Joffrey Long, Private Money Expert Witness, Explains Fractionalized Trust Deed Investments

Investing in Part Of, or a Partial Interest in a Real Estate Loan


Joffrey Long

LOS ANGELES, CA, U.S., June 10, 2019 /EINPresswire.com/ -- Loans secured by trust deeds on California real estate may be suitable investments for qualified investors. Higher interest rates or net rates of return are possible with hard money loans. (private money)

Expert witness testimony, as well as actual making, arranging, selling, and loan servicing of fractionalized real estate loans has provided we with information and ideas presented here. As a licensed California Real Estate Broker and as a private money lending / hard money expert witness, I'm providing concepts for your consideration as you further investigate and consider trust deed investments. I'm not an attorney, so where I may testify in depositions, court trials and arbitration proceedings as a mortgage expert witness, my comments are not to be considered as legal advice or as any standard of care for participants in private money lending or related fields. Each loan, investor, and situation may be different than the ones anticipated here. (The terms "hard money loans" and "private money loans" are used interchangeably and have the same meaning.)

When loans are fractionalized, different investors own various percentages of the loan, meaning that each investor is putting up less than the entire amount required for the loan. An assignment of their interest in the trust deed (referred to as an assignment of partial interest) is recorded with the county recorder. Even trust deed investors who have enough money to fund an entire loan themselves often prefer investing in fractionalized portions of loans.

> Investing in fractionalized trust deeds diversifies your risk and reduces your exposure to individual loans."
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> *Joffrey Long*

Here's why:

We close hard money loans for apartment buildings, rental houses, small mixed-use properties, commercial properties and other income producing real estate. Most of the loans we fund are brought (brokered) to us by third-party originators such as mortgage brokers or other real estate loan originators.

After we provide the loan funds as a hard money direct lender, and close the loans with our own funds, the loans are re-sold as fractionalized trust deeds to private money investors.

We just closed a $750,000 first trust deed secured by a 10-unit apartment building. There are two primary ways trust deed investor funds could have been placed in this investment:
1 – An individual investor could have provided the entire $750,000 for the investment.
2- Various individuals could have invested smaller amounts, from $35,000 to $350,000, totaling the required $750,000. Each investor's ownership in a portion of the note / trust deed would be documented, and the recorded deed of trust, or recorded assignment of a portion of the deed of trust would reflect each investor's separate, recorded interest. Their investments are referred to as fractionalized interests and the loans are referred to as fractionalized loans or "multi-lender loans."

As payments are received by the loan servicer from the borrower, the loan servicer then distributes the monthly payments to the investors through issuance of monthly checks to each multi-lender investor, for their individual share of the payment received.

Being able to invest in this trust deed with as little as $35,000 opened the door to several investors who would not have been able to invest the $750,000 total required to fund the loan.

What you should know: How do people work together and invest in one or more trust deeds?

I'll describe some common steps in raising investor capital for fractionalized trust deeds. These apply only to certain situations and are not necessarily "the only right way" to do this.

• The loan originator, (individual or company making or arranging the mortgage) usually a licensed California real estate broker or other appropriate licensee, finds the loan opportunity.
• The loan originator may fund the loan with its own money, then offer to sell the fractionalized interests, or various percentages of the loan to individual private investors.
Or, the originator may have the individual fractionalized trust deed investors place their funds directly into the borrower's loan escrow. Once all the funds are deposited and other escrow and title conditions are met, the loan closes.

If a private money lender / mortgage broker has the individual investors place their funds directly into the borrower's escrow, the investors generally execute all the lenders instructions to escrow, the investor disclosures, and related documents prior to loan closing.

If, on the other hand, the loan originator is able to initially provide the funds and close the loan themselves, then sell the loan to the trust deed investors, the investors are not part of the borrower's original loan transaction and do not have to execute the original loan escrow instructions. In this case, they are considered "secondary market purchasers," or buyers of part of an existing, already-closed loan.

The distinction, as to whether the broker/originator provides funds and closes the loan, then re-sells the loan to private investors, versus a situation where the investors place their funds into the borrower's loan escrow is a very important issue. Although either method is acceptable when properly completed, investors should know which method is anticipated and should be familiar with the customary and regular practices of the broker/originator(s) that they are investing with. The disclosures and other documents will be different in some respects, for each method of investing. Investors should inquire about and have a basic understanding of the differences and their significance.

• The originator then enters into a loan servicing agreement with the investors, acting as the loan servicer for the loan, collecting payments, disbursing the investor's share of payments to them, providing necessary reporting, monitoring tax and insurance payments or impound/escrow accounts and when necessary, administering collection of delinquent payments, requests for mortgage assistance, providing foreclosure prevention alternatives, loan forbearance agreements and loan modifications, foreclosure of the property and ultimately, administration and liquidation of any real estate owned (REO) properties.

- Instead of handling the loan servicing, the originator/broker may have the investors enter into an agreement with an independent third-party loan servicing company who acts as an agent of the investor/lenders in servicing the loan. The broker/originator may also participate in the loan servicing, using a "sub-servicer" who provides certain services while the originator/broker performs other parts of the loan servicing functions.
- In the event of delinquency or default, the broker or servicer notifies the investors and upon their agreement, instructs the foreclosure trustee to begin filing a notice of default, the notice of trustees sale, and ultimately, provides opening bid information for a trustees sale foreclosure auction.
- There are generally few decisions that must be made by the investors. A majority of interests of the investors, (51% or more) will determine what actions are taken. This is outlined in the California Civil Code and is referred to as the "Majority Interest Rule."

There are "frameworks" or general procedures through which loans are closed and though which private investors are able to become the beneficiaries (owners) of those loans.

What are the advantages to investing
in fractionalized trust deeds?

- One of the common challenges for trust deed investors is simply keeping their funds invested. If you invest a significant amount of your available funds in one trust deed for $250,000 and the borrower pays off the loan early, then all that money remains uninvested until you find another suitable trust deed investment. If the same $250,000 is invested in 5 trust deeds of $50,000 each and even two of them pay off in the same month, you still have 60% of your funds invested.
- The impact of delays in payment or non-payment by borrowers is generally reduced by spreading the same amount of the investor's capital over several trust deeds, rather than having a larger amount invested in one trust deed.
- The investor's risk of having to advance a large amount of funds to cure delinquent property taxes or make other protective advances is reduced, in that the advances on an individual loan would likely be made by the various investors in accordance with their share of ownership.
- More time to investigate, ask questions, think, and decide: If an originator/broker has already funded and closed the trust deed with their own funds, which is generally the case with fractionalized trust deeds, any immediate urgency to close the borrower's loan is eliminated. This allows investors time to review the information from the originator/seller of the note, perhaps conduct their own investigation into the property value and title, and have attorneys, appraisers, or other advisors review the investment.
- Many investors use Individual Retirement Account (IRA) funds for trust deed investments. Often, the amount of funds available in an individual's IRA account is enough for a fractionalized interest in a loan, but not enough for the entire loan. IRA investors invest through a "self-directed IRA," set up through an "IRA Custodian."

Investing in fractionalized trust deeds diversifies your risk and reduces your exposure to individual loans.

Fractionalized trust deed investments can have problems. It's important to consider the risks:

- Investor disagreement: Although the holders of a majority in interest in fractionalized trust deeds may make certain decisions about the investment, there are instances where investor disagreement could cause delays or challenges.
- One or more of the investors could fail to advance their individual share of funds that may be needed to cure a property tax default or other funds needed to protect the investment.
- Difficulty in selling interests in fractionalized trust deed investments: As with individual, "whole loan" trust deeds, should an investor have a need for their funds prior to the loan paying off, an interest in a note secured by a trust deed may be difficult or impossible to sell.

These are some, but not all of the risks associated with trust deed investments. Before investing or becoming committed to invest any money, obtain and review the completed disclosures from the broker/originator(s) of the loan(s) as well as any other documents made available to you. Ask questions. If you're not comfortable with the answers, ask a qualified advisor who is not involved with the parties offering the trust deed investment.

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•The suitability of trust deeds as an investment for YOU, based on your circumstances, including your level of investment experience, your education, your net worth and income, your investment objectives, and your level of specific knowledge and experience with respect to trust deed investments
•Trust deeds in general, the risks, disadvantages and limitations
•The provider, trust deed investment company, or broker who is offering you the investment
•The loan servicer who will service the loan, their licensing, knowledge, experience, and policies with respect to servicing multi-lender loans
•The specific California trust deeds or types of fractionalized real estate loans being offered and their suitability for your circumstances and investment objectives

As a licensed real estate brokerage offering trust deed investments, we are also required to inquire about, gather information and consider the five points listed above, among other factors. We will provide you with the "Investor Suitability" form from the California Department of Real Estate. Please e-mail or call and we'll send it.

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