

How to Price a Balloon

(Due to the complexity of this question, if you wish to talk with me personally instead of during a webinar, please call me at 919-260-7710.)

Thank you in advance for assisting me to price this promissory note with a balloon. Based on my understanding of balloon pricing, I am negotiating with an executor of an estate for his father's seller-financed note. The executor is a bankruptcy attorney in Fort Lauderdale FL.

Before I sign a purchase agreement, I would like to solidify my understanding about how to price a balloon.

First, are there more than four outcomes for the balloon balance as described below?

1. Lender accepts the same terms for the remaining balloon balance. ("Whole Note")
2. Borrower pays the balloon amount in full. ("Balloon Paid")
3. Lender executes a loan modification for the balloon balance with new, more favorable terms.
4. Borrower defaults and lender secures the collateral.
 - a. Wholesale sale with commercial financing
 - b. Retail sale with traditional consumer financing
 - c. Retail sale with new Seller Financing

Next, how to calculate the yield - based on the forecasted outcome of the investment? Following the four outcomes above:

1. PV: Use the amortized term from the last payment date with no future value
2. PV: Use the remaining term from the last payment date to the balloon date with the balloon balance as the future value.
3. PV: Use the terms for the new loan modification which I assume would be favorable to the lender therefore prompting the borrower to refinance at his earliest convenience.
4. PV: Use the remaining term from the last payment date to the balloon date for that period of time *PLUS the return for the least yield of the defaulted outcome?*

Using the actual note terms,

Terms of Note			
FMV "as-is"	\$ 145,000.00	10/28/2013	Origin Date
Sales Price (ARV)	\$ 139,000.00	10.8%	% Downpmt
Down Payment	(15,000.00)	85.52%	LTV Org
Orginal Principal	124,000.00		
Interest Rate	4.25%		
Interest Only?	N		
# Pmts Due	300	12/1/2038	Maturity Date
# Pmts Paid	29	5/1/2016	Paid Until
# Pmts Unpaid	271	12/1/2013	1st Pmt Date
Monthly Payment	671.76	80.63%	LTV UPB
Unpaid Balance	116,909.58	19,480.90	Cash Rec'vd
Balloon Months	72		
Months to Balloon	43		
Balloon \$	104,962.95	8/1/2017	Balloon Date
Balloon Term in Mons	228		
UPB on Closing Date	116,909.58	05/01/16	Closing Date

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Are the following calculations valid for the quote to fund the note @ 12+% yield?

Quote to Buy Whole Note		Balloon Paid	
Yield to Funder	12.00%	12.65%	
Months Delay	0	0	
% Amortized Pmts Sold	100.00%	100.00%	
Amortized Pmts	43	43	
Quote - Amortized Pmts	23,383.81	23,129.05	
% Balloon Sold	100.00%	100.00%	
Balloon Months Sold	228	43	
Balloon \$ Sold	104,962.95	104,962.95	
Quote - Balloon \$	10,858.32	66,865.85	
Total Months Sold	271	271	
UPB Sold	116,909.58	116,909.58	
Quote from Funder	62,645.31	89,994.90	
Subtract Broker Fee			
Offer to Seller	62,645.31	89,994.90	
Cents/Dollar	0.536	0.770	
# Pmts Remain	0	0	
Residual UPB	-	-	
Value to Seller	62,645.31	89,994.90	
Past \$ Recv'd	19,480.90	19,480.90	
Seller's Total \$ Recv'd	82,126.21	109,475.80	
Seller's Total Discount	54,264.27	26,914.68	
Monthly Discount	200.24	99.32	

Ignore these calculations. On a past webinar, Joe talked about buying a part of the pre-balloon cash flow and a part of the balloon cash flow but I have not been successful in splitting the note into pre and post balloon \$.

The quote for the "Whole Note" uses 271 for remaining payments.

The quote for the "Balloon Paid" uses 43 for remaining payments.

My game plan is to (1) purchase the note at 12% yield and then (2) either sell the whole note or (3) the pre-balloon cash flow at a 9.5% yield.

Comments please! And thank you for your insight,

Jackie