

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.

Buying and Selling Loan Documents

By Douglas L. Waldorf, Jr., J.D., M.B.A.

Regardless of the state of the economy, there always seems to be a high level of interest in the topic of buying and selling bank loan documents.

When times are good, lenders follow this avenue to save transactional costs and make their proposals more competitive. In hard times, banks are willing to sell documents to facilitate moving loans out of their portfolios. Let's take a closer look and clear up a few myths along the way.

Buying Loan Documents Saves Closing Costs. True or False?

The answer is "maybe." When a lender purchases documents from a prior lender, there are savings in certain line items. Most notably, there may be savings in documentary stamp tax on the note. Remember that in Florida, documentary stamp tax is due on certain obligations, including a promissory note. However, if the purchasing lender is advancing only the amount of the outstanding principal balance of the note, there is no additional documentary stamp tax due. If there will be new money advanced (defined as *any funds in excess of the principal balance of the old note*), that sum is taxable. It is important to remember that the loan documents

must be prepared in a manner that will meet the approval of the Department of Revenue in order to take advantage of this savings.

Another transactional cost for real estate secured loans, intangible tax, may be reduced by purchasing documents. Typically, when an existing mortgage is assigned to a new lender, the assignment is not subject to intangible tax; however, any new money is. Another point to mention is the lien priority of new money. In order to protect the priority of the new money, it must be documented as a future advance to the mortgage. Careful review of the existing mortgage is required to make sure that it permits a future advance as described in the Florida Statutes.

A final area of savings may be in the cost of title insurance coverage for the mortgage. Generally, no new premium is charged when a mortgage is assigned from one lender to another. However, coverage under the existing loan policy declines as principal is repaid and new money which is insured will result in additional premiums.

Buying Loan Documents Increases Closing Costs. True Or False?

Again, the answer is "maybe." With all the possible savings, when is it not beneficial to buy loan documents? Keep in mind that a bank is not *obligated* to transfer documents

to another lender. It may or may not do so, depending on various factors. Many times a selling bank will charge a fee for the document sale and this reduces any cost savings. In addition, there is often more work involved in handling this type of transaction. Bank attorneys will need to spend additional time to review prior loan documents, as well as prepare new or amended documents to comply with the requirements of the new lender. In addition, transfer documents will also need to be prepared. These typically include an assignment document, UCC-3 forms and an allonge to the promissory note.

There Is Legal Risk Involved In Buying Loan Documents. True Or False?

This is true and here is why: the acquiring bank "steps into the shoes of" the selling bank. If the seller created liability, the buyer may well inherit it. For example, a mistake in calculation or payment of documentary stamp tax made in connection with the prior loan may come to light long after the documents have been sold to the new lender. The auditors will ultimately try to collect the unpaid taxes, penalties and interest from the current noteholder. Further, common practice is for the selling bank to sell the documents "as is, where is" with no representations or warranties of any kind. Many assignment forms even call

for the purchasing bank to indemnify and hold the selling bank harmless for liability arising out of the loan transaction.

Will the buying bank have complete knowledge of the relationship between the borrower and the former lender? Likely not. Could there be lingering issues that may give rise to lender liability? Possibly. In order to reduce the risk, the buying bank will want to have the borrower and all guarantors sign releases covering any such potential claims. In this manner, all parties can start with a clean slate. In fact, many banks will have restated documents prepared which will govern the relationship going forward.

How Do I Pursue a Loan Document Purchase?

Unfortunately, setting up a transaction of this type requires, at some point, communication with the prior lender. This can be an issue since the existing bank is then given the opportunity to compete for the chance to retain the business. In a traditional loan payoff, the prior bank often is unaware that its loan is being refinanced until shortly before closing when a payoff letter is requested. Due to the time

involved in obtaining and reviewing prior documents, the buying bank cannot wait until the last minute in a document purchase transaction. The borrower will also want to determine what fee, if any, the selling bank will charge.

Putting It All Together

Once a determination has been made to buy documents and the prior bank has agreed to sell its documents, bank counsel will need to: (i) review the prior loan documents; (ii) obtain an updated title search of real estate collateral and/or lien search of personal property collateral; and, (iii) prepare the transfer documents and the new loan documents. A payoff letter will be obtained so as to permit confirmation of the entire payoff amount, as well as the outstanding principal loan balance. Finally, the new loan will be closed and the documents effectively "sold" to the new lender.

Closing Thoughts

The selling bank should, upon receipt of its payoff, provide the assignment documents and all of its original loan documents to the new lender. Particular attention should

be given by the purchaser to obtaining the original promissory note (not a mere copy) and also the original mortgagee title policy. Most selling banks do not provide underwriting related documents such as credit approvals, internal memos and the like.

It is also often helpful to send a follow-up letter to the selling bank reminding it that it has sold the documents and therefore should not record a mortgage satisfaction or UCC-3 termination. More than once I have had a selling bank's operations department do this months after the document sale transaction occurred which always creates unnecessary work to clarify the error!

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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In the next issue of The Lender's Perspective we will tackle deeds in lieu of foreclosure. Until then, thanks for reading!

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