenses listed below are the estimated average expenses per note. The loan from JB LLC for each pool of Notes will include working capital equal to ~~\$1,700~~ per Note purchased.

\$2,100

Description	Cost Per Note
Office Supplies	\$ 5
Note Service Setup	\$ 45
Postage	\$ 50
Door Knock	\$ 60
Legal	\$ 1,800
Private Investigator	\$ 30
Notary Fees	\$ 10
Other	\$ 100
TOTAL	\$ 2,100

c) Note Servicing Fees

After a Note is converted from non-performing to performing, Newco will transfer the servicing to a third party mortgage servicing company. The current fee is \$15 per month per Note.

d) Overhead Expenses

General Overhead Expenses	
Description	Cost Per Month
Software Access for ZOHO	\$ 30
Toll Free Number	\$ 50
TOTAL	\$ 80

Corporate Legal and Accounting Expenses	
Description	Cost Per Year
Legal	\$ 1,500
Accounting	\$ 1,500
TOTAL	\$ 3,000

2) Expenses Not Paid by Newco LLC

a) The following expenses are to be paid by JS LLC as part of its management fee. JS LLC will not be reimbursed for these expenses.

i) Computer hardware, meals, travel, office rent, copier, internet access, and fax line.

IX. GROWTH PLANS

The following chart illustrates the expected quantity of Notes to be purchased and required funding. After twelve months, Newco LLC expects to purchase twenty-five Notes per month.

After the first twelve months, Newco will be in a position to create a fund to raise capital. The underlying assets in the fund will be re-performing Notes. The fund will pay its investors a fixed annual interest payment in the 12% to 15% range, and return principal in three years. The capital raised from the fund will be used to purchase non-performing Notes.

Month	Notes Purchased	Note Cost	Working Capital	Total Funding Required
1	11	88,000	12,100	100,100
2	0	-	-	-
3	0	-	-	-
4	11	88,000	12,100	100,100
5	0	-	-	-
6	20	160,000	22,000	182,000
7	0	-	-	-
8	20	160,000	22,000	182,000
9	0	-	-	-
10	25	200,000	27,500	227,500
11	0	-	-	-
12	25	200,000	27,500	227,500
TOTAL				1,019,200

X. FREQUENTLY ASKED QUESTIONS

Where do you buy the notes?

- The banks are selling pools to private investment companies and hedge funds. Some of these companies break up their pools into smaller pools that can be purchased by smaller investors.

What collateral do you receive?

- Promissory note, deed of trust or mortgage, assignment, allonges, and accounting records.
- The Assignment is what transfers ownership and is recorded at the local county.

What is a Second Position Mortgage Note?

- Second position mortgage notes are typically originated when a homeowner finances the full purchase price of their home and needs two loans, typically with an 80/20 split. They also originate from home equity loans.

Why Second Position Mortgage Notes vs. First Position Mortgage Notes?

- **Diversification** – The purchase price per asset is much lower than first position mortgage notes. This results in the ability to purchase a larger number of assets with the same amount of capital.
- **Leading Indicator** – As part of the purchase due diligence, the credit report for the homeowner is reviewed. If the homeowner has a solid payment history with the first position mortgage, then there is a great leading indicator that the homeowner wants to stay in their house and make payments.
- **Scalability** – When investing in “seconds,” the main exit strategy is through the homeowner via a workout agreement. Because of this, assets can be acquired throughout the United States with very little “boots on the ground” operations.
- **Pricing** – There are greater discounts for second mortgages which lead to greater monthly cash flow and profits.
- **Competition** – The capital that can be invested in distressed second mortgages is too small for large Wall Street investment companies. This market dynamic keeps the distressed second mortgage investment business a niche business without competition from the big players. This results in better pricing economics for distressed second mortgage investors.

(FAQ continued)**Why can a private investor get the homeowner to start paying again and the banks can't do this?**

- In some cases, the banks will perform a modification with the homeowner. However, the big banks are so overwhelmed with defaulted loans that their main focus is on the larger first position mortgage notes, and they are selling off pools of second mortgages.
- Typically, the big banks do not have the creativity or resources to work one-on-one with homeowners to work out a mutually beneficial solution.
- Banks need to clean up their balance sheets so they are selling the distressed debt to investors.
- As a result of purchasing the notes at a substantial discount, there is a lot more flexibility to reduce the monthly payment and/or the unpaid balance. This reduction creates a win-win solution, where the homeowner can start re-paying their second mortgage, avoid foreclosure, stay in their home, and the private investor earns an above market rate of return.

Can you foreclose from the second position?

- Yes, you can foreclose from the second position.
- When a note is purchase, the buyer receives the original promissory note signed by the homeowner, as well as the signed mortgage. This collateral provides the buyer with the legal right to foreclose.
- The mortgage is assigned to the buyer and recorded at the local county.
- As part of the purchase due diligence, the buyer confirms there is an accurate chain of title.

Who provides the servicing of the mortgages?

- Servicing is provided by a third party mortgage servicing company that provides all of the required accounting and billing activities. The monthly mortgage payment from the homeowner is paid to the servicing company and the servicing company then wires the money to owner of the note. The typical servicing fee is \$15 per month per loan.

What is a Self-Directed IRA (SDIRA)?

- A SDIRA allows individuals to control the investments within their IRA accounts. Typical investments include notes, real estate, gold, tax liens, and private lending. SDIRA accounts are administered through third-party companies.
- Any individual with an IRA, Roth IRA, or rollover 401K can invest in notes through his or her SDIRA. The money in a SDIRA grows tax deferred, just like an IRA with a traditional investment company. A SDIRA account can be set up for both Traditional and Roth accounts. With the Roth IRA, your money grows tax-deferred and withdrawals are tax free.

XI. NON-PERFORMING NOTES CASE STUDIES**Workout Agreement with Past Due Payment (completed in 3 months from purchase)****Raleigh, NC**

Purchase Price	\$ 5,192
Face Value	\$ 35,523
Discount	85%
Arrears payment	\$ 6,000
New Monthly Payment:	\$ 207
New Loan Terms:	\$22,200 Balance, 20 yrs, 9.5%
First Year ROI $((9 \times 207) + 6,000) / 5,192$	151%

Workout Agreement (completed in 3 months from purchase)**Millmont, PA**

Purchase Price	\$ 5,178
Face Value	\$ 39,161
Discount	86%
New Monthly Mortgage Payment	\$ 260
Yearly Mortgage Payment	\$ 3,120
New Loan Terms:	\$32,365 Balance, 30 Years, 9%
Balloon:	\$6,442
First Year ROI $(9 \times 260) / 5,178$	45%
12 Month ROI $(12 \times 260) / 5,178$	60%

Foreclose and Sell House (completed in 7 months from purchase)**Memphis, TN**

Purchase Price	\$5,400
Face Value	\$78,211
Revenue from Sale of House	\$23,000
Gross Profit	\$ 17,600
Expenses	\$ 3,627
Net Profit	\$ 13,973
7 Month ROI $(13,973 / 5,400)$	258%
12 Month ROI	443%

XII. RE-PERFORMING NOTES PORTFOLIO

The portfolio listed below is Jon Schwartz's personal portfolio of re-performing notes that was purchased through his self-directed IRA. The portfolio was purchased from two private investment companies who purchased non-performing Notes, performed the workouts, and re-sold the Notes. It is shown here as an example of the types of returns that a passive investor can realize if they purchase Newco's re-performing Notes.

Newco will have a very marketable product because of the opportunity for a passive investor to purchase our re-performing Notes and realize yearly cash yields above 20%. Re-performing Notes are typically purchased by investors seeking passive monthly income, similar to rental properties. Investors can purchase the Notes in their own name, but the Notes are typically purchased through an entity such as an LLC, or through a self-directed IRA account. If the re-performing Notes are purchased through a self-directed IRA, then the account grows tax deferred. If the Notes are purchased through a self-directed ROTH IRA, then the account grows tax deferred and withdrawals are tax free – this is a huge opportunity for a passive investor.

City, State	Position	Purchase Date	Purchase Price	Monthly Payment
Forney, TX	2 nd	02/2012	\$ 23,500	\$ 356
Fort Wayne, IN	2 nd	07/2012	\$7,200	\$ 99
Carolina Beach, SC	2 nd	09/2012	\$ 5,600	\$ 242
Pico Rivera, CA	2 nd	12/2012	\$ 27,900	\$ 469
TOTAL			\$ 64,200	

TOTAL MONTHLY INCOME	\$ 1,166
TOTAL YEARLY INCOME	\$ 13,922
YEARLY CASH YIELD	21.79%