

IS THE JUNIOR LENDER TO THE FORECLOSING LENDER ALWAYS A LOSER?

We are constantly looking at new strategies for gaining the attention and acceptance of defaulted owners. Those strategies range from discrete mailings to blatant in-your-eye “bandit” signs along the streets and highways. I have resolved not to work directly with the defaulted owner. I have found that such conversations can be frustrating, demeaning, and sometimes hazardous. On the other hand, finding ways to acquire existing equity in a defaulted owner without getting directly involved with that owner has some special appeal. Some professionals who acquire defaulted properties find the following process interesting.

As always before pursuing a foreclosure property, the equity available in the chosen property must be uncovered. Equity (consisting of the difference between fair market value and total debt) can be an elusive target. In general, however, we can approximate the fair market value by looking at comparable sales of similar properties sold within a short radius of the chosen property. Such “solds” are available through selected websites on the internet, multiple listing services through agents or brokers, and property profiles through local title companies. Care must be taken, however, since most comparable sales are of properties in top selling conditions while most foreclosure properties have some level of deferred maintenance and repairs. Finding the other factor in equity, the total debt, is whole different ball game.

We make our usual tour of the county assessor’s, tax collector’s and recorders files and carefully winnow out all debt recorded between the full valued grant deed and the final date of the trustee’s sale. I know that I have mentioned before, but it doesn’t hurt to mention again, that we make a separate sally into the tax collector’s office to check on current and prior five year real property tax delinquencies. These real property tax delinquencies (not being liens, loans or judgments) are available only through the county tax collector’s office. You can ignore tax delinquencies at your own personal peril.

Let’s presume that we have adequately researched the equity in our chosen defaulted property and are pleasantly surprised with the data we uncovered. To complete our story, we found three trust deeds (contractual debt) recorded after the date of recording of the grant deed and additional non-contractual debt (abstracts of judgment, Internal Revenue Service liens, Notices of Assessment, etc.) sprinkled here and there.

The interesting part is that the property appears to have an adequate amount of equity. That equity arises because of the difference between the apparent fair market value and the total debt remaining between the grant deed and the date of recording of the foreclosing loan.

The second loan is foreclosing, and this second loan is followed by a modest junior third loan. With the completion of the foreclosure of the second loan through a scheduled trustee’ sale looming on the horizon, I realize (as the third trust deed holder also must realize), that without an overbid, the third trustee deed holder will receive nothing from the completion of the foreclosure of the second loan.

The about-to-be-eliminated junior trust deed holder might take no action for a variety of reasons. Such reasons could include a) having no or too little money to cure the underlying senior debt, b) a presumption that any foreclosure on a senior loan will result in an overbid payment to the junior or lender, c) it makes little sense to throw more good money after a bad loan, or d) a decision by the third lender to write this off as part of the his/her learning process. It is even possible, through someone's mistake, proper notification of the impending sale of the senior trust deed has not been received by the third lender. Let's also presume that even after proper notification of the impending trustee's sale, the about-to-be-eliminated junior lender takes no action.

You on the other hand, being the outstanding researcher that you are, decide that the third lender is ignoring a potential bonanza when the overbid on the foreclosure on the second loan is distributed to junior creditors after completion of the trustee's sale because the adequate equity exists.

You, very cleverly, contact the third lender and invite that lender to assign that precarious third trust deed to you prior the trustee's sale of the second loan. You point out the apparent risk that exists if no overbid is received at the trustee's sale of the senior second loan. Without an overbid, the third lender will get nothing.

After some eyeball to eyeball negotiating (I have always been proud of how you handle yourself in these situations), the third lender agrees to sell you that jeopardized third trust deed at a discounted price below the face value of that third trust deed. It is important to emphasize your altruistic attitude as you negotiate a lower and lower price below that face value---because your apparent risk.

Because we have thoroughly examined the potential equity remaining of the property after the trustee's sale of the property, we are confident that we have made a good purchase and simply wait for that over bid that will be received from the trustee of the second trust deed after the sale. If we really are comfortable with our analysis of the equity in the property, we probably can sleep soundly until the cash is received. If, on the other hand, a substantial overbid (paying us the face value of the trust deed we bought at a discount) is not that certain, we may have blundered into a serious financial loss.

If you are uncomfortable with the unknown, you may want to relax in the ability to remove the possibility of wipe-out of your investment by curing the two senior loans and foreclosing yourself. Such a process takes a careful examination of the possible delinquencies by the defaulted owner on each senior loan before acquiring the junior loan to the foreclosing loan. Should the delinquencies be acceptable and the discount on the purchased price of the junior loan be substantial, you as the new third trust deed holder could cure the senior loans and foreclose on your newly acquired third loan.

We call this final procedure "buying the friendly junior loan". Let's go through the process together at the next time we meet.

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