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REAL ESTATE NOTE SALES

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Many lenders are using note sales as a way of disposing of distressed loans secured by real estate. The note is sold at a discount to a buyer who is interested in the note at the reduced price or in acquiring the real estate securing the note. Understanding the key elements of a note sale helps in structuring the best deal.

In a distressed note sale, the lender sells the note and mortgage covering the real estate as opposed to foreclosing the mortgage after default and selling the underlying real estate itself. The note sale allows the lender to recoup losses without the time and expense of foreclosure and resale of the real estate. The buyer steps into the lender's position under the loan, and after closing, can exercise the lender's remedies under the loan documents for a borrower default, including foreclosure on the real estate.

The lender typically sells the note to the buyer "as-is" with few representations and warranties and without recourse against the lender if the borrower fails to pay the note. The buyer will therefore need to conduct due diligence on two levels – on the loan documentation and financial ability of the borrower and any guarantors to perform – and on the underlying real estate. Careful review of the loan documents by the buyer is important as the buyer will be saddled with any problems in enforcing the loan caused by inadequacies in the loan documents. The buyer may request an estoppel certificate from the borrower and any guarantors in order to confirm agreement on the loan balance and payment obligations. At the property level, the buyer will want to review updated title work to make sure that no additional liens have been filed against the real estate. The buyer will also want to determine the environmental condition of the real estate.

At closing, the buyer takes possession of the original note, endorsed to the buyer by the lender. An assignment of the mortgage is recorded in the county in which the real estate is located, and deposits for taxes and insurance held in escrow by the lender are transferred to the buyer. The buyer may obtain an endorsement to the existing mortgagee title policy reflecting the buyer as the new owner of the loan.

Note sales pose numerous risks for the buyer after closing. The borrower may fail to pay the note, damage the real estate, contest foreclosure, or file for bankruptcy. The buyer should consider whether the proposed discount for the note is sufficient to account for such risks. With good communication of concerns, the buyer and lender can hopefully arrive at a price for the note that will allow both parties to achieve their goals.

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