



Sunset Equity Funding

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Understating Trust Deed Investments

Trust Deed investment is when one simply invests in loans secured by real estate. These are generally short term loans typically ranging from 6 months to 3 years. In the current economic climate, professional real estate investors are buying properties at foreclosure sales for bargain basement prices, fixing-up these properties, and reselling them for a profit. Obtaining financing from a private party allows the investor to submit all cash offers and or smaller closing time to ensure a competitive offer.

1- Securities Laws

When one arranges for the Investor participation in a loan, securities are essentially being sold and strict compliance with SEC laws must be adhered to. Majority of brokers engage in fractionalizing a trust deed investment - that is when they have a loan to fund and they gather more than one investor to fund the loan, thus creating a securities risk, a syndicator has two options for complying with the securities law. It is important to ensure that investors only deal with companies such as Sunset Equity Funding who is properly organized to accept investors' funds under the Jobs Act or a licensed professional when investing in Deeds of Trust.

2- Direct Investment v. Indirect Investment

- a. Direct Trust Deed investment is when a loan broker arranges for the investor to directly invest in a predetermined loan scenarios. At which point, the investor will deposit its money into escrow and the loan gets funded. The investor will have his or her name or his entity's name on the deed of trust securing the real property with an associated percentage representing the amount he or she has funded. For instance if the loan is for a \$1,000,000 and in the investor funds \$100,000, the investor will get 10% interest in the note. The risk associated with this method is that in the event the borrower fails to make payment, it's up to the investor(s) to come together and formulate an enforcement action such as foreclosure, lawsuit etc. During which time no payment will be made to investors and the ones that are dependent on the income may find themselves in a dire situation.



The loan broker is also out of the picture at this point and the investor is simply on his own. Therefore, in order to ensure one is made whole, it must do its own due diligence to decide the suitability of the investment and the retained equity in the collateral.

- b. Indirect Trust deed investment is when the investor places its monies with a company that does the investment for them. Depending on the Private Placement Memorandum or offering, the deed of trust is held by the investment firm and separate note evidencing investors share. In the event of non payment by the borrower, the investor continues to get paid and the company will be responsible for collection effort.

3- Fractionalizing a trust deed

When a loan broker is retained by a borrower to solicit and arrange a large loan to be secured by real estate. The borrower and the broker enter into a loan agreement contingent on the broker locating trust deed investors with sufficient funds.

To fund the loan, the broker runs newspaper advertisements soliciting private investors with modest funds to form a trust deed investment group consisting of ten or less investors. The loan is too large for any one of the investors to handle alone or to prudently carry the entire risk of loss.

As investors respond to the advertisements and subscribe, their funds are placed in a loan escrow trust account set up specifically for this loan until sufficient funds accumulate to fund the loan. When fully funded, the borrower signs and delivers his note and trust deed to the loan escrow. Both documents reflect the fractional ownership of the note and trust deed by the numerous investors as beneficiaries, based on their proportional investments.

The broker concurrently enters into a collection and servicing agreement, signed by each of the investors, to service the note and trust deed as their collection agent. The broker is authorized by the agreement to:

- advance payments to the investors from his own funds to cover any delinquent installments; and
- bid in the property for his own account in the event of a foreclosure under the investors' trust deed.

4- Investment Risk

The broker's *singular activity* of fractionalizing the investment in a note and trust deed among multiple private investors creates a corporate security. [*People v. Schock* (1984) 152 CA3d 379] Anytime a loan broker syndicates trust deeds creates it creates a *corporate security* if:



- he accepts money from an investor or executes promissory notes before locating the trust deed investment, called a *blind pool investment*; or
- the trust deed is fractionalized among multiple investors rather than acquired by one trust deed investor for his own account.

However, a broker can package multiple lender trust deed investments and avoid securities violations, provided his conduct falls within one of two readily available exemptions from the securities law.

5- The ten-or-less rules and reporting

The ten-or-less trust deed investment scheme allowing a loan broker to publicly solicit investors to acquire a fractional interest in a trust deed note is structured on compliance with the following rules and guidelines:

- a. A notice permit or claim of exemption, is prepared and filed with the DRE within 30 days after:
 - i. the loan broker originates or sells the first trust deed note made or acquired by ten-or-less investors he solicited from the public;
 - ii. any change to the information in the original notice, called an amendment [Calif. BP §10238(a)]; or
 - iii. the broker becomes the servicing agent for fractionalized trust deed notes with payments exceeding \$125,000 during any three-month period or payments during any three-month period are distributed to more than 120 investors. [BP §10238(b)]

6- Advertising

All advertising employed for transactions under this article shall show the name of the broker and comply with Section 10235 of this code and Sections 260.302 and 2848 of Title 10 of the California Code of Regulations. Brokers and their agents are cautioned that a reference to a prospective investor that a transaction is conducted under this article may be deemed misleading or deceptive if this representation may reasonably be construed by the investor as an implication of merit or approval of the transaction. [BP §10238(c)]

7. The trust deed to include:

Each parcel of real property directly securing the notes or interests shall be located in this state, the note or notes shall not by their terms be subject to subordination to any subsequently created deed of trust upon the real property, and the note or notes shall not be promotional notes secured by liens on separate parcels of real property in one subdivision or in contiguous subdivisions.

For purposes of this subdivision, a promotional note means a promissory note secured by a trust deed, executed on unimproved real property or executed after construction of an improvement of



the property but before the first purchase of the property as so improved, or executed as a means of financing the first purchase of the property as so improved, that is subordinate, or by its terms may become subordinate, to any other trust deed on the property. However, the term “promotional note” does not include either of the following:

A note that was executed in excess of three years prior to being offered for sale.

- i. (2) A note secured by a first trust deed on real property in a subdivision that evidences a bona fide loan made in connection with the financing of the usual cost of the development in a residential, commercial, or industrial building or buildings on the property under a written agreement providing for the disbursement of the loan funds as costs are incurred or in relation to the progress of the work and providing for title insurance insuring the priority of the security as against mechanic's and material men's liens or for the final disbursement of at least 10 percent of the loan funds after the expiration of the period for the filing of mechanic's and material men's liens. [BP §10238(d)]

8. Real estate broker acting as either a principal or an agent to finance:

The notes or interests shall be sold by or through a real estate broker, as principal or agent. At the time the notes or interests are originally sold or assigned, neither the broker nor an affiliate of the broker shall have an interest as owner, lessor, or developer of the property securing the loan, or any contractual right to acquire, lease, or develop the property securing the loan. This provision does not prohibit a broker from conducting the following transactions if, in either case, the disclosure statement furnished by the broker pursuant to subdivision (I) discloses the interest of the broker or affiliate in the transaction and the circumstances under which the broker or affiliate acquired the interest:

- a. A transaction in which the broker or an affiliate of the broker is acquiring the property pursuant to a foreclosure under, or sale pursuant to, a deed of trust securing a note for which the broker is the servicing agent or that the broker sold to the holder or holders.
- b. A transaction in which the broker or an affiliate of the broker is reselling from inventory property acquired by the broker pursuant to a foreclosure under, or sale pursuant to, a deed of trust securing a note for which the broker is the servicing agent or that the broker sold to the holder or holders. [BP §10238(e)]

9. The fractional interests are sold to 10 or less investors.

- a. The notes or interests shall not be sold to more than 10 persons, each of whom meets one or both of the qualifications of income or net worth. [BP §10238(f)(1)]

Investor must make a statement similar to below:



Transaction Identifier: _____

Name of Purchaser: _____

Date: _____

Check either of the following if true:

- My investment in the transaction does not exceed 10% of my net worth, exclusive of home, furnishing, and automobile.
- My investment in the transaction does not exceed 10% of my adjusted gross income for federal tax purposes for my last year, or, in the alternative, as estimated for the current year.

Signature.

- b. The number of offerees shall not be considered. [BP §10238(f)(2)]
- c. Spouses and their dependents, and an individual and his or her dependents, shall be counted as one person. [BP §10238(f)(3)]
- d. A retirement plan, trust, business trust, corporation, or other entity that is wholly owned by an individual and the individual's spouse or the individual's dependents, or any combination thereof, shall not be counted separately from the individual, but the investments of these entities shall be aggregated with those of the individual and counted as one. [BP §10238(f)(4)]
- e. The "institutional investors" enumerated in subdivision (i) of Section 25102 or subdivision (c) of Section 25104 of the Corporations Code, or in a rule adopted pursuant thereto, shall not be counted. [BP §10238(f)(5),]
- f. A partnership, limited liability company, corporation, or other organization that was not specifically formed for the purpose of purchasing the security offered in reliance upon this exemption from securities qualification is counted as one person [§10238(f)(6)]

10. Recordation of Interest

The investor's interest in the trust deed as a named beneficiary will be recorded before a release of the funds from escrow.

11. Maximum Lending Value

Based on the combined principal amounts of the fractionalized note and any prior encumbrances (bonds and trust deeds), as well as the current market value of the real estate as stated in a written opinion of value by an appraiser or the broker, the loan-to-value (LTV) ratio must not exceed the greater of:

- a. 80% for owner-occupied, single-family residences;
- b. 75% for non-owner-occupied, single-family residences;
- c. 65% for commercial and income-producing property;
- d. 65% for single-family, residential-zoned lots or parcels;



- e. 50% for undeveloped property zoned for commercial or residential use;
- f. 35% for other real estate; or
- g. the percent of value set by any private mortgage insurance (PMI) coverage issued for the fractionalized note. [BP §10238(h)(1)]

Note — The percentage amounts specified above may be exceeded when and to the extent that the broker determines that the encumbrance of the property in excess of these percentages is reasonable and prudent considering all relevant factors pertaining to the real property. However, in no event shall the aggregate principal amount of the notes or interests sold, together with the unpaid principal amount of any encumbrances upon the property senior thereto, exceed 80 percent of the current fair market value of improved real property or 50 percent of the current fair market value of unimproved real property, except in the case of a single-family zoned lot or parcel as defined, which shall not exceed 65 percent of the current fair market value of that lot or parcel, plus the amount insured. A written statement shall be prepared by the broker that sets forth the material considerations and facts that the broker relies upon for his or her determination, which shall be retained as a part of the broker's record of the transaction. Either a copy of the statement or the information contained therein shall be included in the disclosures required pursuant to subdivision (l). [Bus & P C §10238(h)(2);

12. Transaction document and Disclosures

A default upon any note or interest is a default upon all notes or interests and,

- a. The holders of more than 50 percent of the recorded beneficial interests of the notes or interests may govern the actions to be taken on behalf of all holders in accordance with Section 2941.9 of the Civil Code in the event of default or foreclosure for matters that require direction or approval of the holders, including designation of the broker, servicing agent, or other person acting on their behalf, and the sale, encumbrance, or lease of real property owned by the holders resulting from foreclosure or receipt of a deed in lieu of foreclosure.

Note — The terms called for by this section may be included in the deed of trust, in the assignment of interests, or in any other documentation as is necessary or appropriate to make them binding on the parties.

- b. The broker must disclose to the investors the identity of the specific trust deed note he is under contract to arrange or buy, thus eliminating the formation of blind pool trust deed investments under the ten-or-less notice of exemption. [BP §10238(j)]
- c. On the sale of fractional interests, the investors' funds must be deposited in a neutral escrow and disbursed on the recording of the investors' individual interests as named beneficiaries in the trust deed and note. [BP §10145(b)]
- d. The broker must maintain records of the loan transaction, clearly identifying the manner of the receipt and disbursement of the investors' funds. [BP §10238(j)(3)]

13. Servicing Agreement



Is an agreement entered into for managing the trust deed investment is entered into by the investors, in which the broker (or other licensed person) agrees to receive payments on the note, disburse the payments received to the investors and begin foreclosure proceedings on a default in the trust deed.

The trust deed loan collection agreement contains provisions for:

- a. the deposit of payments into the broker's trust account on their receipt;
- b. the disbursement to the investors of their pro rata share of the payments within 25 days of receipt;
- c. notice to the investors if the source of payments is other than the borrower;
- d. no guarantee or advance of funds for payments by the broker, unless the advance is due to the borrower's check being dishonored and the investor is notified within 10 days;
- e. filing a request for notice of default (NOD) on prior encumbrances; and
- f. sending investors a copy of any notice of trustee's sale (NOTS), filed on their behalf, or a request for reconveyance. [BP §10238(k)]

14. Material facts will be disclosed to the investors on a DRE designed form.

The Terms of the sale of undivided interests in the trust deed note include:

- a. if it is an origination of a trust deed loan, the name and address of the escrow holder, date for closing and an itemized list of the costs incurred by the borrower and the investors on the origination [BP §10238(l)(1)(B)];
- b. if it is the acquisition of an existing note, its sale price, any premium or discount on the principal balance and unpaid interest, the effective rate of return, name and address of the escrow holder and the itemized costs incurred by the seller and the investors on the sale [BP §10238(l)(1)(A); or
- c. if the note is secured by a blanket trust deed as a lien on more than one parcel of real estate, additional disclosures of the identification and value of each parcel, the dollar amount of equity in each property after an apportionment of the amount of the trust deed note to each parcel and the resulting LTV ratio for each parcel. [BP §10238(l)(1)(C);]
- d. All other relevant material facts affecting the sale of the trust deed note.

15. Disclosure of other investors

On request from an investor, the broker must notify the investor of the names and addresses of all other investors in the note. [BP §10238(m)]

16. Brokers option to Buy



The broker is prohibited from acquiring, directly or indirectly, an option to buy the interests of the investors in the note or to acquire the real estate as part of the initial transaction to acquire, originate or service a fractionalized note. However, the broker, after completing the syndication of the note or entering into a service agreement, may later enter into an agreement to purchase an interest in the note or the real estate if it is negotiated at the time of his purchase. [BP §10238(n)]

17. Broker Servicing

If the broker sells, originates or services fractionalized notes, and the amount of payments received from all sources in any three-month period exceeds \$125,000 or the number of all investors participating during a three-month period exceeds 120, the broker must:

- a. have his trust account inspected by a certified public accountant (CPA) and forward the CPA's trust account inspection report to the DRE within 30 days after the period in review [Bus & P C §10238(k)(3);]
- b. file an annual report on the status of the trust account with the DRE [BP §10238(o);];
and
- c. file an annual report of his trust deed sales, originations and servicing with the DRE. [BP §10238(p);]

For more information please contact Benjamin Donel Esq. at Sunset Equity Funding (www.sunsetequigyfunding.com)

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