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Real Estate Professionals ...*

**MYLESTITLE'S
ADVISORY COUNCIL
Breakfast & Seminar**

*Solutions to Key Maryland
Real Estate Issues*

**THE "NEW" REAL ESTATE PARADIGM:
KEY ISSUES FOR 2011 AND BEYOND**

***"Honey I Reduced My Mortgage by \$1,000,000.00,
OMG, now I owe the IRS \$400,000.00!"***

**TEN THINGS YOU MUST KNOW ABOUT BUYING
DISTRESSED LOANS & LOAN WORKOUTS**

- ❖ *Real Estate, Foreclosure, Tax and Practical Issues.*
- ❖ *How Bankruptcy and Other Issues affect the Purchase of Distressed Debt.*
- ❖ *Lenders Selling Loans in Default to Purchasers who then Foreclose.*
- ❖ *Borrowers Buying Debt at a Discount to Save Properties.*

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Chestnut Ridge Country Club
April 7, 2011

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Excerpts from 1st Quarter 2011

Deja Vu, All Over Again: Sub-Prime is Back! This mornings WSJ — *front page* — has an article by Matt Wirz and Serena Ng, entitled: *Subprime Bonds Are Back*. Really? Is this craziness or rather a significant green shoot that we all should be paying attention to? We report — in real time — and you decide. Frankly, this is what this Blog is all [...]

Real Property MD & Federal Cases As a member of the Maryland State Bar Associations Real Property Attorney's Discussion Group, on March 15, 2011, I was in attendance at a very informative presentation of recent opinions by Maryland and Federal Courts, over the last year. There were three (3) separate presentations, as follows:* Judge Glenn T.Harrell, Jr. MD Cases (Pages [...]

Quality Developers, Great Track-Records, Yet Tightening Credit As reported in the January 28, 2011 edition of the Baltimore Business Journal, Maryland's Cautious Banks Tighten Lending Requirement, the article reflects the current state of lending in Maryland. More specifically, examples are cited of secure, quality developers — with great track-records like Cignal Corp. — who are ready to build, but due to strick lending environments, [...]

What's Next After Freddie Mack/Fannie Mae Die?

By most accounts, and as outlined and analyzed extensively in a Knowledge@Wharton article, What the Demise of

Fannie Mac and Freddie Mac Mean for the Future of Homeownership — the federally sponsored mortgage giants Fannie Mae and Freddie Mac did not cause the housing and mortgage crisis. But they were a big part of the problem, prompting [...]

Foreclosure Settlement.... Here is the proposed Foreclosure Settlement (all 27 Pages), from all 50 States Attorney's ... Not light, but very interesting reading, indeed. Talk about "original" sources 50 State Attorney General 27 Page Settlements on Fraud Closures

HERO or ZERO: Loan Originator Compensation Amendment to Regulation Z Times they are a changing in the mortgage industry. As reported in a recent New York Times article, New Federal Rule for Mortgage Brokers, starting April 1, under a new compensation rule from the Federal Reserve, borrowers who get their mortgages through brokers will most likely pay less for their services and must be offered the lowest [...]

REALLY? MERS was struck down ... This is huge news for all of us Real Estate wonks. MERS has just been struck down by a Federal Bankruptcy Judge. As reported in NewsUnwrapped — a Blog written by local Baltimorean, Steve Meizlish, with the specific intent of Telling-The-Story-Behind-The-Story — we see what could be the beginnings of the unraveling of the Real Estate infrastructure as we [...]

2 Million More Foreclosures in 2011 The current U.S. housing crisis has left Americans worse off than they were 10 or 12 years ago, according to Professor Joseph Stiglitz. Stiglitz now expects the housing situation at the root of the crisis to get worse. He expects an addition 2 million foreclosures in 2011, adding to the 7 million that have already occurred in [...]

Fannie Mae Foreclosures in MD Attorneys who handle foreclosures for Fannie Mae will be able to charge as much as \$1,300 per case in the state starting next month, a nearly 40 percent jump (or \$350 more), that will make Maryland's fee one of the highest in the nation. Read the full story ...

Destroying Mortgage Docs, Really? Mortgage companies want to destroy 22,500+ documents. Read the fully story. That's a good way to get around your obligations. You can't script this stuff reality is better than fiction. What do you think?

Mortgage Definition ... The word "mortgage" is of French origin with the meaning "agreement until death". In light of all the mortgage mess we're embroiled in, thought this was interesting. Just saying ...

10,000 Maryland Foreclosures Halted A MAJOR RULING: In a major ruling Friday (January 14, 2011), a coalition of nonprofit defense lawyers and consumer protection advocates in Maryland successfully got over 10,000 foreclosure cases managed by GMAC Mortgage

tossed out, because affidavits in the cases were signed by Jeffrey Stephan, the infamous GMAC "robo-signer" who attested to the authenticity of [...]

Foreclosure Halt in Mass. In a ruling that may affect foreclosures nationwide, the NYTimes reports that the Massachusetts high court has voided the seizure of two homes by Wells Fargo & Company and US Bancorp after the banks failed to show that they held the mortgages at the time of the foreclosures. Friday's decision by the Supreme Judicial Court of Massachusetts, which upheld [...]

Is The Commercial Mortgage Market Healing? Daniel Indiviglio at The Atlantic just published an interesting article, "Is the Commercial Mortgage Market healing?" Frankly, it is not wholly clear that the commercial mortgage market is, or will, become better in the very near future. However, Indiviglio lays down a fairly solid argument that is more than worthy of a quick look. For quite some time [...]

Did We Just Witness Another Bank Bailout? According to Forbes' recent article, Is Fannie Bailing Out The Banks?, the critics of the giant banks, say ABSOLUTELY. Close observers charge that Monday's mortgage-putback deal between Bank of America and Fannie Mae and Freddie Mac is nothing more than a backdoor bailout of the nation's largest lender. And the even bigger question is whether this just the beginning? The [...]

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Buying Distressed Loans

**Honey, I reduced my
mortgage by \$1,000,000.
OMG, now I owe the IRS
\$400,000!**

Richard E. Levine
Richard M. Kremen
DLA Piper LLP

April 7, 2011

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- Banks and other lenders are anxious to get non-performing loans off of their books.
- This is driven by quarterly earnings reports of the banks. Thus, most deals close by the end of each quarter.
- The lender will have written down the loan to its current value (the value of the underlying real estate).
- The existence of a personal guaranty may be irrelevant in determining the value of the loan.

- The lender and the loan purchaser enter into a loan sale agreement.
- The loan purchaser will seek a due diligence period in which it can study the loan documents and the property.

How Are Loan Purchases Structured?

- Loan documents
- Title policy issued to lender
- Survey
- Correspondence file between lender and borrower
- Rent rolls
- Environmental reports
- Copies of default notices sent to borrower
- Copies of default notices sent to junior lenders
- Subordination agreements and notice provisions

What the Purchaser Will Want to Review

What the Loan Purchase Agreement should contain



- A list of all of the loan documents and copies.
- A statement showing the amounts due by the borrower including interest, late fees and attorneys fees (needed to docket the foreclosure).

- It may not be possible to get estoppel certificates from tenants.
- Tenants could have entered into “sweethart” deals with the current owner.
- Current owner may not have properly billed tenants for CAM expenses.

Other Terms of the Loan Sale Agreement



- The loan will be sold “as-is” “where-is”.
- More than likely, none of the representations and warranties of the lender will survive the closing.
- More than likely, the lender will not agree to indemnify the loan purchaser if something goes wrong.
- When the loan purchaser buys the loan, it will be inheriting any claims the borrower may have against the lender for lender liability.

Alternatives to Purchasing the Loan



- Borrower, lender and loan purchaser enter into a "short sale".
- Borrower agrees to sell property to purchaser. Lender agrees to forgive a portion of the loan and release its lien.
- See tax issues below.

- This scenario is rare. Lender forecloses on the borrower, buys the property at foreclosure and then sells the property to the purchaser. Lender is then taking the foreclosure risks.

Deed in Lieu of Foreclosure



- Once the loan is purchased, it would be possible for the borrower to convey the property to the loan purchaser by a deed in lieu of foreclosure. Liens recorded subsequent to the recording of the deed of trust would not be wiped out.
- How much will the clerk assess in transfer tax upon the recording of the deed in lieu of foreclosure – the value of the property or the outstanding debt amount (including regular and default interest).
- All of these costs must be factored into the purchase price of the loan.

Unpaid Recordation Taxes



- Was the underlying loan secured by an indemnity deed of trust (IDOT)? If so, recordation tax was not paid when the IDOT was recorded.
- When the loan goes into default, the recordation tax becomes due. The recordation tax ranges from 0.5% (Howard County) to 1.2% (Frederick County). Thus, on a \$5 million IDOT, the unpaid recordation tax could be \$60,000.
- The clerk may insist on the collection of this tax when the foreclosure is docketed or the deed from the substitute trustees to the property purchaser is recorded.
- The title company may take exception to its policy if the taxes are not paid.

Foreclosure – Transfer Taxes



- Recordation and transfer taxes in a foreclosure situation will generally be based upon the bid price at the foreclosure sale.
- However, in Montgomery County, these taxes will likely be based upon the unpaid principal balance plus accrued interest (both regular and default interest) unless the noteholder is proceeding against the borrower to collect any deficiency.
- Until recently, Prince George's County had taken the same position as Montgomery, but now the bid price will control everywhere but Montgomery.

- Assume borrower (an LLC) bought land in 2006 for \$10 million and borrowed \$10 million from lender.

- Land is worth \$7 million today.
- Lender agrees to sell the loan to borrower for \$6 million (below the FMV).

- Borrower's members are in a 40% tax bracket.

- Borrower has two members:
- Experienced developer – 60%
- (Formerly) rich investor – 40%

- The borrower has cancellation of indebtedness income (COD income) of \$4 million.
- Unless an exemption applies, the borrower's members would owe approximately \$1.6 million in taxes.

- An exception could apply, allowing the members to reduce the tax basis of other property.

- But this only applies to the extent of \$3 million (loan amount less FMV).

- Borrower's members will still have \$1 million of COD.

- Tax due of \$400,000.

- Assume developer and investor form a new entity to buy the loan:

- Developer owns 1%

- (Formerly) rich investor owns 99%

- New entity buys loan for \$6 million from lender, forecloses and is successful bidder at foreclosure sale for \$6 million.

- Borrower has COD income of \$4 million, of which \$1 million must be reported in the current year.

- Borrower deemed to have sold the property for \$6 million.
- Borrower has a loss of \$4 million (\$10 million basis exceeds \$6 million sale price).
- Borrower can't take the loss because borrower and new entity are related parties.

- Loan purchaser/property purchaser is solely owned by investor.
- Thus, borrower and property purchaser are not related.
- Borrower can take tax loss on foreclosure which offsets the COD income.

- Loan purchaser buys loan from lender for \$6 million and forecloses.
- There is bidding at the foreclosure sale.
- Loan purchaser is the winning bidder at \$7 million.

- Loan purchaser has \$1 million of income.
- It bought the loan for \$6 million.
- It received \$7 million from the foreclosure sale.
- Thus, profit of \$1 million.
- Its tax basis in the property is \$7 million.

- Loan purchaser buys loan for \$6 million.
- It doesn't foreclose.
- It enters into a loan modification with borrower.
- Under "Cottage Savings" regulations, loan purchaser has \$4 million of income!

- How long does the foreclosure process take?
- What happens if the loan purchaser doesn't follow all of the requirements for the foreclosure sale?
- What advertising should be done to be considered "commercially reasonable"?

- How much should the lender bid at the foreclosure sale?
- Should the loan purchaser obtain a title insurance commitment?
- Who must be given notice about the foreclosure?

- What if the sale is challenged?
- What if the borrower files for bankruptcy prior to the foreclosure? Is it likely the stay can be lifted? Is it likely the borrower could successfully engage in a “cramdown”?

■ Can the successful bidder at the foreclosure sale sell the property before the sale is ratified?

■ Can the successful bidder at the foreclosure sale enter into a contract of sale to sell the property before the sale is ratified?



**SUMMARY OF MARYLAND COMMERCIAL AND
RESIDENTIAL FORECLOSURE PROCESSES**

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SUMMARY OF MARYLAND COMMERCIAL FORECLOSURE PROCESS

Maryland is a quasi-judicial foreclosure state. The most common form of a commercial foreclosure in Maryland is the "power of sale" foreclosure. When conducting a foreclosure based upon a loan document that contains a power of sale clause, the lender will initiate the foreclosure process (after the indebtedness has been accelerated and a default notice has been sent pursuant to the terms of the loan documents) by causing the trustees named in the deed of trust or mortgage to file an order to docket with the Circuit Court in the county where all or a portion of the real property is located. The filing of the order to docket creates a "civil action" in the Circuit Court. The order to docket is a summary pleading that includes copies of the loan documents, an affidavit that the secured party has the right to foreclose, and an affidavit setting forth the amount of indebtedness owed. *Md. Rule 14-207.*¹

After the order to docket is filed, the lender will set the foreclosure sale auction date. The foreclosure sale will be a public auction located either at the property or at the courthouse. Between 10-30 days prior to the sale, notice of the foreclosure sale must be sent to the borrower, record owner, and subordinate lienholders. *Md. Rule 14-210.* In addition, notice of the sale must be sent at least 15 days prior to the sale to the county where the property is located and 25 days prior to the sale to the IRS if there are any federal tax liens. To identify all subordinate lienholders (and protect the lender in the event the lender is the high bidder at the sale), the lender will obtain a foreclosure title commitment which will convert into an owner's policy if the lender is the high bidder at the sale.

In addition to the notice letters set forth above, notice of the sale must also be published in a newspaper of general circulation in the county where the action is pending at least once a week for 3 successive weeks with the first publication occurring no less than 15 days prior to the sale and the last publication occurring no more than 1 week prior to the sale. *Md. Rule 14-210.*

The foreclosure sale will be open to all bidders who qualify. The lender will set the bidding qualifications which generally include a cashier's check/certified check for a deposit in an amount that is commercially reasonable. The high bid will be awarded the sale. At the conclusion of the sale, the purchaser will sign and execute, among other things, a sale contract.

¹ Maryland has recently changed its foreclosure law with respect to residential real property. If the property subject to the foreclosure proceedings falls within the definition of "residential real property" under the new foreclosure laws, additional steps will have to be undertaken in connection with proceeding with the foreclosure.



After the sale is concluded, the trustees will file a report of sale with the Circuit Court which includes a brief description of the sale terms. *Md. Rule 14-305*. Upon the filing of the report of sale, the Clerk of the Circuit Court will issue a notice describing the sale and stating that the sale will be ratified within 30 days after the date of the notice if exceptions are not filed with the Circuit Court. The notice will be published with a newspaper of general circulation in the county where the action is pending once a week for 3 successive weeks prior to the expiration of the 30 day period. *Md. Rule 14-305*.

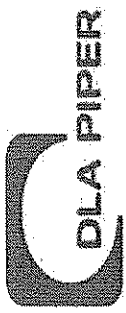
If no objections are filed, the Circuit Court will ratify the report of sale and refer the matter to the Court Auditor to state its account (*i.e.*, reconcile the disbursement of the proceeds from the sale). After the sale is ratified, the trustees are authorized to conduct the closing on the sale with the foreclosure sale purchaser. Once the closing is concluded, the trustees will submit their proposed accounting to the Court Auditor. The Court Auditor will then state his account which will include the proposed distribution of proceeds. *Md. Rule 2-543*. Parties-in-interest have 10 days to file exceptions to the Court Auditor's account. If no objections are filed, the Court Auditor's account will be ratified, the trustees will be authorized to disburse the sale proceeds pursuant to the Court Auditor's account, and the foreclosure proceedings will conclude.

Receiverships

In connection with a foreclosure sale, a lender may be concerned that (a) the borrower is neglecting the property or improperly diverting rental cash proceeds, or (b) the property may have some and allow it to deteriorate while the foreclosure process is being carried out. In Maryland, it is common for lenders to obtain the appointment of a receiver to manage the real property, rents and collateral pending the foreclosure sale. Upon its appointment, the receiver will replace the borrower/owner and manage the property (including collecting rents) until the transfer of title to the foreclosure sale purchaser.ⁱⁱ

In order to obtain the appointment of a receiver, the lender's deed of trust/mortgage must contain a clause providing the lender with the right to obtain the appointment of a receiver upon the occurrence of an event of default. Once the lender confirms that it has the right to obtain the appointment of a receiver, the lender will then pick a receiver that it wants to retain for the matter. Prior to, or contemporaneously with, the filing of the foreclosure papers, the lender will file a petition seeking the appointment of the receiver. The appointment of a receiver may be obtained *ex parte*. In connection with the appointment, the receiver will be required to post a receiver's bond. Once the Circuit Court enters the order appointing the receiver and after the receiver has posted his bond, the receiver will be vested with all rights to manage, control, and operate the property (subject to the secured lender's rights under the deed of trust/mortgage). The receiver will continue in control of the property until the foreclosure sale is concluded and

ⁱⁱ A lender may also seek approval from the Circuit Court to provide the receiver with the power to sell the collateral in the ordinary course.



title is transferred to the foreclosure sale purchaser. After title is transferred, the majority of the receiver's duties will conclude. Shortly thereafter, the receiver will close the receivership estate.



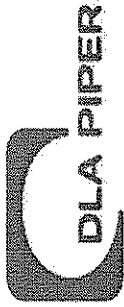
General Commercial Foreclosure and Receivership Timeline

Total Estimated Time – 120-150 days

- Step 1. Prior to initiating the foreclosure process, the loan will need to be declared in default and the indebtedness will need to be accelerated. The lender will need to conduct due diligence in connection with the sale including obtaining an appraisal, updated title report and any environmental reports.
- Step 1A. Prior to, or contemporaneously with, the filing of the foreclosure papers, the lender will file a petition with the Circuit Court to obtain the appointment of the receiver to manage the property until title to the property is transferred to the foreclosure sale purchaser.
- Step 2. The lender will need to file a substitution of trustees appointing attorneys at DLA Piper as trustees on the Deed of Trust.
- Step 3. The order to docket will be filed with the Circuit Court.
- Step 4. Notice letters will be sent (10 – 30 days prior to the sale). In addition, the first advertisements will run (once a week for 3 successive weeks). The lender will need to check if any IRS tax liens are of record. The IRS must receive notice 25 days prior to the sale.
- Step 5. Sale occurs approximately 30-45 days after the order to docket is filed. Contract of sale is signed by purchaser.
- Step 6. Within 7-10 days after the sale, the trustees will file the report of sale with the Circuit Court.
- Step 7. Within 30-45 days after the report of sale is filed (and subject to no objections being filed), the report of sale will be ratified by the Circuit Court.
- Step 8. Closing on the sale will occur 10-20 days after the report of sale is ratified.
- Step 9. After the closing takes place and the deed is recorded, the receiver will transfer possession of the property to the foreclosure sale purchaser and take steps to conclude its duties and to close the receivership.



- Step 10. The trustees will submit their proposed accounting to the Auditor within 7-10 days after the closing occurs.
- Step 11. The Auditor will state his account with the Circuit Court. Parties in interest will have 10 days to file exceptions. If no exceptions are filed, the trustees will be authorized to disburse the proceeds from the sale pursuant to the Auditor's report and the foreclosure proceeding will be concluded.



SUMMARY OF MARYLAND RESIDENTIAL FORECLOSURE PROCESS

Prior to initiating the residential foreclosure process, the loan will need to be declared in default and the indebtedness will need to be accelerated. The lender will need to conduct due diligence in connection with the sale including obtaining an appraisal, foreclosure title commitment, and any environmental reports. Thereafter, the lender will need to file a substitution of trustees appointing attorneys at DLA Piper as trustees on the Deed of Trust.

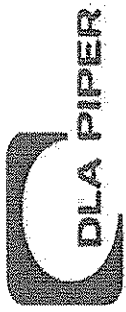
After the loan is declared to be in default, the lender must issue a "Notice of Intent to Foreclose" which must be mailed at least 45 days before filing a foreclosure action in court. The Notice of Intent to Foreclose is sent by certified mail, return receipt requested and first class mail. The notice must include specific information about the mortgage, an application for loss mitigation, instructions to complete the application, and a list of housing counseling resources.

A foreclosure action (called an "order to docket") cannot be filed with the courts until both (a) the loan is 90 days past due and (2) 45 days have passed since mailing out the Notice of Intent to Foreclosure. The order to docket ("OTD") is a large set of documents which must include, among other things, a copy of the promissory note, deed of trust, a statement of debt, an affidavit certifying ownership of the promissory note, the notice of intent to foreclose and either a preliminary loss mitigation affidavit or final loss mitigation affidavit.

The preliminary loss mitigation affidavit will be filed with the OTD if the Lender has not reviewed the borrower's loan for loss mitigation. If borrower does not file a request for mediation, the auction can take place 148 days after default. (The earliest day for auction is 213 days from default IF mediation is requested.) A final loss mitigation affidavit will be filed if the lender feels that it has exhausted all efforts to provide loss mitigation. The lender must send the borrower a copy of the Final Loss Mitigation Affidavit as well as a "Request for Mediation." Thereafter, the borrower has 15 days to request mediation after it receives the Request for Mediation and Final Loss Mitigation Affidavit. To request mediation Borrower must send the completed form (with the applicable fee) to the Circuit Court.

If the borrower does not file a request for mediation, the foreclosure auction can take place 135 days after default. (The earliest day for auction is 185 days from default IF mediation is requested.) If Borrower requests mediation, the request is forwarded to the Office of Administrative Hearings (OAH), where an administrative judge will mediate the case within 60 days after receipt of the request from the court. The judge cannot make decisions, but can act as a neutral third party in an effort to reach a mutual resolution.

The foreclosure sale must be advertised for 3 consecutive weeks prior to sale. After the sale, the circuit court is notified and orders a date for exceptions to the sale to be filed. Within 30 days after the sale of residential property, the sale is ratified and title to the property is



transferred to the new owner. The circuit court is notified and the auditor reviews the notice. If no exceptions are filed, the circuit court issues a final order of ratification.

Within 3 years from the date that the foreclosure is completed, the lender or its servicer may file for a deficiency judgment against the borrower personally for the loan balance plus all fees and costs of the foreclosure.



Maryland Residential Foreclosure Timeline

Timeline #1

Where the Order to Docket or Complaint to Foreclose includes the "Final Loss Mitigation Affidavit,"

(Times in this chart are for general information. The timing of specific events in an actual foreclosure action may vary as permitted by law.)

Day 1	Missed mortgage payment.
Day 45	Notice of Intent to Foreclose must be mailed by regular and certified mail.
Day 90	Order to Docket or Complaint to Foreclose filed in circuit court.
Day 105	Last day for homeowner to request foreclosure mediation.*
	* If foreclosure mediation is not requested by day 105, or if a motion to stay the sale has not been filed, the property may be sold on day 135 and the remainder of this timeline is inapplicable.
Day 110	If foreclosure mediation is requested, circuit court sends the request to the Maryland Office of Administrative Hearings by this day.
Day 170	If requested, foreclosure mediation must take place by this day unless postponement is requested.
Day 185	Foreclosure sale can be held unless a motion to stay the sale is filed.



Maryland Residential Foreclosure Timeline

Timeline #2

Where the Order to Docket or Complaint to Foreclose includes the "Preliminary Loss Mitigation Affidavit."

(Times in this chart are for general information. The timing of specific events in an actual foreclosure action may vary as permitted by law.)

Day 1	Missed mortgage payment.
Day 45	Notice of Intent to Foreclose must be mailed by regular and certified mail.
Day 90	Order to Docket or Complaint to Foreclose filed in circuit court.
Day 118	"Final Loss Mitigation Affidavit" and form to request foreclosure mediation sent by regular & certified mail.
Day 133	Last day for homeowner to request foreclosure mediation.*
	* If foreclosure mediation is not requested by day 133, or if a motion to stay the sale has not been filed, the property may be sold on day 148 and the remainder of this time line is inapplicable.
Day 138	If foreclosure mediation is requested, the circuit court sends the request to the Maryland Office of Administrative Hearings by this day.
Day 198	If requested, foreclosure mediation must take place by this day unless postponement is requested.
Day 213	Foreclosure sale can be held unless a motion to stay the sale is filed.

Bank-sold commercial properties come with risks

to potential auction bidders, mostly because the law does not require that information be made available, and banks are reluctant to give information about the property that could turn out to be erroneous. "The best advice to someone who wants to bid at a foreclosure sale is: 'You're on your own.'"

The successful bidder is generally required to pay the full purchase price, in cash, within 30 days. That 30-day period gives the purchaser time to arrange his own financing, but

in some recent cases purchasers have been denied access to the property to perform physical inspections and property surveys.

What's more, significant impediments can arise, such as the purchaser's inability to gain control of tenant security deposits.

Despite these pitfalls, some recent foreclosure sales in the Washington area, particularly sales involving much sought-after multifamily properties, have commanded

high prices. It's anyone's guess when conventional mortgage financing will be available again.

Until that time comes, banks and other lenders will continue to pursue loan sales and foreclosures, and entrepreneurial investors will be forced to pursue risky and unconventional means to obtain ownership. Welcome to the brave new world.

Frederick L. Klein is a partner in the real estate group of law firm DLA Piper LLP in D.C.

documents, usually in a very short time. Often, the due diligence is incomplete, and the bank staff selling the loan has no background on the property, the borrower or the loan.

Because very few commercial properties are being sold in a conventional manner, investors who have access to capital have found

that buying commercial mortgage loans, and the borrower is in default), is the only practical way to acquire property for investment or

future development.

Meanwhile, purchasers must consider many risks, such as a bankruptcy filing by the property owner that could impede their

ability to gain control of the property within a reasonable time.

Buying a loan with the intention of ultimately becoming the owner of the real estate is therefore not for the faint of heart, and investors are advised to proceed carefully with the assistance of experienced advisers.

Still, the upside can be large if the investor is able to acquire the loan at a significant discount to the value of the property.

An even more unconventional means to acquire commercial property is to bid at a foreclosure sale. In the past several months, banks and other mortgage lenders have moved to foreclose on commercial properties with increasing frequency. Locally, the foreclosure

process is relatively quick and inexpensive. But banks often provide little information

paying) that values would rebound to the levels often seen in 2005 and 2006.

Sometime around the third quarter of 2009, lenders began to explore ways to dispose of their mortgage investments via two

primary means: selling their loans (whether individually or bundled together) to investors interested in ultimately acquiring the

closure proceedings, hoping bidders would compete to purchase the properties.

To the disappointment of many investors — including funds formed solely to buy distressed commercial mortgage debt — these

lenders have been unwilling to provide significant discounts. However, in the past few

months, lenders, eager to reduce the size of their mortgage portfolios, have begun to mark

down their loans for sale, often in excess of 50 percent of the outstanding amount.

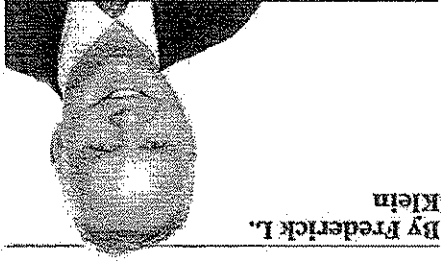
Some banks and other lenders have hired well-known real estate brokerage firms to

manage the sales process. These firms organize the loan information, prepare marketing materials and contact potential purchasers.

Other banks with large portfolios of distressed debt handle their loan sales in-house.

Selling mortgage loans requires careful preparation and skill on the bank's side, while the purchasers — whether individual

investors or distressed debt funds with teams of analysts — must conduct due diligence on both the real estate and the mortgage loan



By Frederick L. Klein

Just a few short years ago, real estate lenders — banks, life insurance companies and securitized lenders — routinely and frequently refreshed their loan portfolios as borrowers refinanced their mortgages, often with larger loans that enabled the borrowers to tap into their growing equity. But some time in late 2007, this cycle slowed to a crawl, and by the time 2009 rolled around, there was virtually no new mortgage debt available. When the music stopped, lenders found themselves stuck with mortgage loans — many secured by commercial properties — that were worth far less than the outstanding debt. The true paying their debt service only because interest rates stayed at historic lows. Meanwhile, investors and operators looking to acquire commercial properties encountered a dwindling supply of available property because owners who ordinarily would have been sellers chose to hold on to their assets, often hoping (and in many cases