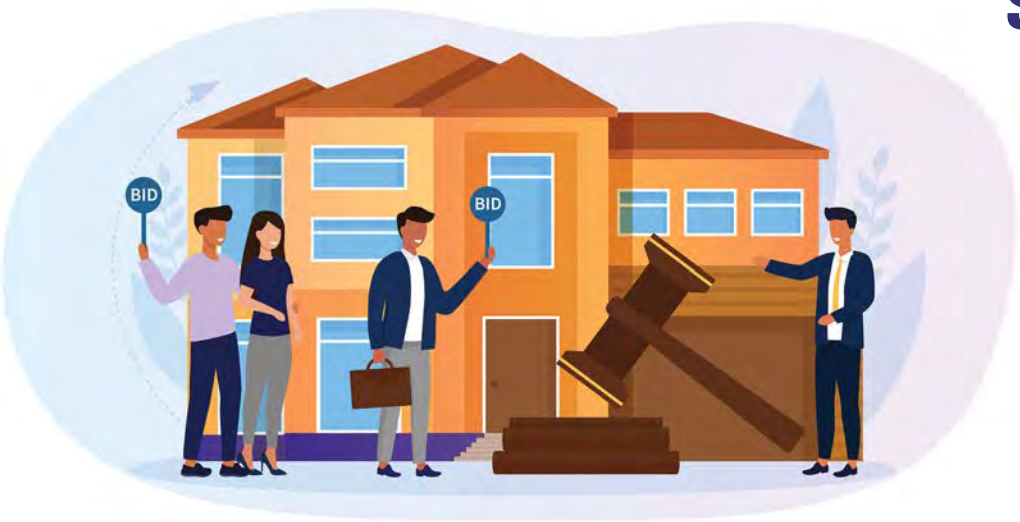
Pros and Cons of Taking Title at the Foreclosure Sale Via an LLC



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In the private lending world, investors often hold loans in their personal names, their family trusts or the name of their investing Limited Liability Corporation ("LLC"). If title remains unchanged, those same entities will take title to the property at the foreclosure sale. However, taking title in your name or the name of your family trust can create risks. Likewise, taking title in the name of your LLC, along with several other parties, can create unnecessary headaches. As result, many investors band together to create a new LLC for the sole purpose of taking title at the foreclosure sale.

The Newly Formed LLC Creates Several Benefits

For starters, if done properly, the LLC should limit the investors exposure for acts that occur post-foreclose to the assets of the LLC, i.e., the property. (Of course, the investors could still be sued for their pre-foreclosure conduct, e.g., wrongful foreclosure.) In addition, in the case of a nasty eviction, it keeps the investor's name off the pleadings and out of the eyes of an occupant. The LLC also provides a mechanism to handle the post-foreclosure costs of managing the property, e.g., eviction costs, property taxes, insurance payments, rehab costs, etc. This is particularly useful when there are multiple investors on the loan. The LLC can be structured to share costs at the same percentages as the investors owned the loan. The LLC can also identify the loan servicer as the managing member to handle the eviction, manage the property and sell the asset. In sum, creating an LLC for the purposes of taking title at the foreclosure sale provides several practical and financial benefits.

So, What Is the Downside?

Other than a little more work and cost, not much. First, the investors should hire counsel to create the LLC. The cost is not extensive, but worth it instead of trying to set up the LLC themselves and risk not doing it correctly.[1] In addition to the cost of the attorney, there is the cost to maintain the LLC - $800 per year. Then, after the property sells, the investor must dissolve the LLC. Not too difficult, but another task to get in the way of the investor's golf game. All in all, the cost and minor additional work is likely worth the reduced exposure and headache.[2]

When to create the LLC?

This is a question we often hear. Ideally, investors want to hold off incurring the costs of creating the LLC until the last minute, once they are confident that the foreclosure sale is going forward. But don't wait so long that your counsel does not have time to prepare the necessary documents or is busy with other work. At Wright, Finlay & Zak, we ask that our clients ideally give us one week's notice; but sometimes we have prepared them with only hours of the request. In addition to creating the LLC documents, the investors' loan servicer will want to create an assignment, assigning the loan from the current beneficiary or beneficiaries to the LLC. While the assignment can be created at any time, it should be signed prior to the foreclosure sale date. However, it does not need to be recorded until just before the Trustees Deed Upon Sale records. That way, the investors remain the beneficiaries all the way up until the official transfer of title to the LLC. Note – the investors REO insurance policy should be in the name of the LLC.

In Conclusion

Creating an LLC prior to taking title to the property at the foreclosure sale is a relatively inexpensive way to reduce investors' exposure and an effective tool to manage the property post-foreclosure.

The above information is intended for information purposes alone and is not intended as legal advice. Please consult with counsel before taking any steps in reliance on any of the information contained herein.

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Endnotes

1 Depending on the circumstances, the offering of the LLC could be considered a securities offering, requiring an exception. Please verify prior to proceeding.

2 This article does not address whether the investor wants to include the asset in a 1031 exchange. Please discuss with your tax professional.

T. Robert Finlay is one of the three founding partners of Wright, Finlay & Zak. Mr. Finlay is an active member of the Mortgage Bankers Association (MBA), California Mortgage Bankers Association (CMBA), United Trustees Association (UTA), American Legal and Financial Network (ALFN), and Orange County Bar Association. Mr. Finlay is a regular contributor to several industry periodicals and has also authored pertinent Amicus Briefs on key issues impacting the mortgage and finance industry. His key published opinions include *Mabry v. Superior Court* (2010) 185 Cal.App.4th 208 (Amicus counsel) and *Bostanian v. Liberty Saving Bank* (1997) 52 Cal.App.4th.