

Chapter 1

Equity purchase investments

This chapter introduces the equity purchase (EP) restrictions that must be known to and applied by all investors who purchase owner-occupied, one-to-four unit residential property during a foreclosure.

The home equity sales scheme

An equity purchase (EP) transaction is the sale or other transfer of title by an owner-occupant of a one-to-four unit residential property when:

- the property is in foreclosure under a recorded and un-rescinded Notice of Default (NOD); and
- title to the property is acquired by either a buyer for rental, investment, or dealer purposes, or a person advancing funds which are to be repaid, called an EP investor.

Conversely, an EP transaction does not occur and the EP rules do not apply if the buyer acquires the property to occupy it as his *personal residence* or a lender originates a trust deed loan. The EP codes distinguish *principal residence* of the seller from the buyer's acquisition of a property to be used by the buyer as his **personal residence**. Thus a buyer's acquisition of a second home or vacation home for "personal use" is legislatively intended to be exempt from the EP laws.

Equity purchase statutes apply to all investors regardless of the number of EP transactions the investor completes. The investor need not be **in the business** of purchasing or advancing funds on homes in foreclosure for the EP statutes to apply. [Segura v. McBride (1992) 5 CA4th 1028]

The investor and all brokers involved must use a written agreement configured and containing notices as required by EP law. Failure to use the correct forms subjects the investor and the brokers to liability for all the losses incurred by the seller-in-foreclosure, plus very severe penalties. [Segura, *supra*]

Printed EP form and language

For example, the **EP agreement** signed by an EP investor must be printed in *bold type*, minimum size ranging from 10-point to 14-point. Also, the printed agreement must be in the *same language* used in negotiations with the seller-in-foreclosure. [Calif. Civil Code §§1695.2, 1695.3, 1695.5]

Additionally, the EP investor and all brokers and agents involved in an EP transaction must use a written agreement containing statutory EP notices. Failure to use **correctly structured forms** subjects the EP investor and the brokers to liability for all losses incurred by the seller-in-foreclosure, plus penalties. [Segura, *supra*]

Editor's note — first tuesday's Equity Purchase Agreement, Form 156, complies with all statutory requirements, and properly sets forth the seller-in-foreclosure's right to cancel. [See Chapter 2]

Equity loan arranged during foreclosure

Consider an owner whose home is in foreclosure due to a default under a trust deed lien on the property. He asks a friend to make him a loan.

The friend advances all funds necessary to cure the default under the trust deed and take the property out of foreclosure, called *reinstatement*.

As security for repayment of the friend's advance of funds, the homeowner conveys title to the friend. As part of the arrangement, the owner is to remain in possession under a lease agreement and is granted an option to recover title to the residence on a final payoff to the friend.

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Later, the owner defaults on the rent and voluntarily vacates. The friend takes possession and locates a buyer, enters into a purchase agreement and conveys title to the buyer.

The owner, now out of possession, seeks to recover the value of his lost equity from his (former) friend. The owner claims a person who takes title and grants an option to the owner to repurchase the property is an *investor* who must first obtain the owner's consent before he conveys any interest in the property to another person since the financing arrangement was entered into while the home was in foreclosure.

The friend claims EP law does not apply to him since he is not in the business of lending money, much less buying homes in foreclosure.

However, EP law applies to all persons whose conduct constitutes that of an EP investor, regardless of the number of EP transactions the person completes. The investor, on selling the property to the buyer, conveyed title to the property without first obtaining written consent from

the owner (even though the investor held title), a conveyance in violation of equity purchase law. [CC §1695.6]

The EP investor's failure to obtain the owner's written permission prior to conveyance of the property on a resale imposes liability on the EP investor for breach of the owner's (redemption) rights since a loan is involved. The money losses collectible by the owner are based on the value of the property at the time the EP investor first transferred title to the property without the owner's consent. [Segura, *supra*]

Additionally, consider an owner-in-foreclosure who is in **bankruptcy** and conveys his property to an investor. The transaction is structured as a grant deed conveyance to the investor with a leaseback agreement and the grant of a repurchase option to the owner. Specially printed equity purchase forms with right of rescission notices to the owner-in-foreclosure are not entered into by the owner and the investor.

Locating properties in foreclosure

To locate properties in foreclosure and begin an investigation of ownership, debt, and value of the properties, an equity purchase (EP) investor needs data on the recording of Notice of Defaults (NODs), Notice of Trustee's Sales (NOTS), rescission of a NOD and trustee's deed, and the content of these documents.

Services exist which gather and publish the daily recording of foreclosure-related documents, their contents, and ancillary information on the properties available from public records. The reporting is available primarily on the internet, and is updated daily. Title companies are also a source of the recorded information.

The foreclosure data are obtained directly from recorded documents or from providers of the data who collect and enter the data directly from the county recorder's records. One such company collecting statewide data available by subscription on their web site is Real Estate Transaction Network at www.retran.net or (877) 711-1147. Monthly fees range from \$99 to \$159 for access. Other web sites that provide similar services include: www.countyrecordsresearch.com; www.foreclosures.com; and www.redloc.com.

Foreclosure data from providers can be sourced and sorted in any manner, such as by address, ZIP code, city, county, type of property, improvements (bed/bath/lot size), recording dates of the trust deed/NOD/NOTS, original loan amount, delinquency amount, Thomas Guide coordinates, etc. Data includes plat maps and photos of some properties.

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The transaction is approved as a sale of the property by a trustee acting on behalf of the bankruptcy court.

The owner-in-foreclosure is not able to repurchase the property on expiration of the repurchase option. A notice to vacate is served by the owner.

The owner now seeks to quiet title to the property in his name, claiming the sale-leaseback agreement violated of the Home Equity Sales Contract Act (HESCA) EP law since the investor, knowing the home was in foreclosure, acquired title to the property without complying with the notice requirements of the EP law.

The investor claims the sale was authorized by the equivalent of a court order, and thus exempt from equity purchase laws, since the sale was approved by a **bankruptcy trustee** acting on behalf of the court. [CC §1695.1(a)(5)]

Here, the sale by the owner-in-foreclosure to the investor was subject to EP law since the exemption for court-ordered sales does not apply to sales of property approved by a mere bankruptcy trustee. [Spencer v. Marshall (2008) 168 CA4th 783]

Cancellation within five business days

After entering into an EP sale, a **seller-in-foreclosure** has a statutory five-business day *right to cancel* the sales agreement he has entered into with an investor. Cancellation avoids the sale entirely.

The seller-in-foreclosure's five-business day **right to cancel** does not commence until proper notice of the cancellation period is given to the seller. Thus, the notice is contained in the purchase agreement forms designed for equity purchase transactions, to trigger the running of the cancellation period from the moment the seller accepts an offer. [CC §§1695.4, 1695.5]

When the notice of the seller-in-foreclosure's cancellation rights are properly contained in the EP agreement, the seller's **cancellation period** ends:

- midnight of the fifth business day following the day the seller enters into any type of purchase agreement with an EP investor; or
- 8:00 a.m. of the day scheduled for the trustee's sale, if it is to occur first. [CC §1695.4(a)]

The buyer's failure to give notice of the seller's right to cancel allows the seller to cancel the sales agreement and escrow. Further, and more critical, the seller has the right to *rescind* the sale after the sales escrow has closed. The right to cancel or rescind continues until the notice is ultimately given by the investor and the five business days have run — without cancellation by the seller before the five-business day period expires. [See **first tuesday** Form 156 §18]

A **business day** is any day except Sunday and the following business holidays: New Year's Day, Washington's Birthday, Memorial Day, Independence Day, Labor Day, Columbus Day, Veterans' Day, Thanksgiving Day, and Christmas Day. Thus, Saturday is considered a business day under EP law, unless it falls on an enumerated holiday. Many state holidays are not included as holidays. [CC §1695.1(d)]

No performance until notice expires

Until expiration of the seller-in-foreclosure's right to cancel the transaction, the **EP investor** may not:

- **accept a conveyance** from the seller of any interest in the property;
- **record a conveyance** of the residence with the county recorder;
- **transfer an interest** in the property to a third party;
- **encumber any interest** in the residence; or
- **hand the seller** a "good faith" deposit or other consideration. [CC §1695.6]