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Fall 2023

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Your Bankruptcy Questions Answered

(page 7)

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FROM THE PRESIDENT

Shafiq Taymuree
2023-2024 CMA President

The Top Five Things I've Learned in Private Lending

Every once in a while, it's helpful to reflect on where you've been, and what brought you to where you are. Recently it occurred to me that I've been in private lending for over 25 years and running funds for about 20 years. There has been plenty of trial and error along the way, but the accumulated knowledge and wisdom from those years is a huge blessing. So, it seemed appropriate to share the benefits of that learning, and I've decided to share five important pieces I've learned about how to create ongoing success in the private lending space. I hope you find these learnings helpful for your lending practice or if you are already successful, you can share this with someone starting out along with anything you can add to it.

Function with Integrity

Success in Private Lending comes from playing the long game and building a reputation. So, build a great one, and it will reward you with success. Communicate clearly and honestly. Follow through on your commitments. Don't favor quick wins over borrower satisfaction. Be humble enough to admit what you don't know, and diligent enough to learn it. A well-earned positive reputation is your best and easiest marketing. It will drive deals and income your way throughout your career.

Be a Solution Provider

Avoid becoming product-centric. Every loan is the solution to a need the borrower has that is a challenge to go the conventional route. Make the extra effort to understand the borrower's problem and focus on solving it. Be fine with the best solution not being a product you focus on and help direct them to the resource that can. Not only will you provide better service to the borrower, but your reputation as a problem solver will inspire confidence and bring the borrower back for future loans. Many times, this practice has generated referrals from the borrowers that we could help and those we couldn't help internally, but we were helpful!

Always Innovate

Change is inevitable, and it moves fast. Don't resist it. Embrace it. Be on constant alert for ways to open new markets. Always be searching for ways to improve your products, services, and processes. Assume your competitors are always getting better, because they are.

Never Stop Being Curious

Don't ever assume you know everything you need to know. There is always something to learn at any stage of your career. Make it a habit to ask questions. Be in permanent discovery mode, looking for new trends, new developments, and new markets.

Give Back

Contribute to your industry. Share your knowledge and help others to learn and grow. Do it for the good of the industry, but more importantly, do it for your own good. The more you share, the more connections you make, and the more you foster open exchange of ideas that accrues benefit to you. You may find that the greatest value in the act of giving back is the value it generates for you.

These five lessons continue to serve me well in all phases of my professional life. Again, I hope the above learnings might help or inspire others in the industry. As you may have guessed, it is the fifth (and most recent) of these lessons which served

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FROM THE EDITOR

Mayumi Bowers
Editor, POINTS OF INTEREST

There is a saying: ***After a long time of practice, our work will become natural, skillful, swift, and steady.*** But despite all the practice, I have yet to get skillful when dealing with delinquent loans, bankruptcies and foreclosures. My loan portfolio, probably like your portfolio, has seen an uptick in problem loans from higher delinquencies to more foreclosures and everything in between. No matter how long I have been in this industry, being prepared when a loan goes south is imperative and there is always room for improvement. While I keep practicing, I am not sure that I will ever be skillful, swift, and steady. This edition of Points of Interest focuses on issues like bankruptcies, foreclosures preparation, etc. to help you with your continued practice, practice, and more practice.

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SACRAMENTO SUMMARY

Michael D. Belote, Esq.
CMA Legislative Advocate

Playing Defense

Every year in Sacramento, legislators introduce around 2,500 new bills, to address problems real and imagined. A very small handful are suggested by organizations such as CMA to make necessary changes in the law. Even the largest organizations try to limit these "sponsored" bills to perhaps a half-dozen annually.

For every one sponsored bill, however, most organizations seek to amend or defeat probably ten bills suggested by others. This reactive side of lobbying, or playing defense, is thus significantly more important than the affirmative side, although both play a role in an effective government relations program. The reactive side is so important that most organizations would be just as happy to forego the affirmative side if the legislature just promised to pass no bills in a given year!

2023 is no exception to this phenomenon. When the new two-year session of the legislature commenced in January, CMA and other real estate groups were concerned about the potential reintroduction of last year's SB 1323, dealing with foreclosures. This bill, which consumed enough oxygen for five legislative years, and was stopped just steps from the governor's desk, would have mandated a parallel foreclosure track, with the trustee listing and potentially selling the subject property, all without the involvement of the actual owner or lender. It could have made to it practically impossible to recover the security upon default without the threat of lawsuits.

CMA and our real estate allies had a counterproposal ready if SB 1323 was reintroduced this year. With only weeks remaining in the legislative year, thankfully we have not seen such a proposal. This illustrates the importance of reading every bill, and every amendment to every bill, because things can pop up late in any legislative year, with little time to react.

Two issues which have been raised, on the other hand, are elder abuse and "hidden fees." SB 278 was designed to combat elder abuse, by equating "assisting" with a transaction which constitutes elder abuse with perpetrating the act itself. No one argues that accomplices should not be held accountable, but what if a CMA member simply makes a garden variety loan, with no notice of anything amiss, and it later turns out that someone had undue influence over the senior citizen?

Elder abuse is obviously a sensitive topic in Sacramento, but SB 278 has become a "two-year bill," meaning it will not be enacted this year. On the other hand, SB 478 on hidden fees is likely to be enacted this year, to take effect on January 1, 2024. In an excellent example of industry working with the author and legislative committees, the bill has been amended to address problems raised by CMA and industry allies.

The hidden fee issue has become quite au courant. The subject was even raised in this year's State of the Union address by President Biden. But the discussion normally focuses on "hidden" fees in hotel stays, ticket purchases and the like, not on highly regulated areas of commerce like real estate.

The problem was that, as first proposed, SB 478 would have subjected CMA members, other lenders, and others participating in the loan process to private lawsuits under the California Consumers Legal Remedies Act for even the smallest errors

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BANKRUPTCY
LAW

A Potpourri of Bankruptcy issues for Lenders to Consider

Benjamin R. Levinson, Esq.
Law Office of Benjamin R. Levinson

As a long-time practicing attorney who specializes in representing private mortgage lenders in bankruptcy, I have frequently fielded common questions about various actions related to bankruptcy filings. This article will cover a few of those questions.

Can I Make a Refinance Loan to a Debtor in Bankruptcy?

On occasion, I get asked by a CMA member if it is okay to give a refinance loan to a borrower who is a debtor in an existing bankruptcy. My response is: Assuming you follow your underwriting standards for making the loan, comply with state law disclosures, and obtain certain bankruptcy protections as a condition of your loan, you can make a refinance loan to a debtor in bankruptcy.

What bankruptcy protections are necessary, you ask? First, you need a court order from the Bankruptcy Court that allows the debtor to obtain post-petition financing. That requires a debtor to make a motion to incur new debt or borrow money with notice to creditors in the bankruptcy.

Not all of the terms of the new loan need to be spelled out in the motion, but general approval of a loan not to exceed a certain amount and not to exceed a certain interest rate will be required. Second, if you are going to be the new lender, you should ask for the motion and Order to include certain conditions of your loan.

One of those loan conditions is that the debtor stipulates to relief from stay in the event the debtor defaults on your loan. Not only should that be a condition of your agreement to underwrite the loan, but it

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should be in the motion and the Order approving the refinancing.

If you do not have any language in the Order regarding termination of the stay, and the Debtor defaults on your loan, you will have to make a motion for relief from stay to allow you to foreclose on the collateral and also to obtain possession if the collateral is the debtor's residence. This is an increased cost that would not be necessary with prior approval in the Order that provides for relief from stay to allow foreclosure and obtain possession of the property.

Another issue in the motion and Order is the allowance for you and/or your agents to send notices out directly to the debtor for monthly statements, default notices, etc. Without that specific provision in the motion and Order, you leave open the possibility of a defaulting debtor later seeking monetary sanctions against you for violation of the bankruptcy stay for sending those notices. A violation of the stay claim permits recovery for actual damages, attorney fees, and occasionally punitive damages. You can eliminate that risk by distinct language in the motion and Order regarding service of notices on a debtor.

Occasionally, a debtor will seek dismissal of its bankruptcy in contemplation of a new loan instead of seeking approval in the bankruptcy. If you are going to be that new lender, you must be careful not to make any promises of a new loan in exchange for a dismissal of the bankruptcy. You should not participate in that decision. If the bankruptcy is dismissed and your new loan is not completed and the current lender forecloses, the borrower is likely to concoct reasons to file suit against you.

It is always best practice to consult with your bankruptcy attorney when you are providing a refinance loan to a debtor in bankruptcy. The attorney can make sure the conditions of your loan are in the motion and Order and monitor the bankruptcy motion to address any questions from the judge.

What Happens to the Rents, Issues, and Profits of Income Property When a Bankruptcy is Filed?

Under California law, your deed of trust language usually provides a covenant that the rents, issues, and profits of the property are additional security for your loan (generally called an "assignment of rents" clause). The assignment of rents may also be in a separate loan document recorded contemporaneously with the deed of trust.

That assignment of rents clause is an absolute assignment of the existing and future rents under Civil Code § 2938. The language usually allows the trustor to collect the rents, issue, and profits while the loan is current. When the loan becomes delinquent, the lender's right to collect the rents, issues, and profits, is absolute as additional collateral of your loan in addition to your security in the real property.

Most of the time lenders are dealing with rental income from either residential or commercial tenants. So, that will be the focus of this section.

If your loan becomes delinquent pre-bankruptcy, you have the right to try and collect the rents directly from the tenant after service of written notice to the tenant and to the borrower/trustor. Civil Code § 2938 sets forth the method and required language in the notice.

However, if the borrower/trustor or the tenant do not cooperate and turn over the rents, you need to have a receiver appointed to manage the property, make sure it is insured, and collect the income from the property. The timing for obtaining a receiver is important because the foreclosure process moves quickly. A sale can occur approximately four months from the time the NOD is recorded. You want to collect the rental income and prevent the borrower/trustor from collecting the rents for at least three of those months if possible.

Sometimes the receiver is just about to be appointed and the debtor files bankruptcy. Other times, the receiver is in place for a few months and bankruptcy is filed just before sale. The treatment of the receiver in bankruptcy may be affected by the amount of time the receiver has been in place.

Under the Bankruptcy Code, the income from real property is defined as "cash collateral." 11 U.S.C. § 363(a) provides: "… 'cash collateral' … includes the proceeds, … rents, or profits of property…." Cash collateral also includes income from use or occupancy of rooms in hotels or other lodging facilities.

When a borrower files bankruptcy and owns income property, the first thing a lender should do (through its bankruptcy counsel) is to file and serve a pleading called "Notice of Perfection of Assignment of Rents" with the court. That provides all parties to the bankruptcy with notice that you hold an interest in certain cash collateral on a particular property and perfects your rights to the cash collateral. Additionally, there is case law that requires a creditor to make a claim for the cash collateral or that rental income belongs to the debtor until the creditor makes its claim by filing a notice.

Second, make sure your bankruptcy counsel contacts the debtor's counsel in writing and puts them on notice that you do not consent to the use of cash collateral by the debtor. Ask the debtor's counsel to provide a budget to you of necessary hold-back expenses (insurance, possibly pro-rata property taxes, and a small reserve for repairs) and agree to turn over the net cash collateral to you as lender on a monthly basis. Bankruptcy Courts prefer cash collateral agreements being negotiated by the parties so the Court does not have to decide issues related to a budget or turnover. Many Courts have special language and forms they require in determining cash collateral agreements.

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If the debtor's counsel and the debtor do not cooperate, then you will have to make a motion to prohibit the use of cash collateral and to sequester the rents. In my experience, a competent debtor counsel will prefer to negotiate the terms of cash collateral usage rather than fight a motion to prohibit its use.

If a receiver had been appointed pre-petition, the Bankruptcy Code provides that the receiver is now a "custodian" and prohibits the receiver from distributing the debtor's rents from the property, except as necessary to preserve the property. 11 U.S.C. § 543.

That same section requires the receiver, now custodian, to account and turnover the rents collected back to the debtor unless the creditor who had the receiver appointed can provide evidence to the bankruptcy court that the turnover provisions should be excused.

In order to keep the custodian in place and excuse the required turnover back to the debtor, the creditor must make a motion and seek to keep the receiver/custodian in place. One of the factors the court may consider is how long the receiver was in place before the bankruptcy was filed. If the receiver had been place for at least three months, the court may continue to keep the receiver/custodian in place for the protection of the lender creditor and other creditors in the bankruptcy. On the other hand, if the receiver was appointed just prior to the bankruptcy, the court is likely to remove the receiver/custodian and give possession of the real property and rents back to the debtor. Among other factors the bankruptcy court may consider are the pre-petition conduct of the debtor and the pre-petition condition of the real property prior to the receiver's appointment.

Whether to keep a receiver in place as custodian is going to be determined on a case-by-case basis. However, even if the receiver is removed, you have the protections of limiting the use of cash collateral by the debtor as set forth above.

Conclusion

The takeaway for this article is for lenders to pay attention when their borrowers file bankruptcy. Retain competent bankruptcy counsel quickly to make sure your interests are protected. Do not ignore the bankruptcy filing at the outset because there are strict deadlines for filing claims, filing objections, and other issues that must be dealt with related to rental income and the stay.

Additionally, do not be afraid to make a loan to a debtor in bankruptcy if you follow all your underwriting guidelines and the conditions of your loan are incorporated into the motion to approve the refinance and resulting order.

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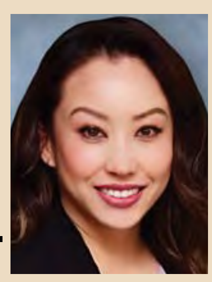
An Investor's Guide to Private Lending Licensing Requirements



Jennifer Young, Esq.
Geraci LLP

Introduction

Trust deed investments have gained popularity among investors seeking to diversify their portfolios. For trust deed investors, understanding the licensing requirements and legal considerations associated with this investment strategy is crucial to making informed decisions and safeguarding their interests. As an investor venturing into the realm of trust deeds, it's essential to navigate the regulatory landscape effectively. In this article, we will demystify the intricacies of licensing, explore potential exemptions, clarify the threshold of becoming a 'lender,' and address the impact of accreditation on trust deed investing.

Understanding Trust Deed Investing

Generally, trust deed investing involves investors lending money to a borrower to purchase or refinance a property. In return, the borrower signs a promissory note to repay the loan, and the trust deed is recorded as a lien on the property. The investor becomes the "beneficiary" of the trust deed and is granted a legal interest in the property until the borrower repays the loan. The trust deed serves as collateral, and in the event of a borrower default, the investor may have the right to initiate foreclosure proceedings to recover its investment through the property's sale.

Trust deed investing is a common way for individuals to participate in real estate financing and earn a return on their investment through interest payments (including the potential appreciation in property value in the event of borrower default and foreclosure). Like other lenders, trust deed investors are subject to the relevant laws and regulations governing lending activities in California. It's important for trust deed investors to understand the legal implications and risks involved in such investments and to comply with applicable state regulations.

Do You Need a License to Invest in a Loan?

In California, a lender may originate and fund mortgage loans through one of three licenses: a Real Estate Broker License from the California Department of Real Estate ("DRE"), a California Finance Lender License ("CFL") from the California Department of Financial Protection and Innovation (the "DFPI"), or California Residential Mortgage Lending Act license ("CRMLA") from the DFPI. An unlicensed individual or entity may only make one commercial loan a year, unless one of the exemptions discussed below applies.

Trust deed investors are those not directly engaged in the business of lending or originating loans; instead, they provide funding for loans at closing and hold a beneficial interest in the trust deed securing the loan. Therefore, it's important to note that although trust deed investors may not require a license to make loans under certain circumstances, the entities or individuals who are actively involved in the business of lending or originating loans (such as mortgage brokers, lenders, or loan servicers) do need to be licensed under California law.

In the same vein, once a trust deed investor actively participates in loan originations, mortgage lending, or related activities, the investor will fall under the scope of licensing requirements and regulations. In such cases, they should consult with an attorney familiar with California's lending laws and regulations to ensure compliance. Non-CA investors or those investing in non-CA loans should also seek legal advice to ensure compliance with relevant state regulations.

Understanding Exemptions

Under the California Financing Law, there is a "de minimus exemption" from the licensing requirements which allows an unlicensed individual to make no more than one commercial loan (a loan with a principal amount of $5,000 or more, the

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proceeds of which are intended by the borrower for use primarily for other than personal, family, or household purposes) in a 12-month period. The more commonly used exemption available for an unlicensed lender are loans arranged by a licensed California DRE Broker.

These exemptions can vary depending on the specific circumstances involved. Additionally, it's important to note that exemptions can change over time, so it's essential to consult with legal experts to confirm the current status of exemptions available.

CA DRE Brokered Loan – Individual Trust Deeds/ Whole Loans

Typically speaking an unlicensed investor will need to work with a licensed CA DRE Broker to help identify potential loans to fund. In California, if a mortgage loan is originated and brokered by a CA Real Estate Broker to an unlicensed individual, the unlicensed individual can fund the loan without a license and retain the usury exemption for California. However, California real estate law requires an unlicensed person to obtain a DRE Broker license if that person makes more than eight loans secured by real property in California within a 12-month period (and is not otherwise licensed under the DFPI).

CA DRE Brokered Loan – Fractional Loans/Co-Lending

While co-lending arrangements can offer advantages such as participating in larger transactions, potential securities issues must be considered. Trust deed investors exploring co-lending arrangements must be aware of potential securities issues.

If the co-lending structure qualifies as a security under federal and state laws, it may be subject to registration, disclosure requirements, and compliance obligations. Verification of accredited investor status becomes crucial, and providing a private placement memorandum (PPM) may be necessary. Additional complications will also arise in instances where non-accredited investors are involved and where investors reside outside of CA or reside in multiple different states.

Mortgage Funds

Participating in a pooled investment fund managed by a licensed professional may also grant investors an exemption from individual licensing requirements. Investing in a fund can provide diversification and expert management of a trust deed portfolio.

The benefits of investing in a mortgage fund are that the investment is passive, so the investor does not need to manage funding new loans, payoffs, or potential defaults, and the investment is diversified across all the loans held in the fund. The fund manager handles all the details with the loans in the portfolio, taking an annual management fee in addition to the upfront origination fees they charge to the borrower. Most funds are structured to allow investors to reinvest dividends back into the fund, which most investors elect to do. Private lenders managing mortgage funds enjoy greater flexibility in carrying out their lending/investment activities, which enables them to offer improved economic terms and consistent returns for their investors.

Accredited Investor Status: Does It Affect Licensing?

Being an accredited investor, as defined under Regulation D of the Securities Act of 1933, can open doors to certain investment opportunities. However, it's crucial to understand that accreditation status does not automatically exempt you from licensing requirements for trust deed investing. Licensing is primarily determined by investment activities, regardless of your accreditation status.

Emphasizing the Importance of Professional Guidance

Throughout the trust deed investment journey, new investors should prioritize seeking professional guidance. Engaging legal counsel experienced in trust deed investing and securities matters can help navigate the complexities of licensing, regulations, and potential securities implications.

Conclusion

For new trust deed investors seeking to understand and potentially grow their wealth, trust deed investing in California offers an exciting opportunity. By grasping licensing requirements, exploring exemptions, addressing securities implications, and considering the transition to private lending, you can embark on your trust deed investment journey with greater confidence and security. Staying vigilant about the ever-evolving legal landscape and seeking professional advice will ensure compliance and minimize legal risks. With the right guidance, investors can confidently pursue their investment strategy and aim for success in this dynamic market.

FORECLOSURE

The Mortgage Industry's F-Word is Back in Style

Elizabeth M. Knight
PLM Lender Services, Inc.

Yes, the "F" word is back in style and ramping up. We, of course, mean "foreclosure." It is not quickly ramping up as many people might have thought. However, the numbers are slowly but surely growing. We, at our firm, see more commercial properties coming into our foreclosure division from the banks where, in our servicing division, we are seeing not only the commercial properties struggling but more and more returned checks on our 1-4 properties so foreclosures are on the horizon. If you see your portfolio beginning to have higher delinquencies, you are not alone. This article deals with simply the beginning of the process and the thoughts behind starting a foreclosure.

Most think that the question is "when should a foreclosure be commenced?" But, the question should be "should a foreclosure be commenced?" Making the decision to commence a foreclosure should not be taken lightly or as a matter of procedure. Each file must be reviewed individually in order to be sure the best decision is made, considering all factors: borrower, lender, property type, other tangibles and non-tangibles.

The first things to be reviewed before initiating a foreclosure:

Recovery Potential

After reviewing all of the costs involved, what is the recovery potential? If it is a first deed of trust, typically recovery shall be made whether or not it is in full or partial. A review to see if there is a personal guarantee that may assist with collection is important. The use of this personal guarantee is an entire article in and of itself.

Other Options

Options to review before foreclosure: Forbearance, modification, deed in lieu, taking the loss without putting forth further funds, doing nothing except continuing to send collection letters (you do not want to "zombie-ize" the loan), then, of course, judicial foreclosure or non-judicial foreclosure.

Timing

If multiple properties are secured, reviewing each property and timing need reviewing.

Receivership

On a commercial property (including ag land) or multi-family, should a receiver be obtained?

The next major review should be the file. Once the decision is made to commence the foreclosure, the file must be reviewed for the ability to commence the foreclosure:

1. If this is a CFPB file, is the loan 120 days delinquent, have the required calls been made, has the required 45-day letter(s) been sent?
2. Should steps be taken if a senior lien, taxes, or insurance are delinquent on a CFPB loan and the subject loan is not 120 days delinquent?
3. If this loan is a HOBR loan, have the required call(s) been made, has the proper waiting period been performed, has the 30-day letter been sent, have the 30 days expired?
4. If an attempt has been made for a forbearance or modification under HOBR or CFPB, have all proper steps been taken and have the proper timelines been followed?
5. If a Notice of Intent has been sent, has it expired?
6. If there was a conversation with the borrower giving a date to cure, has it expired?
7. Does the deed of trust or note contain any special language about notice? Typically, if calling a loan due because of alienation, there could be a 30-day notice requirement
8. If the loan matured, if a Balloon Payment Notice was required, was it sent timely and properly?
9. Has your lender insinuated themselves directly and corresponded with the borrower? What has been told to the borrower?

Once it has been decided to commence a foreclosure, of course, all information going over to the trustee must be correct but it is important to **not include any fees that**

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Foreclosure – continued from page 15

were not allowed for under the note, deed of trust or California Civil Code. Many times we see fees such as "forwarding fee," "foreclosure document preparation fee," "delinquency oversight fee," etc. being shown on foreclosure instructions as a fee the servicer wants collected. If these fees were not disclosed in your loan documents as allowable charges under the loan, it would be unwise to include them in the notice of default. Default interest is another issue that is routinely seen. This is a hot topic which this author will not delve into in this article.

The last little tidbit to mention is to not tell a borrower that a foreclosure WILL BE commenced, if there is not an intention to commence the foreclosure. Words like 'NOTICE OF SEVERELY DELINQUENT ACCOUNT' versus 'NOTICE OF INTENT TO FORECLOSE'; "We will be reviewing your account for further collection action," versus "Your account will be placed in foreclosure if we do not received the required funds."

Foreclosure is not a procedure to be taken lightly. Remember that a foreclosure is a logical step but it must done wisely and all steps must be performed precisely. Be sure that the person reviewing the file for foreclosure or whichever option chosen is knowledgeable. A discussion with the lender(s) is always important since it is their investment. Typically, the lender(s) will look to the servicer/broker, for guidance. It is important to be able to discuss all options with them. It is their investment, after all, and they have to live with the decisions and consequences that are made.

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Lender Alert:

LIBOR Is Going Away Are You Prepared?

Nema Daghbandan, Esq.
Geraci LLP

As many of you are aware, LIBOR (the London Interbank Offered Rate) was phased out on June 30, 2023. Congress passed the "Adjustable Interest Rate (LIBOR) Act" in March 2022, and the Federal Reserve followed with a regulation in December 2022 that required the transition away from LIBOR and, in most cases, forced the transition to the Fed's chosen index replacement.

The following guidance is meant for existing loans.

Lenders should use **extreme caution** if deciding to use LIBOR for new loans.

What Do Your Loan Documents Say?

First, check the language in your loan agreements that describe the interest rate index ("Index") for your adjustable rate loans. If your loan agreement uses LIBOR as an interest rate index, look to see if the loan agreement:

- Identifies an Index that will replace LIBOR when it is no longer available, and
- Gives the lender or another person the right to choose a replacement Index.

OPTION 1

If your loan agreement identifies a replacement Index, you must use that Index.

OPTION 2

If your loan agreement does NOT identify a replacement index, the following applies:

a.) If the lender or another person is authorized to select a new Index to replace LIBOR, that person:

- *May* choose to use the Federal Reserve's Index replacement; or
- *May* instead choose to use an alternative Index replacement that is commercially reasonable under terms of your loan agreement.

b.) If no person is authorized to select a new Index to replace LIBOR, you must use the Federal Reserve's replacement Index (which are different forms of SOFR [Secured Overnight Financing Rate] described in the table below).

Please note that while the federal law and regulation do not require notification to the borrower, your loan documents may require borrower notification.

PLEASE NOTE: Federal law says that when you use the Federal Reserve's Index ("Fed's Index") to replace LIBOR:

1. The Fed's Index is commercially reasonable;
2. Your borrowers may not bring any claim against you for using the Fed's Index; and
3. You may use the Fed's Index without first getting your borrowers' consent.

Choosing another Index that is not the Fed's Index will not provide you with these safe harbor provisions and will likely require your borrowers' consent.

Replacement Index and Margin Adjustment

The Federal Reserve's regulation has a list of both:

- Indexes to replace LIBOR (which are different forms of SOFR), and
- Adjustments that you need to make to your current margin, which makes up for the average difference between LIBOR and SOFR.

The Federal Reserve's replacement Indexes and margin adjustments are as follows:

Original LIBOR	Replacement Index	Margin Adjustment
Overnight LIBOR	SOFR	.00644%
1 month LIBOR	1 month CME SOFR	.11448%
3 month LIBOR	3 month CME SOFR	.26161%
6 month LIBOR	6 month CME SOFR	.42826%
12 month LIBOR	12 month CME SOFR	.71513%

As you know, the interest rate for a LIBOR loan is calculated by adding a "margin"

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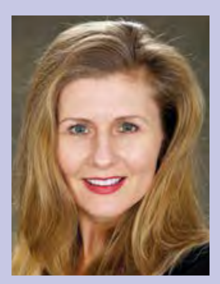
Bidding Strategies and Issues Under California's Post-Foreclosure Auction Process

T. Robert Finlay, Esq.
Wright, Finlay & Zak, LLP



Michelle A. Mierzwa, Esq.
Wright, Finlay & Zak, LLP

Effective January 1, 2021, California enacted a secondary auction process for residential foreclosure sales.[1] Previously, the foreclosure sale was complete, and the highest bidder was deemed the successful purchaser when the "hammer fell" at the conclusion of the auction on the courthouse steps. Civil Code § 2924m created a secondary "auction" whereby defined eligible bidders could outbid the successful purchaser at the foreclosure sale or, in the case of a representative of all eligible tenants, match the successful foreclosure bid.[2] As expected, there have been very few legitimate tenant or prospective owner occupant bidders since the law's enactment. Instead, most participants in the post-foreclosure auction have been non-profits (or, at least, companies claiming to be non-profits).

While significant industry attention has been devoted to understanding the poorly designed bidding process and determining who is, and is not, an eligible bidder, little attention has been paid to the foreclosing lender's bidding strategy at post-2020 residential foreclosure sales. This will be the focus of this article.

Pre-2021, foreclosing lenders would generally start their bidding low, bidding up the property to the amount of the debt or the value of the property, whichever is less. For example, if the lender was owed $1.1M and property was worth $1M, a lender may start bidding at $750k with instructions to bid up to $1M. If there was no competitive bidding, the lender would take back title for the amount of its $750K specified bid. The lender would then rehabilitate the property and hopefully be made whole from the resale. In that scenario, there was no downside to taking the property back after sale at below debt/value in the amount of $750K.

Post-2020, this historical bidding approach creates risk. Under the same scenario with today's post-foreclosure auction process potentially in play, a representative of all eligible tenants could grab the $1M property by simply matching the $750K foreclosure bid, or other eligible bidders could grab it for one dollar more. In that scenario, the foreclosing lender would lose roughly $250K of equity. Not ideal to say the least!

To avoid this result, lenders should reconsider starting their bidding well below the property value. Again, assuming that the full debt and property value were roughly $1M, the foreclosing lender would want to start bidding at roughly $1M.[3] This way, if an eligible bidder wants to out-bid the lender post-foreclosure, the lender will still maximize its recovery, without leaving any amounts up to the $1M value on the table.

While this new bidding strategy seems fairly obvious, it's a different approach to what lenders have been doing for decades. In addition, Civil Code § 2924m created some additional complications.

Multi-Collateralized Debt Scenario (all residential): $1M loan cross-collateralized by two single family residential properties – Property A and Property B. Property A is worth $700k and Property B is worth $500k. The lender opts to foreclose on Property A first, taking the property back after its unopposed opening bid of $700k. Ideally, the lender should wait for the 45-day post-foreclosure auction process to expire before completing a foreclosure on Property B. Otherwise, the lender will not know how much it should bid at the second foreclosure. Assuming the lender ends up with Property A after a $700K unopposed opening bid,[4] it can credit bid up to $300k at Property B's foreclosure sale. But, if the lender doesn't wait until the 45 days post-foreclosure auction period to expire, an eligible bidder could bid up Property A to, lets say, $750k. Now, the lender can only credit bid up to $250k at Property B's foreclosure and anything over that amount would be deemed excess proceeds, payable to the next in line, i.e., the junior lienholder or borrower.

Multi-Collateralized Debt Scenario (residential and commercial): $1M loan cross-collateralized by a $700k commercial building and a $500k residential property. Since the post-foreclosure auction process

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does not apply to commercial foreclosures, the lender would be better served to foreclose on the commercial property first and thereby, immediately obtain access to the proceeds or title and fix the remaining amount owed. The lender could then immediately foreclose on the residential property. Foreclosing on the residential property first would involve the 45-day delay while waiting to see if an eligible bidder would come along and affect your bid at the second foreclosure of the commercial building.

Junior Lien Foreclosure: Historically, foreclosing junior lienholders always had to worry about being foreclosed out by the senior lienholder. But the new post-foreclosure auction process further complicates matters. Imagine that junior lienholder takes back title at its own foreclosure and is facing a foreclosure by the senior lienholder in less than 45 days. If the junior lienholder advances funds to cure the senior lien during the 45 days and then an eligible bidder outbids the junior lienholder (now property owner) via the post-foreclosure auction process, the junior lienholder has no (easy) way of recouping the funds advanced to cure the senior lien, giving the successful eligible bidder a windfall. The junior lienholder's lien has been extinguished by its own foreclosure so it cannot use the lien to collect the advance. And nothing in Civil Code § 2924m allows the junior lienholder to recover the advance.[5] To avoid this scenario, the junior lienholder has a couple of options. First, the junior lienholder could negotiate a continuance of the senior lien's foreclosure (ideally in advance of the junior actually foreclosing). However, the continuance will need to be long enough to encompass the conduct of the junior sale, the post-sale 45-day period and a buffer for transmission of reinstatement funds to the senior lender. There is also the risk that if the junior lienholder is required to postpone its sale for any reason, the senior lienholder may not be willing to grant a further continuance. Alternatively, the junior lienholder could advance the funds to cure the senior lien prior to its own foreclosure, adding the advance to its debt prior and then adjust its bid accordingly.[6] In sum, with some advance planning, the junior lienholder can avoid any exposure created by the new post-foreclosure auction process.

Again, the post-foreclosure auction process created by Civil Code § 2924m has done very little to put foreclosed properties into the hands of tenants or honest prospective owner-occupants. In fact, the law has merely given investors who used to exclusively buy properties at foreclosure sales, another "bite at the apple" by rebranding as "non-profits." Fortunately, the 2023 amendments to Civil Code § 2924m in Assembly Bill 1837 should reduce any abuse. Nevertheless, there will still be eligible bidders using the post-foreclosure auction process to buy properties, so its important that foreclosing lenders update their bidding strategies accordingly.

If you have any questions about Civil Code § 2924m or bidding strategies at a foreclosure sale, please feel free to contact Robert Finlay at *rfinlay@wrightlegal.net* or Michelle Mierzwa at *mmierzwa@wrightlegal.net.*

Disclaimer: The above information is intended for information purposes alone and is not intended as legal advice. Please consult with counsel before taking any steps in reliance on any of the information contained herein.

Endnotes

1 See Civil Code § 2924m.

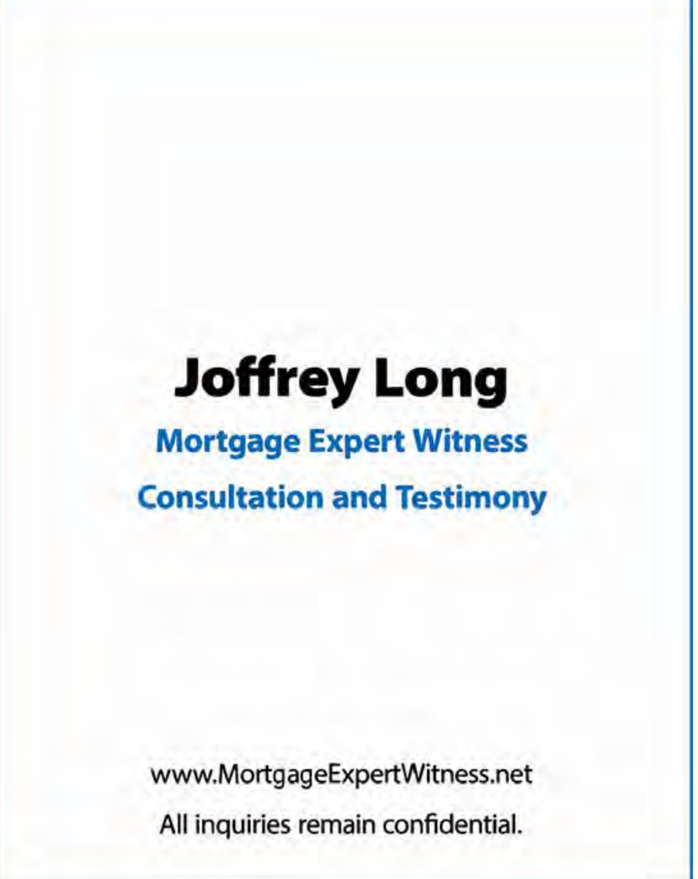
2 Eligible bidders include existing tenants, prospective owner occupants and qualifying non-profits or governmental entities.

3 This assumes that, after rehab and sales costs, the lender can net $1M. The lender may adjust its bid up or down to the amount it expects to recover on resale, after deducting rehab costs, sales costs, property taxes, etc.

4 Existing case law provides that a secured creditor is not prohibited by fair value principles from using underbids in sequential trustee sales against multiple security without first determining fair value, See, *Dreyfuss v. Union Bank* (2000) 24 Cal. 4th 400. However, the potential application of SB 1079 will cause the secured lender to want to bid closer to fair market value so that equity in the first property foreclosed is not left on the table if a post-auction bidder triggers the process and bids a dollar over the lender's specified bid.

5 The junior lienholder could sue the eligible bidder for unjust enrichment. But no one wants to end up in litigation.

6 WFZ is working with various industry groups on a legislative solution as well.



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Industry Calendar

— 2023 —

OCTOBER			
Oct 30, 2023	CA DRE	RE 852	Trust Account Report
Oct 30, 2023	CA DRE	RE 854	Trust Fund Non-Accountability Report
Oct 30, 2023	CA DRE	RE 855	Trust Fund Status Report
Oct 30, 2023	CA DRE	RE 856	Trust Fund Bank Account Reconciliation
NOVEMBER			
Nov 1, 2023	NMLS		NMLS Renewal Opening Date
Nov 14, 2023	NMLS		Mortgage Call Report
DECEMBER			
Dec 8, 2023	NMLS		SMART Deadline for NMLS renewal
Dec 15, 2023	NMLS		At-Risk Deadline for NMLS renewal

— 2024 —

JANUARY			
Jan 30, 2024	CA DRE	RE 852	Trust Account Report
Jan 30, 2024	CA DRE	RE 854	Trust Fund Non-Accountability Report
Jan 30, 2024	CA DRE	RE 855	Trust Fund Status Report
Jan 30, 2024	CA DRE	RE 856	Trust Fund Bank Account Reconciliation
FEBRUARY			
Feb 14, 2024	NMLS		Mortgage Call Report
MARCH			
Mar 1, 2024	CFPB		Home Mortgage Disclosure Act Report
Mar 15, 2024	DFPI		CFL Annual Report
Mar 30, 2024	NMLS		Financial Condition Statement (for 12/31/23 Fiscal year)
Mar 30, 2024	CA DRE	RE 881	Mortgage Loan Business Activities Report
Mar 31, 2024	CA DRE	RE 857	Residential Mortgage Loan Report

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The California Mortgage Association welcomes the following members who are new to the association:

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Ayvaz Capital Group Inc.
13243 Raven Street
Sylmar, CA 91342
(818) 445-2228
petrosayvazyan@yahoo.com
Regular Member

Christian Faes
F2 Finance LLC
401 Wilshire Boulevard, Fl 12
Santa Monica, CA 90401
(424) 354-6166
christian@f2yes.com
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Tony Ingoglia
Socotra Capital
2208 29th Street, Suite 100
Sacramento, CA 95817
(916) 277-9314
tony@socotracapital.com
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John MacLean
Fidelity Mortgage Lenders, Inc.
11952 Wilshire Boulevard
Los Angeles, CA 90025
(818) 590-7223
john@fidelitylenders.com
Regular Member

Timothy Shields
Thunderbird Capital Corporation
1601 Dove Street, Suite 128
Newport Beach, CA 92660
(949) 263-1085
tim.shields@tbird.capital
Regular Member

FROM THE PRESIDENT – *continued from page 2*

as the inspiration for this message. At the outset of my CMA membership, I believed the CMA was a resource from which to acquire knowledge and hone my skills. But it soon became apparent that the more I contributed, the more I benefited. So that lesson, perhaps, resonates a bit more than the others. And for that I am grateful to the CMA and all its members.

Sincerely,

Shafiq Taymuree
2023-2024 CMA President

LIBOR – *continued from page 17*

to LIBOR. For example, if LIBOR is 4% and the margin is 1.5%, the interest rate for the applicable period will be 5.5%. Apply the Margin Adjustment by adding the amount to the margin. Continuing the example, assume you were previously using 1 month LIBOR, then instead of the margin being 1.5% the margin will now be 1.61448%. You are permitted to continue using any rounding methodology found in your loan agreement.

Please Note: All of the above guidance is limited to non-consumer loans that are neither derivative transactions nor loans made by banks or Federal Housing Finance Agency regulated entities.

SACRAMENTO SUMMARY – *continued from page 5*

in fee disclosures. As such, the bill would have simply layered additional liability upon existing remedies available to regulators and consumers.

Working with the very fine author of SB 478, Senator Bill Dodd and an array of committee consultants, the bill has been amended to exclude persons subject to existing disclosure obligations under RESPA, TILA, HOEPA, the California's Finance Lenders Law and Real Estate Law. The bill itself remains controversial, and many groups are seeking exclusions, but it no longer raises concerns for CMA and our industry allies.

With the legislative fall recess commencing in mid-September, Governor Newsom will have until the middle of October to sign or veto the many hundreds of bills sent to his desk. In a typical year, approximately 1,000 new laws are enacted into the California Codes. Be sure to attend the CMA fall seminar in late September to learn about those bills relevant to your business!

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Please submit ads digitally where possible (PC format, not Mac) either on CD, zip disk, floppy disk, or via E-mail. Such electronic submissions should be in EPS, TIF, or PDF format, including all fonts where applicable, and should be compatible with Adobe Photoshop, Illustrator, PageMaker, InDesign, or Acrobat. We will also accept camera-ready (printed) full-sized images suitable for scanning, at either 133 or 150 line screen. Please see above for specific ad sizes and dimensions. Artwork should be e-mailed to "Advertising c/o **CMA**" at *teresa@camgmt.com* or mailed to:

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2. No advertiser is guaranteed placement, but every attempt will be made to provide the desired position.
3. Publisher reserves the right to revise, reject or omit any advertisement at any time without notice.
4. CMA accepts no liability for its failure, for any cause, to insert advertisement.
5. Publisher reserves the right to publish materials from a previous advertisement if new materials are not received by material deadline.
6. The word "advertisement" will appear on any ad that resembles editorial material.
7. Drawings, artwork and articles for reproduction are accepted only at the advertiser's risk and should be clearly marked to facilitate return.
8. No verbal agreement altering the rates and/or terms of this rate card shall be recognized.
9. All advertisements, layout and designs produced for the advertiser by CMA's Graphic Staff will remain the property of CMA.
10. All requests for advertising must be in writing, in the form of this signed contract, for the protection of both the advertiser and CMA.
11. Once an order for advertising is placed, it cannot be withdrawn or cancelled in whole or in part.
12. By signing this contract, advertiser agrees to pay in full for reserved space, even if the ad is not run due to lateness or absence of materials.

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	_____Spring '24	_____Summer '24	_____Fall '24
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Last 4 digits of card: ____________ Billing Address:____________________
Print Cardholder's Name:____________________ Signature: ____________________
*Do not e-mail credit card information; mail or fax only.

(rev. 9/23)

Full Credit Card# ____________________ Exp: __________ CVV#: ________

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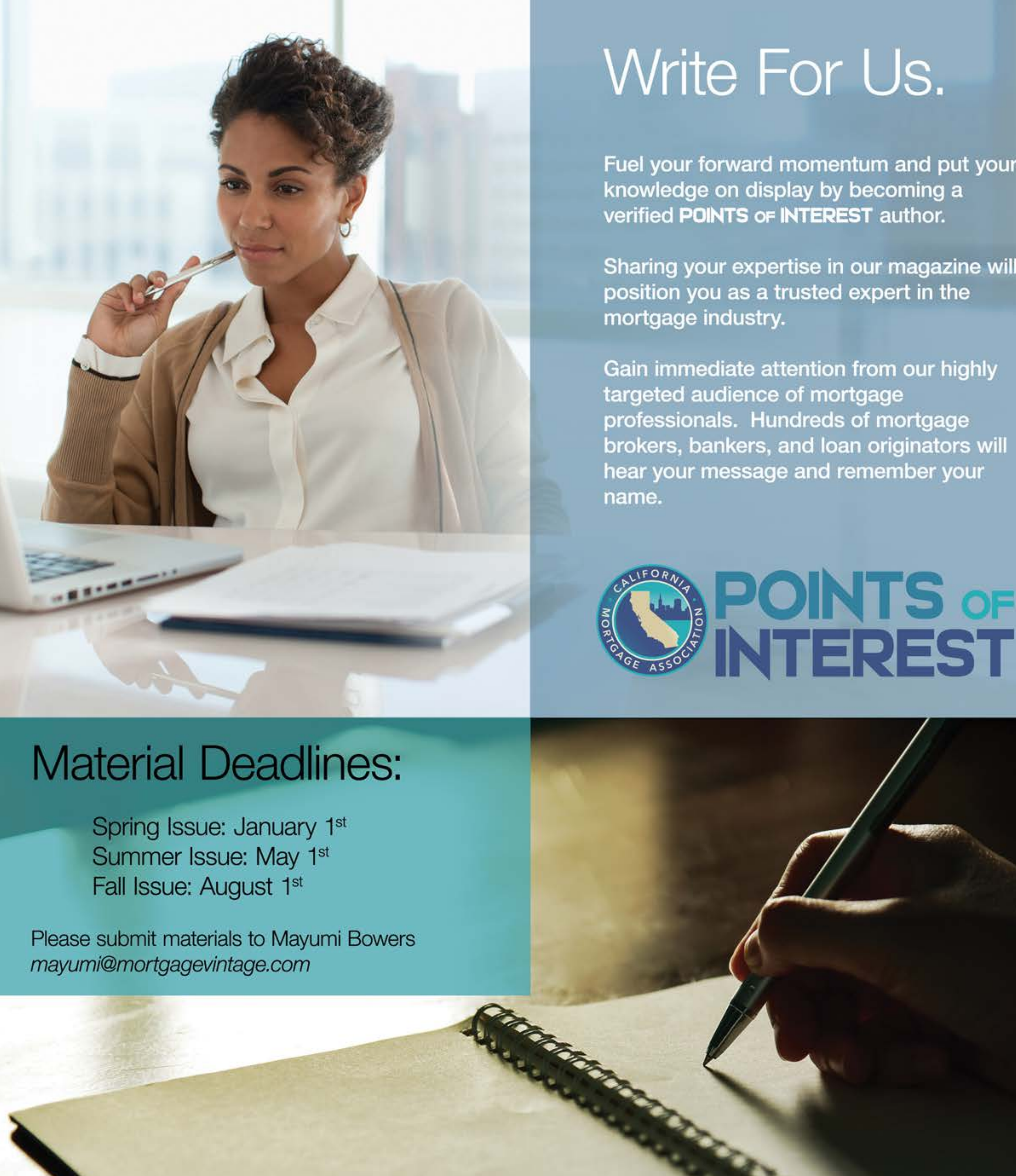

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