Junior Lender Buyouts

An often overlooked option for buying Notes is the “Junior Bene Buyout”. When multiple loans exist on a property and the borrower stops making payments, the unpaid lender(s) will begin foreclosure proceedings to recoup their investment. In many states, Non-judicial foreclosure is the preferred method of foreclosure due to its relatively quick and low cost process (as compared to Judicial foreclosure).

As an example, suppose we have a property worth $500,000 and essentially no equity:

Market Value: $500,000
*1st Trust Deed: $350,000 12/1/2017
2nd Trust Deed: $150,000 06/4/2018
The 1st loan has the asterisk, identifying it as the foreclosing loan.

Foreclosure law requires that when the 1st T.D. lender initiates foreclosure and issues a Notice of Default, the Trustee must send out notifications to all junior lien holders, warning them that they are at risk of being wiped off the property when the property is sold at auction.

The junior lender is on notice that if they do nothing, their only hope is that the property sells at the Trustee sale for more than the senior lender is owed; if they are next in line on title they will receive whatever excess funds exist after the Lender payoff and all costs associated with the foreclosure are covered. Their other option is to bring the 1st Trust Deed lender current, and then start their own foreclosure.

The fact is, many of these lenders have neither the knowledge nor the money to bring the senior loan current and start a foreclosure. As such, they are often very amenable to accepting a discounted offer for their Note as opposed to risking everything on someone bidding up the price at the Trustee sale.

<u>First Step:</u>

Identify a situation where there is a junior loan that is at risk of being wiped out. Call customer service at your local title company and ask for a copy of the Deed of Trust and any assignments just in case the loan has already been sold since it was originated. The Deed of Trust and any assignments will contain the name and address of the junior lender.

<u>Contact the Lender:</u>

Do a search on the name and address of the Lender and determine your best means of contacting them; phone, email or letter. When you contact them, your approach should go something like this:

> I’m contacting you today regarding the Note and Deed of Trust that you hold against the property located at “123 Main ST”. I may be able to help you with the problem there. First of all, I would like to know if you received your copy of the NOD filed by the senior lender. I want to make sure you understand the problem that this creates. My business is buying distressed notes and I may be interested in making an offer on your Note and Deed of Trust before the foreclosure by the senior lender wipes your Deed of Trust off this property. Have you considered selling your Note and Deed of Trust? If so, how much do you have in mind?

<u>Closing the deal:</u>

Before reaching an agreement on price, remember to always review the Note to understand all the terms of the loan. Confirm it is enforceable (no breaches of state or federal lending laws) and make sure the Borrower was fully vested on title when the loan was made. Offer to buy the Note at a deep discount to its face value. Your offer price will depend on:

- The current estimated market value of the property
- Liens/Loans senior to Junior Loan you're interested in
- The time remaining before the senior loan forecloses
- Ability of junior lien holder to bring the senior loan current and start a foreclosure

When you reach an agreement, the lender endorses the Note over to you and then executes an Assignment of Deed of Trust, which is then recorded against the property. Some investors prefer to use a Note Purchase Escrow to handle the transaction, but it is not mandatory. You are now the holder of the junior loan, and step into the shoes of the prior lender and are owed the full amount owed by the borrower, not the amount you paid the lender.

1st Step as the new Lender:

Your first step is to contact the senior lender and reinstate the loan. After reinstating the loan, contact a Trustee to begin the foreclosure process; the foreclosure is based on your advances as well as any delinquent payments owed on the loan you purchased. Any advances or costs you incur are added to the total amount you are owed and bear like interest as stated on your Note.

Possible outcomes:

Now, one of 3 things can happen:

1) The property owner will find the money to reinstate your advances and any delinquencies/costs you have incurred. If this happens, your return on investment will be phenomenal since you purchased the Note at a huge discount.
2) The property progress all the way to Trustee sale. If this happens and a bidder buys the property, you will be paid in full on a Note that you purchased at a big discount, again resulting in a phenomenal return.
3) The property progresses all the way to Trustee sale but no-one bids on the property. In that case, you are the new owner of the property subject to any senior loans and liens.

So, in our example, if you purchased the 2nd Trust Deed for say $10,000 and then advanced another $20,000, your total investment is $30,000. When the property reverts to you after the sale, you now own a property worth $500,000 for a total cost of $350,000 + $30,000 =$380,000.

Again, even when properties have very little or no equity and you have relatively little money to invest, "Junior Bene Buyouts" can be extremely lucrative.