

Perspective



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This newsletter is designed to address legal issues that impact lending in Florida. Whether making loans or collecting bad loans, *The Lender's Perspective* will provide timely and valuable insight to the creditor.

Taking Title to Real Estate Collateral in a Special Purpose Entity

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This issue of *The Lender's Perspective* will focus on a lender taking title to real estate collateral in a special purpose entity. In this article, a "special purpose entity" will be defined as any entity created and wholly owned by a lender for the purpose of holding title to real property obtained by foreclosure or deed in lieu of foreclosure.

Why take title in a special purpose entity?

A reason often given by lenders for holding title to OREO assets in a special purpose entity is limitation of liability. With this structure, lenders aim to protect their principal business from the risks of owning real estate. These risks include the presence of hazardous waste on the property, injuries to individuals on the property, violations of local ordinances and laws, claims of tenants in possession and claims brought by subsequent purchasers of the property. While much of the potential liability can be

mitigated by insurance, many lenders feel more comfortable with title being held separately.

How to take title in a special purpose entity.

Title to OREO property typically vests in a lender either by foreclosure or deed in lieu of foreclosure. In either case, a special purpose entity can be used to hold title to the property and, with some planning, this can be accomplished without significant transactional costs. Let's look at each scenario and consider the best way to reach the lender's objective.

First, consider a pending foreclosure case. The prevailing mortgage holder will obtain a final judgment foreclosing its mortgage. If it merely proceeds to the public sale, is the high bidder and takes no further action, the clerk will issue a clerk's certificate of title to the foreclosed property in the name of the mortgage holder. Unless this happens to be the special purpose entity, there will need to be a subsequent conveyance. This may cause documentary stamp tax to be due and, in any event, the lender will be in the chain of title which is generally what is intended to be avoided. Alternatively, the holder of the foreclosure judgment could assign its judgment and foreclosure sale bid

rights to the special purpose entity prior to the foreclosure sale. This can be done in the pending lawsuit and, when completed, the special purpose entity is the bidding entity at the foreclosure sale. If it is the high bidder, title will be issued in its name, thus accomplishing the lender's objective.

Next, consider the case of a deed in lieu of foreclosure. Here, the borrower is agreeing to convey title to the lender voluntarily and without the necessity of a foreclosure lawsuit. One way to achieve the lender's objective is to first assign the promissory note and mortgage to the special purpose entity. The only cost of the assignment, other than document preparation, is the nominal cost to record the mortgage assignment. Once this step is taken, the lender can proceed with the deed in lieu which will be made directly to the special purpose entity as the holder of the note and mortgage. You should make sure that all of the borrower's releases and indemnifications run both to the special purpose entity and to the lender.

Transfers After the Fact

What happens if you fail to plan ahead and instead acquire the property in the name of the lender itself? You can always transfer the title to the special purpose entity but

you need to keep a few things in mind. First, at a minimum, you should convey by a special warranty deed. A grantor in a special warranty deed is making certain title warranties but only as to what occurred while it was in title. Resist the urge to use a quit claim deed as title insurers are sometimes hesitant to issue policies where a quit claim deed appears in the chain of title. This can create issues when you later sell the property to a third party.

Next, remember that a deed is subject to documentary stamp tax which is levied by the State of Florida at the rate of seventy cents per one hundred dollars of consideration. The question is whether

there is any consideration paid when a transfer to a single purpose entity occurs. In 2005, the Florida Supreme Court decided a case which held that no documentary stamp tax would be due on a deed from the owner of property to a wholly owned legal entity provided that the property was not encumbered by a mortgage and provided no other consideration was paid. This decision was confirmed by new legislation that took effect last year. Accordingly, so long as the bank that owns the real property also is the sole owner of the special purpose entity, and provided the property is not encumbered, the transfer should be able to be made without incurring liability for documentary stamp tax.

Mr. Waldorf is a Board Certified Real Estate Lawyer whose practice focuses on banking industry clients. He represents lenders in commercial and residential loan transactions, mortgage foreclosures, deeds in lieu of foreclosure, forbearance agreements, and defaulted loan workouts.



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As always, thanks for reading and watch for the next issue of The Lender's Perspective. This newsletter is written quarterly and back issues are available at www.henlaw.com.



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