Special Report

Probate "Buy-outs"& "Work-outs": How to Use Financing in Friendly and Adversarial Estate Matters

How to use the untapped equity in realty to reallocate estate and trust assets and expedite the close of probate

The Suburban Group

Mortgage Bankers **Probate Specialists**

Probate "Buy-outs"& "Work-outs": How to Use Financing in Friendly and Adversarial Estate Matters

By Rick Harmon

This special report covers the following:

- ***What can you do with mortgage financing?***
- ***What financing options are available?***
- ***What does the attorney need to do to obtain financing?***

Its no surprise that probate related mortgage financing is fast becoming the preferred alternative to selling. Once a rarely used method for providing liquidity, borrowers have embraced financing despite the fact that it's not available through the big banks and mainstream home lenders.

Everybody wants to go to heaven but nobody wants to die

Faced with the very real prospect of being forced to sell their family home to a stranger, Heirs often prefer to find a way to keep estate realty. Typically, one or more siblings want to keep estate property while others only want their money. In other cases, there is insufficient liquidity in the estate to pay creditor claims and the cost of administration without selling what is the major asset: estate realty. Consequently, borrowing is a quicker, less expensive and more attractive solution compared to selling estate realty.

Attorneys, too, are seizing upon mortgage financing. Experience has proved that it's much easier to close an estate when all interested parties get what they want. It hardly seems that it was almost ten years ago I started preaching this method to the probate legal community. Clearly, the financing concept has taken root and become an acceptable practice.

A bridge over troubled waters

So, what can you do with mortgage financing? Here are just a few examples:

1. Pay attorney fees
2. Arrange a buy-out by other heirs
3. Resolve dispute "work-outs"
4. Close probate sooner than selling
5. Provide quick funds for emergencies
6. Pay Medi-Cal and other creditors
7. Stop foreclosure

8. Pay delinquent taxes
9. Money for repairs
10. Get "Junior" and his family out of the house (also called a "get out" loan)

Splitting heirs

What financing options are available for fiduciaries and individuals? What is the maximum loan amount a borrower can obtain? What rate and terms can a borrower expect? What are lenders really looking for when qualifying borrowers?

In order to gain an accurate perspective, we'll evaluate the borrowing options available to each entity in the mortgage market. Conventional mortgages offer the most favorable rates and terms. Lenders that do the heavy priced-based advertising are offering these type loans. Borrowers must qualify based on a myriad of market-driven lending guidelines relating to risk, income, savings and property condition, just to name a few.

It's important to note that ***not all borrowers sign personally***. Probate Code §9805 states that the personal representative executing a debt instrument shall not be personally liable. Accordingly, non-natural person borrowers, usually fiduciaries in these cases are by definition non-conforming borrowers. This is important to a borrower because, since the lender has no recourse beyond the security (real estate) for such a loan, traditional mortgage sources such as Fannie Mae and other lending channel will not buy these loans. These borrowers only fit the non-conventional equity lender guidelines. Let's begin by reviewing typical lending guidelines for non-natural person borrowers:

Executors and Administrators can obtain equity-based mortgages for up to 50-65% of the property value, per lender's appraiser. This depends on the type and quality of the property and the complexity of the file. Interest rate premiums for first mortgages are typically 2.5-4% above the equivalent 30 year fixed rate for a conventional loan for a fully qualified, "A" paper borrower. Mortgage terms available are usually shorter than for conventional loans: 10-15 years on average. Shorter terms are not uncommon.

Lenders will require that the subject property be in insurable condition, since the mortgage is primarily qualified by the soundness of the security (the property's equity).

Conservators, Guardians, Trustees & other Fiduciaries will generally find terms available for these non-natural person borrowers about the same as for executors and administrators. Similarly, lenders will use the protective equity remaining in the property to be used as security as the major driving force in approving these loans. Another factor, which may influence a lender's decision to lend, is whether or not the borrower is a professional fiduciary. Also, the presence of a major adversarial situation or even litigation may dissuade a would-be lender from granting a loan.

Loans to individuals (signing personally)
When purchasing or distributing estate or trust realty, borrows may obtain up to 80% of property value, and sometimes more. In the mortgage industry, lenders offset lending to higher risk borrower by reducing the maximum loan size on a given property *and* charge rate and fee premiums as the market and situation dictates. This market-driven approach to financing does translate into the greatest number of options for individual borrowers.

Borrowers must qualify based on credit risk score, income, and meet program guidelines. Strong borrowers will have a better chance of obtaining a loan, of course. Sub-prime borrowers (with less-than-perfect credit, low or hard-to-prove income, or little or no savings) may still qualify for attractive financing at competitive rates. "Ken and Barbie" type borrowers, in fact, represent only a fraction of the clients referred to us. However, just getting borrowers qualified is only part of the challenge for most banks and mortgage lenders.

Trust and estate buy-out and work out transactions are well beyond the expertise of the most seasoned loan officer/processor/underwriter teams. The biggest difficulty is in getting conventional mortgage lenders to fully understand and appreciate the circumstances for which the borrower wishes to buy out other heirs by using their future distributive share to offset the amount of funds required (similar to a non-cash down payment). Most all lenders want to see cash deposited into escrow, i.e., a down payment.
Consequently, don't expect your financing plans to be completed smoothly (or at all) unless the attorney and lender can work "in concert."

Lenders will scrutinize an incredible number of aspects of most conforming loan transactions, not all of which are directly related to the borrower. For instance, the property must currently be in insurable condition. Properties with deferred maintenance and/or defects usually require correcting prior to funding.

In a market as competitive as the mortgage industry there is little or no room for gaps in interest rates available to borrowers. Advertised interest rates are only available for "conforming" loans. Higher interest rates available for higher risk ("sub-prime") borrowers. This must be balanced with the observation that many lenders advertise rates that don't reflect what's available in the real world for anyone but our "Ken and Barbie" example. Still, the surprising fact is that, in a great many instances, attractive financing options do exist for borrowers, in spite of their own limited income and other resources.

Heirs know how to add, but not subtract

Yes, this seems all too often true. However, our experience suggests that many misunderstandings (read that adversarial actions) result from a mistrust of assertive

heirs by others, a lack of understanding of the probate process, and unrealistic financial expectations resulting from a sale to a third party.

What must the attorney need to do to obtain financing for client?

The primary actions that the attorney must be concerned with are as follows:

1. Discuss general options with client
2. Contact lender regarding file particulars (we suggest you choose the lender)
3. Obtain a written buy out agreement from affected parties (if appropriate)
4. Request written financing plan from lender
5. Complete specific noticing or court actions, as necessary

Attorney actions that are specific to Executor & Administrator loans:

- Full IAEA Power requires a Notice of Proposed Action to appropriate parties
- Limited/Special Powers requires Court Order to Borrow (PC §9800 or §10514)

Actions specific to Conservator & Guardian loans:

- Requires Court Order to Borrow (or Sell) in all cases

Actions specific to loans to Trustees & Trust Fiduciaries:

- Review trust for "Power to Encumber." Power to borrow not sufficient
- If no Power, requires Court Order to Borrow
- If Power present, need Death Cert. and/or Trust Transfer documents
- If Successor Trustee, need copy of entire Trust Agreement & recent Trustee's Certification of Trust Status (to obtain title insurance)

Actions specific to loans to borrowers signing individually (personally)

- Title must vest in name(s) as individual(s)
- Transfer may take place prior to or during escrow
- Transfer via Deed, Assignment, Preliminary or Final Order for Distribution, or as agreed upon with transfer agent in advance
- Agree on plan for distribution on loan proceeds
- Always consult with lender prior to taking transfer actions

Special Notes for attorneys and conclusions

For Estates and Trusts in foreclosure:

- Contact secured creditors immediately, document with letter
- Obtain preliminary title report & review with client
- Have a back-up plan (borrow vs. sell)
- If property reverts to lender, submit demand for costs of administration

For loans to non-natural persons

- Gain flexibility by Petitioning/Noticing for more funds than needed
- Use flexible language (i.e, "approximate interest rate") if possible
- Provide lender courtesy copy of drafts for their review prior to filing

- Advise lender if increased bond required or likely to be required
- Distribute estate realty to heirs subject to new mortgage

Frequently Asked Questions:

Q: What if the client doesn't have reasonable expectations of financing options?
A: Review with client the timeline and costs associated with a buy out plan versus selling to a third party. Use the "Heir-Splitter" worksheet to illustrate the different options.

Q: What if a lender's borrower pre-qualification letter doesn't specify the vesting?
A: Don't be surprised if, at the last minute, the lender requires the property to be transferred and vested in the name of the borrower personally. Demand a written statement that clarifies this matter if the loan is to be made to an estate or trust.

Q: What if available financing falls short of giving all parties cash?
A: An alternative to distributing cash could be a promissory note or other non-cash asset. Poor condition of subject property may restrict loan limits to third parties buyers, too.

Q: I'm not sure how to best structure this transaction. Any suggestions?
A: Yes, help is available. If your lender is experienced with estate and trust buy-outs, they will have sample petitions and other forms, or provide this service at additional cost.

For all probate attorneys:

1. ***Consider financing even if just a "back up" plan***
2. ***Get a friend at a title insurance company and give them all the business you can***
3. ***We've included several financing-specific forms for your convenience:***
4. ***Find more estate and trust resources at: www.Closeprobate.com***

To make your next financing plan go smoother, call

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