

TRUST DEED INVESTMENTS

WHAT YOU SHOULD KNOW!!

By

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INTRODUCTION

The advantages of *Trust Deed Investments* are brighter at this time than they have been for many years. Although Trust Deed investing is relatively simple, it is often misunderstood. It is our objective in this report to help people clearly understand how this type of investment works and the good sense it makes for someone seeking a secure investment with a good rate of return.

The terms “Trust Deed” or “Deed of Trust” are often used interchangeably to describe an investment in a Promissory Note secured by a Deed of Trust recorded against a parcel of real property.

WHAT IS A TRUST DEED INVESTOR?

When you invest money in Trust Deeds, you become what is known as a “Private Money Lender.” Much like a bank, you loan money to a property owner secured by his real estate.

SECURED INVESTMENT

Today’s investor is presented with a tremendous number of opportunities for his investment dollar. During this period of weak and volatile stock market performances and low interest rates on CDs and money market accounts, few alternatives remain that make sense for investment capital. The primary difference among investment options and strategies is the level of risk. While all investments bear some type of risk, *Trust Deed Investments* can be one of the safest investment alternatives available because the investment is secured by real estate.

Essentially, you are investing your money in a debt obligation (Note) from a property owner, secured by a Deed of Trust, which is a legal instrument used to perfect a security interest in real property. Simply stated, when one invests in a Note, the collateral is real estate secured by a Deed of Trust that is recorded in the county where the property is located. This protects the investor (Lender) if the borrower defaults on the loan. The investor has the right to foreclose on the property if the borrower does not fulfill his or her obligations as detailed in the Deed of Trust.

HIGHER RATES OF RETURN

In addition to the security of real property behind the loan, there is also the advantage of receiving higher than usual rates of return for the Trust Deed investor. The reason for this higher rate of return on the investment is twofold: First, the borrowers are willing to pay a higher than market interest rate due to the flexibility private investors provide when making such loans. Private investors are not limited by the traditional rules and criteria that banks set. They can make loans quicker with far fewer hoops for the borrower to jump through. Second, Trust Deed Investments offer investors a retail rate of interest on their invested capital. Investments in Notes secured by Deeds of Trust usually have a higher yield than bonds, CDs, or insurance annuities, because those investments are “wholesale investments”. Investors in those products give their funds to a party paying interest at wholesale rates. The corporation, bank or insurance company offering the investment then in turn reinvests those funds at higher rates to earn the retail rate of interest on those funds.

TRUST DEEDS VS. MORTGAGES

Today, people commonly refer to the debt on their real estate as a “mortgage”. Most often, the correct term they should be using is “Deed of Trust” or “Trust Deed” depending upon the customary term in the state where the property is located. A true “mortgage” is rarely used anymore except on agricultural properties because of all the advantages a Deed of Trust offers. A Trust Deed is the document used to secure the debt and is recorded as a lien on the real property. Professionals in the lending business add to the confusion between the two terms. For example, companies that make home loans often refer to themselves as mortgage companies when they are actually companies that make loans to borrowers secured by Deeds of Trust. There are several important distinctions between a Deed of Trust and a Mortgage. Some of the benefits of Deeds of Trust arise from these distinctions and are discussed below.

Non-Judicial Foreclosure. The principal advantage of a Deed of Trust is that the investor (Lender) has an effective fast and final option by which to recover his investment in the event of a default. This option, “non-judicial foreclosure”, allows the investor to sell the property at a public auction to recover the money he is owed. Non-judicial foreclosure means that the investor can initiate the process of foreclosure without the services of a lawyer or judge, and without a court proceeding. In fact, in some states the process can be started the first day after a payment is missed. A “mortgage” in default must be foreclosed “judicially” which means an actual legal proceeding must be filed in court against the borrower and in some instances can be very costly and take many months to complete.

No Right of Redemption. Another advantage of a Trust Deed over a Mortgage is that the “right of redemption” after the foreclosure sale does not exist with a Trust Deed. A right of redemption under Mortgage laws gives the borrower a time period (usually six months) to repurchase its interest in the property after the judicial foreclosure sale has been completed. When a non-judicial foreclosure sale occurs under a Deed of Trust, the sale is final and there is no right of redemption. This is important because clear and marketable title can then be immediately passed to the successful bidder at a foreclosure sale.

As these examples show, not only is a Trust Deed exceptionally secure, but it also provides a fast, simple and effective process by which to recover investment dollars. Although it is unlikely a prudent investor will have to resort to these processes, they are readily available and provide encouragement for a borrower to quickly pay any funds that are due or risk losing the real property.

UNDERSTANDING THE PROMISSORY NOTE AND DEED OF TRUST

The promissory note and the deed of trust describe the rights and responsibilities of the borrower and the lender. These documents provide the mechanism for the lender to foreclose.

Promissory Note. The Promissory Note is the document in which the borrower promises to repay the money that was loaned. This Note sets forth the amount borrowed, the interest rate and the particulars on how the loan is to be repaid. Typically, a Promissory Note is no more than one or two pages in length and is relatively easy to understand. There are two parties to a Promissory Note:

- ***The Borrower.*** The borrower is the person or persons who have borrowed the money. The borrower is sometimes referred to as the payor or obligor. This also includes anyone who may have co-signed on the loan such as a spouse, non-marital partner or business partner.
- ***The Lender.*** The lender is the person or financial institution that originally loaned the money or any person or financial institution to whom the original lender sold your Note. The lender is sometimes referred to as the payee, obligee or holder. The current lender may be a company or person that specializes in buying promissory notes from original lenders.

Deed of Trust. At the closing of a loan, in addition to the Note, the borrower also signs a Deed of Trust. Lenders require that borrowers pledge property as security (collateral) for their loan. A Deed of Trust is a security agreement and evidence of the lender's interest in the property. To be valid, a Deed of Trust must be recorded in the county recorder's office of the county in which the property is located. The deed of Trust creates a lien (legal claim) against the property, which remains in full force until the loan is repaid or the lender forecloses.

Parties to a Deed of Trust. There are three parties involved in a deed of trust: the **grantor** (the borrower), the **beneficiary** (the lender) and the **trustee** (an individual or company authorized to foreclose if the borrower defaults.)

- ***The Grantor.*** The grantor is the person, or persons, who owns the property, has signed the Promissory Note and has pledged the property as security for the loan. The grantor is the borrower.
- ***The Beneficiary.*** The beneficiary is the person or business that loaned the money to purchase or refinance the property. If the original beneficiary sells the loan, the person or business that purchases the loan will be the new beneficiary.

- **The Trustee.** The trustee is the party who receives “bare legal title” to the property when the Deed of Trust is recorded. The trustee holds “bare legal title” as security for repayment of the loan. The trustee serves two primary functions:
 1. Conducts a foreclosure of the property if there is a default on the loan, *or*
 2. Return the Deed of Trust to the borrower and remove the lien from the property when the loan is paid in full (called reconveyance).

To conduct a foreclosure or reconvey (return) a Deed of Trust, a trustee cannot act on their own. A trustee will be involved only upon the request of the beneficiary (the lender.)

THE NON-JUDICIAL FORECLOSURE PROCESS

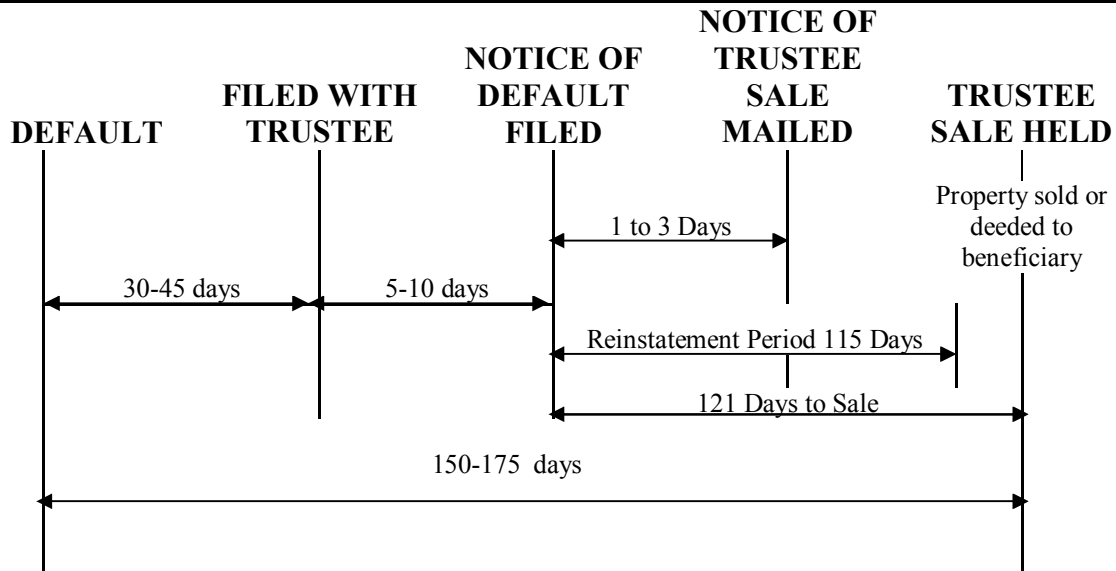
The foreclosure process begins when the lender (the beneficiary) requests the Trustee to record a “**Notice of Default**” in payment of the promissory note held by the beneficiary as security on the property.

The trustee, as the neutral third party in the non-judicial foreclosure process, is responsible for administering the entire foreclosure process on behalf of the beneficiary. Upon receipt of the request to start a foreclosure from the beneficiary, the trustee orders a Title Report on the property as the first step in the preparation of the Notice of Default. This report is entitled the “**Trustee Sale Guarantee**” and is prepared by a title company and normally requires 5 to 10 days to complete. It lists all liens, judgments and encumbrances recorded against the property and the owner. Upon receipt of the Trustee Sale “Guarantee, the trustee records the Notice of Default with the county recorder in the county to which the property is located. This action officially commences the foreclosure “reinstatement” period.

Next, the trustee will mail a “**Notice of Trustees Sale**”. This Notice of Trustees Sale notifies the grantor and all interested parties that the property is in default and is scheduled for public auction on a specific date, at a specific location and time. The Notice of Trustee Sale must be published once a week for four consecutive weeks in an authorized publication that has a general circulation in the county where the property is located. The law requires that the grantor and all parties with an interest or claim in the property be mailed a copy of the Notice of Default and a Notice of Trustees Sale by certified mail no less than 120 days before the date of the scheduled trustee’s sale. If the borrower does not by the 115th day (after the recording of the Notice of Default) reinstate the loan; the beneficiary has the option of demanding the payment in full, including all fees and expenses, as a condition of stopping the sale.

Loans not reinstated or paid in full will result in the property being offered for sale at public auction on the date, time and location stated in the Notice of Trustees Sale document. At the trustee sale (public auction) the successful bidder will receive a Trustee’s Deed, which conveys title and ownership of the property in default. Properties not sold at the sale to third parties are deeded to the beneficiary (the lender) through a credit bid. This happens most of the time.

IDAHO'S TYPICAL NON-JUDICIAL FORECLOSURE TIME LINE



ACTION	WHEN	PURPOSE
Trustee sends borrower a Notice of Default and Notice of Trustee's Sale.	After the loan has gone into default, trustee must comply with time requirements for recording and giving notice.	Gives borrower notice of being in default and that Trustee has begun foreclosure proceedings.
Reinstatement Period	A minimum of 115 days from date Trustee records Notice of Default.	Gives borrower opportunity to bring loan current by paying arrears, lender's costs and expenses.
Notice of Trustee's Sale	Trustee sends notice to borrower a minimum of 120 days before the auction date.	Informs borrower where and when property will be sold.
Redemption Period	Last 5 business days before Trustee's sale.	Borrower may stop foreclosure by paying off entire balance of loan plus foreclosure cost.
Trustee's Sale	Date listed on Notice of Trustee's Sale, which must be at least 120 day's after Notice of Trustee's Sale was mailed to borrower and other interested parties.	Trustee sells property at auction. Trustee gives buyer a Trustee's Deed upon Sale.

WHAT IS FRONTLINE FINANCING'S ROLE IN THE INVESTMENT?

We endeavor to provide our investors with quality investments. The foundation of our business is providing sound performing loans that provide long term income to our investors. We are proud to say that none of our investors have ever lost a penny of principal and have received all of their scheduled interest to date. •

Preservation of Capital. Our first objective is preservation of the investors' capital. Regardless of the yield, a loan has to make sense. The first question we will ask is, "Is the loan likely to be get paid back?" The answer to this is based largely on the borrower's credit history (his or her previously demonstrated willingness and inclination to pay on time or not) and their income (their ability to repay the debt).

The second question is, "If the borrower does not pay the loan back, is the investor likely to get their money back through the repossession of the collateral in the worst case scenario?" We will generally only borrow a very conservative percentage of the total value of the piece of property so that there is a sufficient equity above the loan amount available in the property in the event foreclosure becomes necessary. You will hear this ratio called the LTV (Loan to Value). For example, a loan in the amount of 70% of the value of the property would be expressed "70% LTV". A cornerstone of our philosophy is to purchase quality, well located real estate for investor loans. You have heard the old adage, "Location, Location, Location!" In our opinion, it is truer than ever today.

ESSENTIAL ELEMENTS TO CONSIDER WHEN MAKING TRUST DEED INVESTMENTS

1. **Knowledge, Experience and Integrity of the Borrower.** Before placing your trust and money with a borrower, you should know their history. The main principals of Frontline Financing have over 50 years of real estate experience. As an attorney, real estate broker, and mortgage loan broker, they have personally been involved in over 4,000 real estate transactions.
2. **Market Value and Equity of the Property and the Security for the Loan.** The market value of a property is crucial to your decision to lend your funds or purchase a Promissory Note because there is a possibility that the only way to recover your investment is through the sale of the property. Therefore, the market value of the property should be correctly estimated, and the total loan to value ratio property analyzed as illustrated below. This information should be made available to you before you commit your money to the transaction.

• Past performance is not a guarantee of future performance. Each investment package will include specific disclosures as required by law.

- **Market Value.** The sales price, the cost to build, or the value in use to a specific owner does not necessarily represent the market value of a property. A market value opinion requires consideration of comparable sales and other market data by a competent professional.
- **Loan to Value Ratio.** The total loans against the property, including your loan, divided by the market value of the property determines the loan to value ratio. For example, if a borrower has a first Deed of Trust in the amount of \$25,000 and is requesting a second Deed of Trust in the amount of \$40,000 and no other liens will be placed against the property, which is valued at \$100,000, the loan to value ratio is 65%. ($\$25,000 + \$40,000 / \$100,000 = 65\%$)

The lower the loan to value ratio and the greater the borrower's equity, the more incentive for the borrower to protect the equity in the property (i.e. the borrower may refinance the property if it is unable to make payments under your Promissory Note) or the likelihood that a third party bidder will purchase the property at a foreclosure sale and payoff your loan.

- **Preliminary Title Report. (Prelim)** The preliminary title report, also known as the "prelim", is prepared by a title company and is an offer to insure the title of the property. A current prelim should provide the following information regarding the property: 1) the names of the owner(s); 2) the legal description, street address, and the assessor's parcel number; 3) a copy of the assessor's plat map which illustrates the configuration, dimensions, and general location of the property; 4) assessed valuation; 5) existence and priority of liens and encumbrances; 6) the name of the owner(s) of existing lien(s), i.e. the owner of record of any Deed of Trust which you may be purchasing; 7) request for notices concerning status of the liens, any notices of default, and notices of trustee sales; 8) notice of any lawsuits or bankruptcies affecting the property; and 9) potential off-record interests of a spouse or other party. In reviewing the prelim for the above information, you need to be alert to various problems, which might affect the marketability, market value and equity of the property, which is the security for your loan.
3. **Process Involved in Funding of the Loan.** The funding of our investors' loans is done through a neutral third party, an escrow or closing agent such as at a title company. We provide direction (escrow instructions) telling them that the funds deposited with them are only to be used for a specific purpose and to make sure that all potential problems (outstanding loans, delinquent taxes, etc.) are handled prior to the funding of the loan. In addition, we provide the appropriate insurance policies (both fire insurance and title insurance).
 4. **Documents and Instruments Describing, Evidencing, and Securing the Loan.** In our efforts to keep our investors fully informed, Frontline Financing will supply to our clients three separate packages of information regarding each particular loan that is made. The first package of information is supplied prior to loan funding. This will contain all the

necessary information that is needed in order to make an intelligent decision regarding a particular loan. Some of the things included in this package are:

- A loan summary sheet prepared by Frontline Financing highlighting all the essential information regarding the property and the loan
- A property valuation report
- A preliminary title policy

If the investor decides to proceed with a loan, Frontline Financing will give you instructions regarding the funding of your money to the closing agent. Once this occurs and the loan is funded, a second package will be sent. This package will include documents such as:

- A copy of the Deed of Trust
- The Note secured by the Deed of Trust
- A copy of the fire and liability insurance policy

Finally, the third and final package will be sent to you about four to eight weeks after the closing. This package will include the following documents:

- The recorded Deed of Trust
- Final title policy

FREQUENTLY ASKED QUESTIONS

How long do I need to commit my money to the investment?

Frontline Financing primarily only offers loans for relatively short time periods – usually ranging between one to five years. It is always the investor’s choice whether to make a loan. If you have a specific time period for a loan that you are most comfortable with, let Frontline Financing know and we will help locate a loan that matches the length of loan you are willing to make.

How much does it cost to enter into a Trust Deed Investment?

There is never a cost to the investor to enter into a Trust Deed investment. The borrower pays for all the costs associated with the property valuation, the closing, title insurance and loan servicing.

What rates of return are available?

Interest rates will vary depending upon the property, borrower, equity position, term of the loan and whether it is a first or second lien on the property. Most of our loans are currently yielding between 9% and 12% for first position trust deeds, but there are exceptions at both the low end and the high end. Each loan is individually evaluated and priced.

When is the interest paid?

Interest on the total amount of the loan is paid monthly unless the investor prefers a different payment schedule. You are sent a check for the amount of all monies due to you for each payment.

Do you have a Trust Deed Fund or group investment available?

Yes, while many investors prefer to lend on specific Trust Deeds, there are some investors that alternatively choose to invest in a Trust Deed Fund. Instead of investing in a single Trust Deed on one property with one borrower, a Trust Deed fund allows investors to own an undivided interest in a diversified portfolio of loans secured by Trust Deeds. If you invest in a Trust Deed fund, you will be investing in many loans covering many different properties with multiple borrowers much like a mutual fund holds a basket of different stocks. In a fund, if a particular loan defaults, the impact to the investor is greatly minimized.

Why should I consider investing in a Trust Deed Fund?

Investing in a Trust Deed Fund offers other advantages as well. It places the review and decision making process for funding a loan into the hands of experienced professionals and relieves the individual investor of the time commitments and stresses involved in evaluating the merits of each individual loan.

Who borrows money at 10% to 12% interest?

There are many reasons borrowers request private money loans. While a bank may take 30 - 45 days or even longer to evaluate and fund a loan, private investors are often able to fund a loan within a week after the initial request. Usually the borrower may only need a short term loan and needs it funded quickly because time is of the essence. Sometimes a rehabber or investor may need quick short term funds to fix up a property or to have a loan in place while they wait for a bank to refinance their property.

Why then doesn't every fixed income investor invest in Notes secured by Deeds of Trusts?

Some investors are not interested in or are not suited to deal with the concerns or inconveniences of retailing their own capital. A borrower's late payment means the investor must wait to collect the payment due on the loan. Trust Deed investors must be comfortable with the concept that if payment is not made, they will either receive their money from the foreclosure sale or they will own the property securing the loan. The possibility of unintentionally owning real estate doesn't unreasonably disturb most successful Trust Deed investors. Most Trust Deed investors are comfortable with the knowledge that if they have to foreclose, they would likely acquire the underlying real estate at a below market price allowing them to realize additional profit from their loan. Therefore, they are willing to own the property if they must. Further, relatively few Trust Deed Investments selected with conservative criteria are ever foreclosed upon and that when foreclosure is necessary, a full return on the investment is usually always achieved. This is due to the fact that private Trust Deed investors generally loan on a lower percentage of the value of the property (LTV) than do most banks and thrifts. The borrower usually has more equity to lose when borrowing from private sources.

Current investors and people who are interested in working with Frontline Financing are invited to contact us directly with any questions or to set up a no obligation appointment to discuss our investment opportunities.

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