Foreclosure Bailouts Revisited
By Bill J. Gatten
4/2/2002

In answer to a recent question by a Network Member regarding percentages of splits with potential seller-prospect in Foreclosure, I though others might benefit from my answer. It went like this:

Dear Bob (Not his real name for anonymity's sake…his real name is Earl Halderson),

When working foreclosure bailouts as an investor in any state, when you plan to leave the borrower in the property you must be extremely careful to deal only at Fair Market Value, avoid creating a debtor's lien on the property, and make your deal fit well within the increasingly more stringent laws concerning foreclosure consultants and specialists. Be especially careful with regard to regulation concerning Usury, Fraudulent Conveyances, illicit conversion and Bankruptcy Fraud. The Civil Code Regs in California are the tightest of any state and they provide a good guideline to follow in order to stay out of trouble (in any state) when dealing in foreclosures (See Ca. CC Sec. 1695 and 2945 http://www.leginfo.ca.gov/calaw.html).

Most importantly though, be aware that the biggest problem with "foreclosure bailouts" across the board is in-fact a weird medical condition known as "Pernicious Post Recovery Amnesia." It affects most of the population and can wipe investors out like flies. The symptoms of PPRA tend to set-in when Mr. and Mrs. Eternally Grateful get back on their feet financially and try to sell, or borrow against the property and find you in the way. It's then that their memory fades and they determine that even though you were once their veritable "Angel Ascended from Heaven," you are now a warty, spittle-dripping, greedy old troll, bent solely on capitalizing on that momentary lapse of consciousness in the foggy distant past. And, even worse…when the situation is brought before a judge, it's amazing how contracts--no matter how carefully drafted—suddenly are found to mean nothing anymore. "After all" Judge Jones determines, "these poor folks were down and out and not in their right mind: you were rich and greedy…you lose! Next case! What? You saved their home for them only ten minutes before they lost it at the auction? Oh that's nice. You still lose…and shut up or you'll go to jail! Next case! Wait! You owe these innocent victims quadruple damages! Pay up…AND go to jail! And I hate you! Next case…"

So how does a NEHTrust™ (PACTrust™) help in these situations?

Well, the idea is for the owner in default to get out of default first (with your help), and then make sure the property is not sold or transferred beyond the owner's own inter vivos (living) trust. The owner merely vests its ownership (legal and equitable) with a trustee for a land trust, and then leases the property back from the trust…with you, his new best buddy, as a silent co-beneficiary. You now have a vested interest in the trust and a silent agreement to share in the proceeds of the--now "income"--property when it is ultimately sold or refinanced at a specified time in the future.

With this system, you offer the owner in distress full Fair Market Value with the right to challenge your assessment of value at any time (with an appraisal at his expense). You also make a provision in your contract that: should a subsequent default occur, you would buy out the defaulting party's equity at Fair Market Value...again determined by you, but wholly challengeable by the defaulting party by means of a an MAI (Member American Appraisal Institute) appraisal…following payment of a $2,000 Default Fee, and the cost of the appraisal. Should the defaulting beneficiary prove that more money is owed than was offered by the investor, he is paid the full amount (less late payments, late fees, charges, penalties, interest and unpaid insurance and taxes) via an UN-secured promissory note. Therefore one would offer the loan amount plus, say, a dollar. Even though the recourse is there, once the defaulting party is out of the property its interest in causing problems fades fast…unless he or she really IS being cheated out of what's rightfully theirs: then, in such case, the recourse process serves him quite well.

Be certain as well, before you get involved with a bailout, that the loan/s is/are no longer in default, and that no recorded notices or clouds on title relative to the default are extant (i.e., open a silent Escrow to hold all executed documents, check title and disburse a cashier's check to the lender following receipt of its Reinstatement Quote). Though not mandatory, we think it wise that, at least in the beginning, the borrower's continuing payments are not more than what he has been paying historically: the NEHTrust payments (triple net lease obligation) might, however, be scheduled for an increase in six months or so, and perhaps for periodic increases after that.

So, how about the structure relative to being fair to all concerned, and to not being seen as taking advantage of anyone.

Here let me suggest going in 50:50 with the defaulting borrower. In other words, the borrower is left with 100% of its existing equity (that which still exists after we've reduced the MAV to an amount equivalent to the low-side of FMV, less anticipated costs of closing, and remarketing. The investment that was made to cure the default is then added into the Investor Beneficiary Refundable Contribution. That is to say that the amount to be refunded to the investor at termination prior to any other distributions of proceeds, can be that amount actually expended, plus maybe ten or twelve percent per-year of the agreement (I.e., $5,000 spent up front on a 5 year NEHTrust(tm)…the Refundable Contribution would be stated as $7,500 to $8,000 and returned to the investor prior to participation in all the other profit centers and division of net proceeds).

Once the trust is established, the formerly defaulted borrower of record leases the property from the trustee and becomes the Resident (lessee) Co-beneficiary, thereupon being under penalty of a simple eviction in the event of further missed payments or other default. The eviction is by the trustee, as directed by the co-beneficiaries…one of whom is the defaulting party himself…kind of hard to argue out of that one ("Judge, I'm kicking myself out, and it's just not fair!").

The profit centers for the investor in the above scenario are:

1) Positive cash flow (but be sure you don't impose a positive CF for, say, six months; and even then don't increase the aggregate monthly rental by more than perhaps 10% (not a “rule,” just a safety measure);

2) Half of the equity extant at start above your adjusted MAV

3) Half of the mortgage principal reduction;

4) Half of any future appreciation that is over and above the MAV at inception;

5) That amount that was added to the initial investment to create the Investor Beneficiary Contribution (the part that says “Thanks for saving us from foreclosure”)

What if a borrower in default wishes only to get out from under the burden and just walk away?

Then you are free to acquire the property via the co-beneficiary land trust transfer system (or any other system) for whatever you can. If you need to offer an incentive to someone who may have considerable equity, perhaps you could offer to leave at least half of his or her equity intact to be repaid when the trust terminates and the property is disposed of at termination. In this regard, however, even if you had to leave the owner with, say, 75%, or even ALLl the equity, it would likely still be a good deal…IF most or some of the above profit centers are still there and you can get a seven to ten year (or so) term.

Is this a cool way to make a living, or what?

Bill

*If you don’t have our Quick Start Success Pack or don’t belong to the NARS National Network already…it might be a real wise decision to become a part of what we do. This is only a tiny peek at the whole picture.

Give us a call at 1 800 207 4273 or go to our website at www.landtrust.net.