firsttuesday Journal

MLO RECESSION SIDE HUSTLE GUIDE

Examine how mortgage origination providers will survive the ongoing downturn in mortgage originations.

1 **Originator fees are slashed**
How the recession will impact mortgage loan originators (MLOs), and the timing of the mortgage industry's recovery from the 2023 recession.

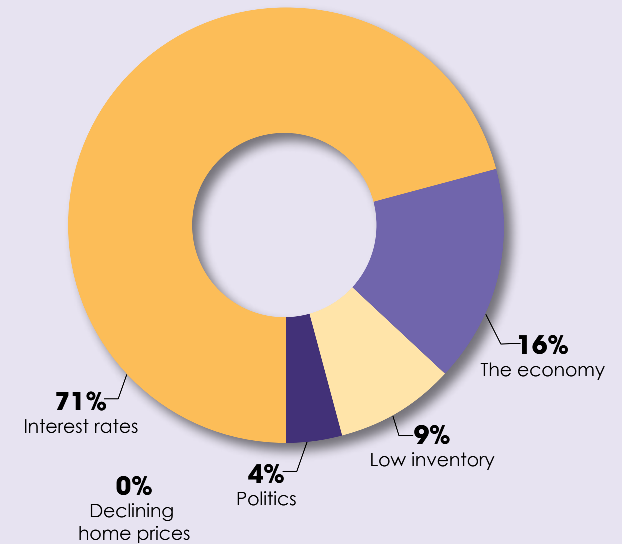
2 **Buyers' agents and underwater home sellers**
How to work with the evolving base of homebuyers and sellers to earn fees, even as the volume of traditional cash-to-new-loan sales slows to a tepid trickle.

3 **Working with REO property**
How to shift into foreclosure mode to earn fees for services needed by foreclosing lenders.

4 **Arranging mortgage originations for investors**
How to solicit and work with property investors during a recession.

1 Originator fees are slashed

The mortgage industry staggers into the 2023 recession — and avoids zombie status



A recent **firsttuesday** poll asked readers about the biggest obstacle in today's real estate market. An overwhelming 71% of respondents blamed *interest rates*.

While placing blame is more arguably leveled at pandemic period conditions which precipitated adverse conditions — such as interest rates — the *scarcity of mortgage origination fees* is not in dispute.

2022's rapid pace of interest rate increases — yet to be absorbed by an offsetting decline in property prices — has left mortgage-reliant homebuyers floundering with no present way to engage. As evidence, based on mortgage rate hikes alone and not mathematically asymmetric property prices, a current typical **California homebuyer** is limited by the amount of their income to borrowing *31% less purchase-assist mortgage money* than a year ago when all interest rates were still distorted at near-historic lows.

This buyer purchasing power tumble has collapsed directly onto the mortgage industry. For mortgage loan originators (MLOs), a multiplier effect accelerating the **implosion of fees** was the fast decline in home sales volume and near instant evaporation of any financial logic to justify homeowner refinancing.

The irretrievable, record level of mortgage origination fees in 2020-2021 was very juicy, thanks to the surge in **refinancing**. Now, all that is fully depleted with our recent resumption of rising rates in the current half of the historical rate cycle. What's next for the mortgage industry?

Mass exodus

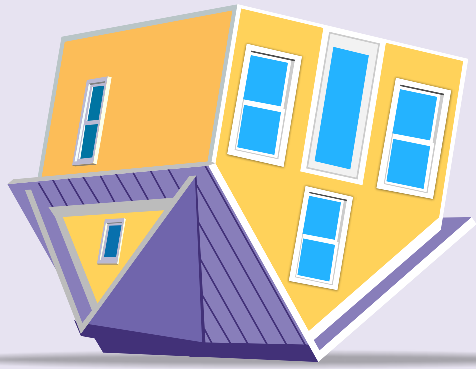
2023 started the year with refinance volume at *87% lower than* the amount experienced in 2021, according to the Mortgage Bankers Association (MBA). As a result of the deep slash to mortgage originations and thus MLO fees, the MBA anticipates a 25%-30% decline in mortgage industry **employment** in 2023-2024. For a trade organization which is typically driven by fervent optimism in the mortgage market, that's saying something.

Already, mortgage originators are cutting staff or exiting the business altogether as MLO employment will more likely see a 50% decline by 2024, roughly twice the share forecasted by industry leaders.

The short term aside, lower bank earnings are expected for the next two-three decades. However, bankers will certainly attempt to keep rising consumer mortgage interest rates appealing to *emotional* and *status-driven* homebuyers in an effort to maintain a **profit margin** for the business of originating home mortgages.

Low earnings by bankers and servicers will be further complicated by increased **mortgage delinquencies**.

During the pandemic, the **foreclosure moratorium** and **forbearance programs** kept millions of homeowners in their homes while not making



mortgage payments. With forbearance programs, mortgage servicers agreed to temporarily halt the foreclosure process while homeowners attempted to find jobs and bring their mortgages current.

But no such grace will be granted during the 2023 recession, as politicians will seek to avoid excessive stimulus and consequential *hyper-inflation*. When property values decline — to square with purchase-assist mortgage amounts a typical homeowner qualifies to pay — and homebuyers who purchased in the past three-to-four years fall underwater, **mortgage delinquencies** will certainly rise, along with the fallout of short sales, foreclosure sales, and real estate owned (REO) inventory for sale.

But the reality is not one of gloom and doom. There are plenty of *opportunities* for **California Department of Real Estate (DRE)** licensees with MLO endorsements — you just need to know where to pivot.

The 2023 recession got a head start in real estate

Mortgage originators as professionals who want to avoid becoming a negative statistic need to adjust their survival strategy — fast.

In the first half of 2023, an **economic recession** is not yet on the books. But its effects are already causing waves that are damaging real estate transactions, including:

- severe cuts to buyer purchasing power;
- degenerative home sales volume;
- failing **turnover** rates for tenants and sellers;
- plummeting home prices; and
- inadequate single-family residential construction;

Further, while home prices surged on the bountiful geyser of record-low interest rates in 2020-2021 — known as the "Fed Put" — **firsttuesday** forecasts prices to fall like dead weight, not finding a bottom until around 2025.

Here in California, depending on region and price tier, home prices are already down 9% to 12% from their May 2022 peak at the start of 2023.

To survive the tumultuous years ahead, mortgage originators who are DRE licensed with an MLO endorsement first need to accept that the extra income generated by refinances is gone. Going forward, to offset the downward spiraling fees from purchase-assist mortgage originations, DRE licensed MLOs will need to tap into some *creativity*.

Concurrent services rendered to maintain income

When income begins to slip, the only thing you can do — other than find a new job — is to achieve results producing income from still-running segments and upcoming recession-related services in the real estate and mortgage market.

Preparing now for reduced MLO income will set you up so your mortgage business survives in the years ahead before home sales and future financing recovers. As fees from **mortgage originations** continue to plummet, lost income needs to be covered either by a greater share of the volume of mortgage originations — extremely difficult in a recessionary environment — or by pursuing *alternative forms of income*.

This series on **MLO side hustles** aims to shift your focus from traditional forms of income during recovery and boom periods to those alternative income streams for real estate services arising during recessions and over the course of a slowdown in mortgage origination fees.

During today's recessionary market, this includes fees for:

- arranging home sales with **carryback financing**;
- assisting with short sale mortgage discount negotiations as a facilitator for **negative equity homeowners**;
- taking listings on **REO inventory** held by servicers/lenders;
- arranging **private money mortgage originations** for funding commercial and investment purposes, not consumer mortgages; and

- working for **equity purchase (EP) investors** purchasing homes from sellers-in-foreclosure. [See **RPI** e-book *Buying Homes in Foreclosure Chapter 16: Assumptions: formal and subject-to*]

Having peaked in March 2022, watch for mortgage origination volume to continue to slow through the 2023-2024 period, with falling property prices bottoming in 2025. A **sustainable recovery** for the housing market will occur once end users sense prices have bottomed, launching the next rise in mortgage origination volume and prices to take off around 2026-2027.

2 Buyers' agents and underwater home sellers

Consumer mortgage originations plummet — so what now?

The rapid mortgage interest rate hikes of 2022 caught homebuyers and sellers completely off balance. With prices toppling traditional sales volume and mortgage rates essentially eliminating financial justification for refinancing, mortgage loan originators (MLOs) are now left to fight over what remains of the scraps of mortgage originations to be arranged and funded.

Mortgage industry institutions forecast **consumer mortgage origination volume** to continue to nosedive in 2023. The natural result is fewer *origination fees* to go around.

In turn, **mortgage industry employment** — MLOs as legislated licensees — is forecasted to *fall by 25%-30%* over the next two years. Already, lenders are reactively cutting staff and even exiting the consumer mortgage industry altogether, according to the MBA.

firsttuesday's forecast is a more realistic minimum *50% decline* in MLO employment — eliminating those MLOs who continue to maintain the same approach to earning fees developed in the recovery since 2010. [See Chapter 1: Originator fees are slashed]

In other words, leaning on home **refinancing** and **single family residence (SFR)** purchase-assist mortgage originations, i.e., federally controlled *consumer mortgages*, will leave an MLO to exit the industry — fast.

To survive a decline in **consumer mortgage** originations, MLOs need to gain the attention of sellers and buyers by preparing themselves to negotiate sales transactions with alternative mortgage products arranged as **seller financing**. This practice of carryback sales was common throughout the decades in which interest rates last rose, peaking in 1980.

Arranging the sale of carryback notes

Beginning in 2022, a spiraling housing market has forced sellers to increasingly turn to **seller concessions** to appeal to buyers who are turned off by the convergence of high prices and rising mortgage rates.

But instead of reducing the profit from the sale of the home by accepting price concessions, paying mortgage points, or kickbacks for down payment or renovations, etc., sellers who want to maximize marketability, uphold their price profit margin, and earn interest in an installment sale can offer **seller financing** at an acceptable interest rate.

Seller financing is also known and advertised as:

- an installment sale;
- a credit sale;
- **carryback financing**; or
- an owner-will-carry (OWC) sale.

Carryback financing generally offers the buyer:

- a moderate **down payment**;
- a competitive **interest rate** on the carryback trust deed note;
- less stringent **terms for qualification**, no appraisal and far less documentation than imposed by institutional lenders; and
- no mortgage **origination costs** or lender processing hassle.

For the seller, carryback financing makes their property **more marketable**, primarily enabling a higher sales price.

Taxwise, the carryback trust deed note allows the seller to **defer any tax bite** on their profits while earning interest on the amount of deferred tax.

On closing, the rights and obligations of real estate ownership held by the seller shift by grant deed to the buyer. In the carryback sale, the seller receives a trust deed note from the buyer as their primary net proceeds from the sale, taking on the rights and obligations of a secured creditor, called a **mortgage holder**.

Real estate agents and brokers who are MLO endorsed are perfectly poised to counsel and assist a seller by negotiating a carryback sale. They will find themselves taking a higher number and varied types of property listings and closing more transactions — simply, they will be *more competitive* in the paradigm of the new market.

Thus, different streams of fee-based earnings using MLO based knowledge will offset MLO income in the down years looming for consumer mortgages as the recession of 2023 takes hold and continues to strangle. [See **RPI** e-book *Creating Carryback Financing*]

Market your MLO-related expertise — FARM — for property owners who have not listed their property for sale or whose listings have expired. Emphasize your knowledge acquired negotiating consumer mortgages and, today, expanded by learning the basics for arranging carryback paper.

Further, market your knowledge to other real estate licensees who have any type of property listed for sale, specifically agents and broker-associates who lack an MLO endorsement. Partner with them — *team up* — to write up purchase agreements and counteroffers with carryback financing provisions for their buyers and sellers to consider. Share in the brokerage fees on carryback sales transactions you help arrange.

Oral agreements with brokers regarding the sharing of fees are enforceable, though a written understanding of the assistance is helpful to avoid confusion or forgetfulness, or worse.

Then, an investor acquires the carryback notes

Often when arranging seller carryback financing, the MLO needs to locate a trust deed note investor who will purchase the seller's carryback on close of the sales escrow. This gives the seller a *cash-out* closing due to the concurrent sale and assignment of the carryback note to a **trust deed investor**.

Trust deed notes when properly structured — interest, payments, principal, and due dates — are considered *profitable investments* for trust deed investors, also called **private money lenders** or **hard money lenders**. They may also be dealers who buy and sell trust deed notes and mandated to operate under a DRE broker license.

Comparable to a buyer of real estate entering into a purchase agreement with the *advice and assistance* of their **transaction agent (TA)**, the trust deed investor buying a carryback note does so with the advice and assistance of an MLO as their well-informed **trust deed broker**. [See **RPI** Form 241]

Editor's note — Stay tuned for more about how MLOs can work with investors during a recession in Part 4 of this series.

Short sale negotiator

A **short sale**, also known as a *short payoff* or *discounted payoff* (and, humorously, a *haircut*), is a sale of encumbered property in which the mortgage lender accepts the seller's net proceeds at closing in full satisfaction — the haircut — of a greater amount of mortgage debt secured by the property sold.

A short sale is an **alternative** to a foreclosure sale for both the homeowner and the mortgage lender when the principal owed on a mortgage is greater in amount than the current market price of the property it encumbers.

Thus, the homeowner with a **negative equity** or **underwater** status may sell and relocate, advertised via the **multiple listing service (MLS)** as a *short-sale listing*. This listing status is needed to put the buyer and their agent on notice the mortgage holder needs to approve the price the buyer is paying as a condition for closing.

Short sales last resurfaced as a trend midway through the long recovery from the 2008 **Great Recession**. During the peak in short sales, roughly 25% of MLS sales transactions statewide were short sales. Mortgage lenders had learned that foreclosure was a *premature default response* for forcing the property to be sold. Mortgage holders and servicers still start foreclosure to demonstrate they are in control. In the process, they report the foreclosure to three credit agencies, all of whom oblige lenders by automatically dinging the owner's credit rating.

As home values plunge in **California**, likely to continue through 2024 into 2025, recent homebuyers with mortgages who bought within the past couple of years are increasingly falling *underwater*. When **unexpected circumstances** intervene — such as job losses or relocation by employers — these underwater homeowners become more likely to default on mortgage payments and are unable to sell their home for a price sufficient to cover the property's mortgage debt.

Editor's note — These consumer mortgages are not personal loans imposing a liability on the property owners, but real estate loans which limit the mortgage holders' recovery to the "value of the encumbered property."

That's where an MLO comes in, as a DRE licensee who sandwiches themselves into a transaction for a fee as the licensee who negotiates with the mortgage lender to agree to a discounted payoff.

A **short sale negotiator** works as an agent authorized by the seller to represent the seller to obtain the mortgage holder's approval of a discounted payoff. The short sale negotiator may be separate from but working in coordination with the sellers agent to complete the sale. Or they may be the buyers agent with limited authorization from the seller for short sale negotiations with the seller's mortgage holder. [See **RPI** Form 102-1]

Any DRE-endorsed MLO facilitating short sale negotiations with the sellers lender needs to first thoroughly understand:

- California **anti-deficiency law**, which bars a mortgage holder from collecting a loss due to a deficiency in a value of the encumbered property when the mortgage is a **nonrecourse** debt — such as a consumer mortgage providing purchase-assist funding or refinancing of a consumer mortgagee for a buyer/owner-occupant of a one-to-four unit residence;
- the trust deed foreclosure process and documentation, as well as time periods for **reinstatement** and **redemption** prior to the trustee's sale and elimination of ownership;
- negotiations to clear title of any junior financing encumbering the property whether the amount of the first mortgage is either less or more than the short sale net proceeds;
- the California Homeowner Bill of Rights, which restricts lender **dual-track foreclosures**, prohibiting the lender from advancing the foreclosure process while the homeowner is concurrently working on a mortgage modification with their servicer;
- income tax defenses to the **relief-of-indebtedness** income treatment triggered by the lender voluntarily reporting a loss on the mortgage to the Internal Revenue Service (IRS); and
- the state of the seller's income and net worth for **insolvency** evaluation by the mortgage holder/servicer.

This knowledge — combined with the *first-hand experience* of an MLO accustomed to working hand-in-glove with lenders to fund home purchases and refinances, now supplemented with short payoff negotiations with a mortgage holder — is the great pedigree of a **short sale specialist**.

Foreclosure consulting

Foreclosure in California is a codified process, triggered by default on a trust deed or its note – the mortgage documents – to recover dollar amounts owed on a debt by an advertised auction of the real estate encumbered as security for repayment of the debt.

On the owner's default, the **mortgage holder** (the lender or carryback seller) is forced to initiate the foreclosure process by a trustee's sale or judicial sale procedure. The owner's control is due to the **put option** provision contained in all trust deeds and codified by California's one-action rule making foreclosure the sole remedy for defaults on a mortgage.

The *put option* grants an owner the right to default and force the mortgage holder to buy the property — the put — through a foreclosure sale. The highest bidder acquires the property at a foreclosure sale, which typically is the mortgage lender. Thus, a negative equity homeowner has affirmative steps they can take to rid themselves of the underwater property and the mortgage debt; that is, they simply default on payments.

Functioning in tandem with the put option provision in a trust deed, California is an **anti-deficiency** state.

Critically, *no deficiency judgment* is available through the courts or otherwise for the lender to recover their loss on a foreclosure due to a decline in the market price of the buyer-occupant's one-to-four unit residence below the principal amount of their *purchase-money* mortgage. All consumer mortgages, with the exception of some refinancing conditions, are purchase-money mortgages subject to the deficiency bar which keeps these mortgage holders who foreclose out of the courts.

Foreclosure consultants assist defaulting homeowners to navigate the process and seek foreclosure alternatives for a fee.

A *foreclosure consultant* is any person who, for a fee paid by the seller-in-foreclosure, agrees to:

- stop or postpone the foreclosure sale;
- prevent lienholders from enforcing or accelerating their note;
- help the seller reinstate the mortgage or negotiate an extension of the reinstatement period;
- advance funds to the seller; or
- arrange a mortgage for the seller. [Calif. Civil Code §2945.1(a)]

Here in California, foreclosure consultants need to first register as a Mortgage Foreclosure Consultant with the Department of Justice and obtain a surety bond for $100,000. [CC §2945.45(a)]

A DRE-licensed broker or agent acting on behalf of an owner-in-foreclosure avoids being labeled a foreclosure consultant when they:

- receive only a contingency fee (paid on closing) from the owner for negotiating the sale of their residence in foreclosure;
- receive no **advance fees** or costs from the owner, an activity which converts the broker into a foreclosure consultant;
- make a **Regulation Z (Reg Z) consumer mortgage** as a principal for an amount sufficient to cure defaults, or arrange a Reg Z consumer mortgage as an MLO-endorsed broker employed by the owner; and
- receive no **ownership interest** in the property from the owner, except a security interest under a trust deed when acting solely as a principal (lender) making a MLO loan. [CC §2945.1(b)(3)]

Foreclosure consultants will find themselves muddying through a highly regulated foreclosure and mediation business, including competing with U.S. Department of Housing and Urban Development (HUD) advisors available free to the public.

Instead, consider the job title of *foreclosure consultant* as an entry point to working with homeowners to pursue **foreclosure alternatives**, such as a:

- short sale;
- **mortgage modification** to reduce and/or defer payments to match the homeowner's reduced income; or
- **deed-in-lieu of foreclosure**, commonly called a "friendly foreclosure," when the property owner voluntarily hands the mortgage holder who accepts a grant deed conveying title to them in exchange for canceling the mortgage debt.

A *deed-in-lieu of foreclosure* saves the mortgage holder time and money since they don't have to deal with the costs of an inevitable foreclosure sale when the owner decides, as they may, to retain possession until the foreclosure sale takes place. Further, mortgage holders sometimes will offer *relocation assistance* to shorten the time for resale of the property and reduce losses.

Buckle up: it's going to get bumpy

These three strategies will set up MLOs to continue working with a base of sellers, buyers, their agents, and lenders in the recessionary years ahead.

Rather than viewing the sales market as controlled by and primarily for the exclusive benefit of *sellers*, the attitude and thinking of licensed agents and brokers in a recession needs to shift to a cyclical market with conditions now shaped primarily by *buyers*, including the prices buyers will pay, and the terms of a purchase that motivates buyers to acquire property.

3 Working with REO property

An REO is born — again

When home prices decline, recent homebuyers quickly find themselves underwater, weighed down by a mortgage balance larger than their home's **fair market value (FMV)** — a detrimental condition known as **negative equity**.

When the inability to make mortgage payments or the need to relocate strikes, some of these homeowners will seek out mortgage modifications or short sales. [See Chapter 2: Buyers' agents and underwater sellers]

Alternatively, many will simply head toward foreclosure, waiting for the trustee's sale to compel them to vacate. These homes will become **real estate owned (REO) properties** in the portfolios of mortgage lenders.

The last time REOs were a significant presence in the housing market was in the years following the 2008 **Great Recession** and foreclosure crisis. In 2009, REO sales made up a whopping half of all home sales. Thus, any real estate professional who wanted to make a living needed to work with REO properties, on both the buyer/seller side and the bank/servicer side.

Further back, recall the Resolution Trust property disposal unit formed following the modest 1991 recession to sell seemingly endless quantities of property taken back by defunct **savings and loans associations (S&Ls)**, providing a fiesta for investors with auction paddles they couldn't keep from holding up.

While the REO share in 2023-2025 will not rise to the significant levels of 2008-2012, REOs will rise to swallow a significant share of the market — and MLOs who want to continue to make a decent living in the leaner years ahead will take note.

Watchful brokerage offices, typically the small ones, will set up **REO and MLO departments** to capture this unconventional sales market dominated by lenders.

Forming a broker price opinion (BPO)

The lender who bids an amount equal to a *full credit bid* at the **trustee's sale**, or the sum of all monies owed under the trust deed note, will quickly find themselves with REOs stacking up on their balance sheet, unable to breakeven. This buildup of vacant unlisted homes — **shadow inventory** —damages all home values, as well as the lender's balance sheet.

The lender who bids the full amount fails to recognize the property's current FMV, or what today's homebuyers will pay for a comparable property on the market. Instead, they prefer to avoid reporting a loss on the books and kick the "REO can" down the road, hoping and praying the property's FMV will rise to the level necessary to justify their full credit bid in the near future. Mortgage lenders are not well informed about the economics of real estate, just government guarantees to ensure profits on all mortgages.

However, contrary to the lender's bet, during a recessionary environment, their REO's value is likely to fall further and further underwater, a repeat of the REO disaster in the 1991 recession period.

Mortgage holders need to seek out a **broker price opinion (BPO)** early on — certainly *before* the trustee's sale and preferably some 90 days into a default. Without a BPO, mortgage holders have no data for taking steps to greatly reduce the risk of further costs, or worse, a loss by a full-credit, high bidder posture at the trustee's sale.

A **Department of Real Estate (DRE)-licensed MLO** is ideally placed to quickly prepare a BPO, distinct from an **appraisal** which is less helpful for lenders in a rapidly shifting downward-trending market.

Appraisers are essentially *historians* opining on events past. But a BPO allows a DRE licensee to step up with **current market conditions**, including:

- the pricing of properties closing escrow *today* (rather than over the past six months); and
- the direction the market is heading, important for when the foreclosure process takes six months to one year in the future to end up in a trustee's sale and as an REO on the lender's balance sheet.

The MLO calculates a BPO using data available by downloading a **property profile** — title condition — on the home and a printout of recent sales in the surrounding area from a title company website.

REO sales by lenders are not to be used as comparable sales to set property values for property. Mortgage lenders, their services, and private and government guarantees for consumer mortgages set the stage for REO inventory to be "dumped" by a lender — to get rid of the unwanted asset after settling the lender's claim as a loss.

Editor's note — Don't think for a minute that REO re-sales do not set values in the open market: they do and will continue to do so when the number of REOs rise in 2023-2025, as REOs listings compete with private sellers — conventional listings — for the limited stock of homebuyers able and willing to buy during the recession.

A broker's BPO is documented with a **comparative market analysis (CMA)**. The *CMA* is a worksheet used when estimating a property's value based on prices recently paid for comparable properties. The CMA reflects observations on a visual inspection of the comparable properties, noting in each property's column for itemized features distinguishable from the subject property the dollar adjustment needed to correct for its greater or lesser value than the subject property.

When preparing a CMA, licensed brokers and agents have a duty to be honest and truthful. As part of this, the comparable properties are to be fully analyzed *before* giving an analysis. In a word (or two): **due diligence**.

Without supporting data, the BPO documented with a CMA is merely a guess and thus a dishonest analysis with no basis for being accurate. [See **RPI** Form 318]

A BPO illustrated by a CMA will confirm:

- how ownership is vested and who has authority to employ management;
- the liens on the property and their foreclosure status;
- any use governed by covenants, conditions and restrictions (CC&Rs) affecting occupants;
- comparable sales figures in the area; and
- price adjustments for:
    - zoning;
    - easements;
    - location;
    - landscaping;
    - improvements;
    - livable space; and
    - amenities. [See **RPI** Form 318]

The MLO who offers BPOs as a service will see increased fee generation during the coming downturn, as well as set themselves up to perform other REO services foreclosing lenders need.

Inspect vacant REO properties

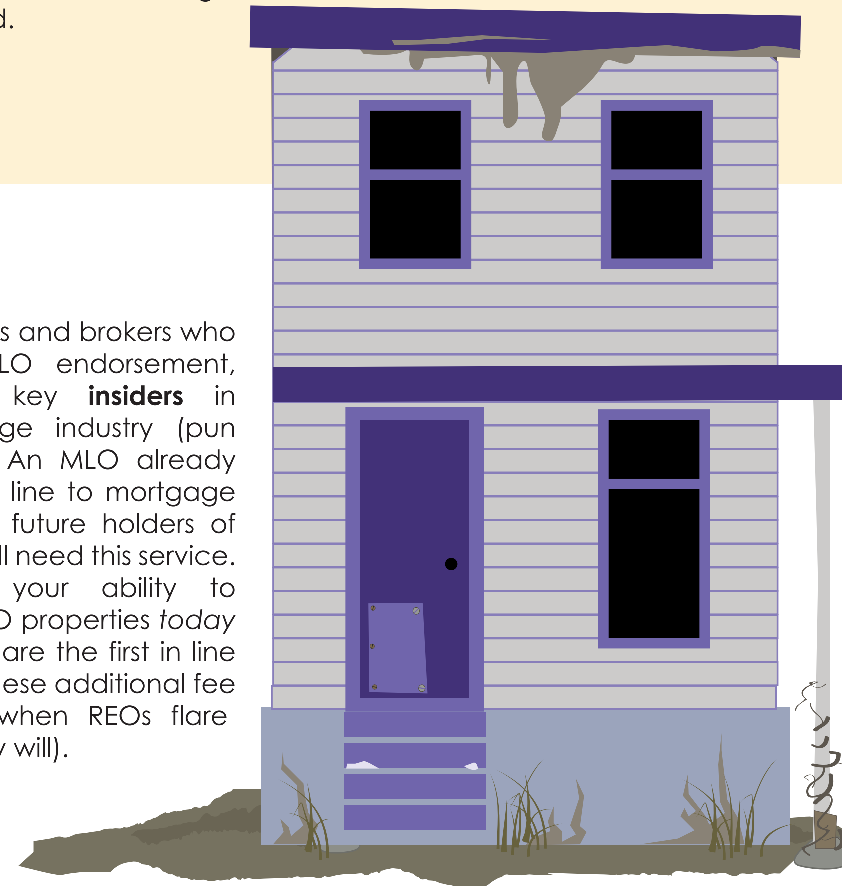
When lenders pile on the number of REO properties, *someone* needs to manage these assets. But who? That's where the creative MLO comes in.

Simply put, lenders employ a DRE licensee charged with confirming frequently that nothing deleterious is occurring on their REO properties. This includes checking for:

- squatters or adverse possessors;
- vandalism; and
- performance of maintenance.

This management activity may be part of an agent's agreed-to activities under a **listing agreement** employing the agent's broker to locate a buyer for the REO property. For these additional activities, the agent may charge a fee separate from and in addition to the fee for marketing the property for sale. [See **RPI** Form 102]

Unlike agents and brokers who lack an MLO endorsement, MLOs are key **insiders** in the mortgage industry (pun intended). An MLO already has a direct line to mortgage lenders, the future holders of REOs who will need this service. Advertising your ability to manage REO properties *today* ensures you are the first in line to take on these additional fee generators when REOs flare up (and they will).



Head of the REO line

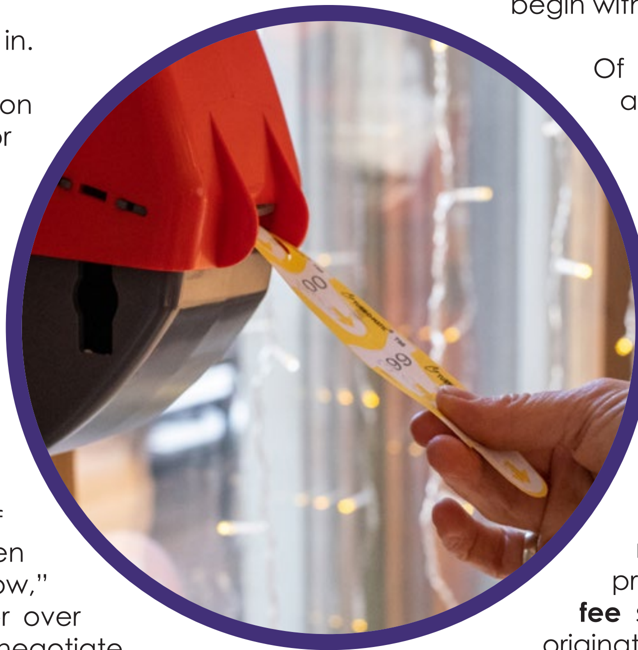
When a private homeowner lists their property, they turn to an agent they trust, often someone who is referred to them by a person in their inner circle of friends and family. This is known as **word-of-mouth marketing**, and agents and brokers are adept at navigating this type of referral network.

But when a lender or servicer lists an REO, they are often out-of-state entities with no local contacts or true insiders to turn to.

That's where an **MLO-endorsed licensee** comes in.

To be first in line for fees when the REO situation snowballs, an MLO first needs to forage for contacts among the mortgage lenders they have worked with in the past. The goal is to obtain **employment agreements** when foreclosure sales are completed — listing REOs for sale.

Once an REO listing agreement is secured, that's when the real work in negotiations begins — not price discussions with a buyer, but with the employing REO lender.



Too often, the lender will play the game of *taking offers*, rarely making counteroffers when a potential buyer's price comes in "too low," instead demanding a higher resubmitted offer over and again. This tactic demands the buyer to negotiate with themselves, removing the lender from price setting in an offer-counteroffer bargain. Ultimately, this behavior disincentivizes the prudent buyer from continuing their pursuit of the REO property due to the difficulty and interminable nature of dealing with the lender — a **deal killer**.

Lenders thus retain control by doing nothing until pressured by government agencies to sell the properties. Worse, government agencies may well need to take over lenders who mismanage. At this point, the agency does the selling, which happens fast, as occurred in the early 1990s with the Resolution Trust arrangement.

When price negotiations stall, a long adjustment period occurs as. Over time, the REO's value continues to diminish — alongside buyer interest in the property. Thus, the lender or mortgage guarantor ultimately ends up suffering a larger **loss** than necessary had they simply priced the property appropriately and negotiated with the buyer to begin with. Lenders lack psychological security.

Of course, lenders do not know how to sell a property, as that is not part of their job description. However, agents and brokers *do* know how to attract buyers — doing so is in their professional DNA. Even better, an MLO-endorsed broker is comfortable in both corners, sandwiching themselves into deals as savvy in both *home sales* and *lender dealings*.

Don't overlook the fact most all buyer-occupants of an REO home need a **purchase-assist mortgage**, a well-known DRE MLO service, funded by a lender other than the lender who foreclosed. Performing multiple services means multiple fees may be properly earned. there being no **referral/kickback fee** situation as the MLO involved packages the origination — all in house.

Prepare for the REO resurgence now

While REOs are not yet a fixture in California's housing market, the potential for REOs rises with each passing day of declining home sales volume and pricing.

Ensure your future access to fees by forging relationships with key players in the REO landscape — namely, servicers and lenders — today.

These relationships will send servicers of REO property first to you to manage the sale of REOs, immensely helpful for ensuring a future income stream when traditional listings are few. They will also lead you to REOs before they hit the market, enabling the homes with the best investment potential to reach your desk before they hit the streets.

4 Arranging mortgage originations for investors

Investors need business-category mortgages, not consumer mortgages

In the years since 2010 when **mortgage loan originators (MLOs)** were federally created to package consumer-type mortgages for home purchase and refinancing, a typical year swelled with traditional *cash-to-new loan* sales and refinances. In turn, this generated consistent consumer mortgage demand. Naturally, MLO income consists of *fees* earned on **consumer mortgage originations**.

However, those years saw next to no contact by MLOs with real estate investors.

MLOs are not in the business of packaging mortgages for investors who look for purchase-assist financing to acquire income property, or refinancing an **income property** they own. That's because investors seeking financing need access to *commercial mortgages* — also known as **business mortgages** — a different category of mortgage controlled by different rules and practices than the *consumer mortgages* MLOs have authority to originate for a fee.

During an economy's **recovery period**, prices rise, temporarily escaping from the mean price trendline to which they eventually return. During the years of property price distortions, prudent investors sit on the sidelines. They strategically wait for real estate prices to *normalize* — a return to realistic **capitalization rate** levels indicative of a long-term investment in **income producing property**. This long line of individual investors has built up rapidly in recent years of unjustifiably escalating property prices here in California.

Now that prices have begun to decline in what is fast becoming a long, drawn-

out *face plant* for owners who sell, these investors are ready and prepared to jump in once prices reach their cyclical bottom.

They have been a silent, patient group.
Around 2025-2026, this buildup of long-term, **buy-to-let investors** will flood the market, competing at the same time with the cyclical arrival of short-term investors — **speculators**. Collectively, they will propel the market out of the recession, likely in 2026-2027.

The various types of investors an MLO gears up to work with during a recession include:

- **equity purchase (EP) investors**, who purchase property from sellers-in-foreclosure; [See **RPI** Form 156; **RPI** e-book *Buying Homes in Foreclosure*]
- **investor assumptions** on seller-occupant sales, or mortgage takeovers by an investor with or without written due-on-sale waivers from the lender;
- **local syndicators** who form and manage real estate acquisitions of any type property, the purchase price paid using commercial mortgage funds coupled with equity funds raised from investors joining the syndicate, structured always as a **limited liability company (LLC)**; [See **RPI** e-book *Forming Real Estate Syndicates*] and
- **speculators** or **flippers** who purchase with short-term, hard money mortgage funds in anticipation of a resale at a profit in a matter of months based solely on an upward wave of market momentum.

MLOs pivoting to cash-in on fees from services needed by the coming wave of investors will offset the dearth in consumer mortgage origination fees during a recession.

However, they first need to learn a few necessary additional skills to *arrange* commercial mortgages for funding by private lenders, and some community banks who *make* these commercial mortgages.

Mortgage loan brokers, please step up

In contrast to an MLO, whose authority is limited to "originating" consumer mortgages secured by one-to-four unit residential real estate for a fee, a DRE-licensed broker with their licensed agents may hold themselves out and provide services as a **mortgage loan broker (MLB)**. *MLB* services deal with all aspects of arranging and funding commercial mortgage originations and real estate related investments.

Yes, a DRE-licensed broker and their agents who are MLO-endorsed may negotiate both consumer mortgages and business mortgages. The dichotomy in mortgage categories, which did not exist prior to **Dodd-Frank** in 2010, is the result of the federal preemption of rules and licensing for consumer mortgage originations. When the federal government carved up mortgage lending arrangements, they created two distinct categories:

- the **consumer mortgage** — funding buyer-occupant home purchases and refinancing; and
- the **business mortgage** — funding investments, businesses or agriculture, commonly called *commercial mortgages*.

While federal law primarily controls the origination of consumer mortgages, business mortgage originations — commercial mortgages — were left to be controlled by state law requirements.

Thus, in **California**, a DRE licensee holding an MLO

endorsement has the authority to offer services as an MLB able to originate *both* consumer and commercial mortgages.
An MLB may:

- **arrange** a commercial mortgage, negotiating the terms of a business-purpose mortgage on behalf of an investor and with the lender who funds the mortgage, often an individual, individual retirement account (IRA), pension fund or small local bank;
- **originate** a mortgage using their own funds; and
- operate as a **trust deed broker** to negotiate the sale or purchase of an existing trust deed note on their own behalf or for a client.

Commercial mortgages and other non-consumer mortgage-related transactions include arrangements such as:

- representing hard money or private lending to originate commercial category mortgages;
- **mortgage-backed loans (MBLs)** — when a trust deed note is assigned as security, not the property directly;
- carryback financing; and
- trust deed investments other than consumer mortgages.

When originating a commercial mortgage, the MLB may also be employed by the lender to act as a **servicing agent** or **contract collection agent** on the mortgage for an additional fee. [Calif. Business and Professions Code §10233]

Evaluating investment property for mortgage funding

While all qualified consumer mortgages are guaranteed or backed by the federal government in some manner, commercial mortgages present a vastly different bet by lenders.

Thus, when a commercial property investor defaults, the initial **source of recovery** is the value of the property itself, which changes based on ever-evolving market factors. The mortgage originator *gambles* that the future value of the property will be sufficient to cover any future default, even during a foreseeable recession when property values decline.

Editor's note — A secondary source of recovery on the default of a commercial mortgage is the person who signed the note, as well as any persons who signed guarantees assuring payment. Unlike homebuyer-occupants, investors are not protected by California's ***anti-deficiency laws*** *except when the mortgage holder completes a trustee's foreclosure sale.*

Therefore, a thorough analysis of the income property is required by the prudent commercial mortgage lender, and their DRE licensed agent, to ensure an appropriate value has been assigned to the property securing the mortgage.

In contrast, **appraisers** and their consumer mortgage lenders are evaluating property for purchase by buyer- or owner-occupants and are never really "on the hook" for the valuations, since the mortgage lender recovers under government guarantees.

To avoid an investor's over-optimistic valuation of property they seek to buy, the MLB packaging a mortgage to fund the purchase needs to order or (much better) be trained and prepare a price evaluation themselves, called a **broker price opinion (BPO)**.

Astute readers will note that BPOs have historically been called broker price opinions (BPOs), as though an opinion of value. But legislation

has clarified the meaning of words in the mortgage world. A BPO for mortgage originations is a *comparative pricing analysis,* an analysis of market data on sales, not an opinion.

The MLB develops a BPO by first downloading a **property profile** — title condition — on the property and a printout of recent sales in the surrounding area from a title company website.

A broker's BPO is documented by preparing a **comparative market analysis (CMA)**. The CMA is a worksheet used when establishing a property's value based on prices recently paid for comparable properties. The CMA reflects observations on a visual inspection of the comparable properties, noting in each property's column for itemized features distinguishable from the subject property the dollar adjustment needed to correct for its greater or lesser value than the subject property. [See **RPI** Form 318; Chapter 3: Working with REO property]

In contrast, a BPO without supporting data has no CMA documentation and is merely an uneducated guess. Thus, it is a "no docs," dishonest analysis with no basis for being accurate. [See **RPI** Form 318]

A BPO developed by preparation of a CMA will confirm:

- how ownership is vested and who has authority to employ management;
- the liens on the property and their foreclosure status;
- property taxes and their payment status;
- any use governed by covenants, conditions and restrictions (CC&Rs) affecting use by occupants including any HOA policies;
- comparable sales figures in the area; and
- price adjustments for:
  - zoning;
  - easements;
  - location;
  - landscaping;
  - improvements;
  - livable space; and
  - amenities. [See **RPI** Form 318]

The completed BPO will confirm an appropriate valuation of the investment property to be funded.

High-interest mortgages, a teaser in a recession

The amount of interest — annual earnings — a private, non-exempt lender can charge is regulated by statute and the California Constitution. Collectively, these are referred to as **usury laws**. [Calif. Constitution, Article XV; Calif. Civil Code §1916-1 through 1916-5]

Here, a **DRE-licensed broke**r has an edge on the commercial mortgage market during periods of high risk of mortgage defaults, and thus high rates of interest to cover the losses on a lender's mortgage portfolio. That rate of interest when negotiated by a broker can exceed limits on annual earnings — interest, etc. — a private "hard money" lender may charge and collect when a broker is not involved.

The goal of *usury laws* is the prevention of **loan sharking** by private lenders, all other lenders being exempt. *Loan sharking* is the act of charging exorbitant interest at a higher rate than the allowable ceiling-rate established by the *usury laws*. These mortgages are categorized as **usurious**. [CC §1916.3(b)]

However, as we are now entering a period of rising mortgage interest rates, earnings by lenders originating commercial mortgages will exceed

the usury rate ceiling — presently set at 10% in California and subject to change annually. [Calif. Const. Art. XV §1]

Types of lenders exempt from *usury law restrictions* when funding a mortgage include:

- DRE-licensed brokers;
- savings and loan associations (S&Ls);
- state and national banks;
- industrial mortgage companies;
- credit unions and pawnbrokers;
- agricultural cooperatives;
- corporate insurance companies; and
- personal property brokers. [Cal. Const. Art. VX]

A huge advantage of the DRE licensee with an MLO endorsement is that the mortgage originated at an interest rate exceeding the 10% **usury rate** ceiling requires a licensed broker to *arrange* (negotiate) the otherwise usurious commercial mortgage lending situation to qualify the mortgage as *exempt* from the state's usury law.

Two basic distinctions for private mortgage lending exist, based solely on whether a DRE-licensed broker is involved:

- **brokered** real estate mortgages; or
- **restricted** or **non-brokered** real estate mortgages.

When a DRE-licensed broker is involved in "arranging or making" a real estate mortgage, the transaction is exempt from *usury restrictions* and falls into one of two categories:

- mortgages funded by a licensed real estate broker **acting as a principal** — the lender — for their own account; or
- mortgages arranged by a DRE-licensed broker **acting as an agent** negotiating the mortgage origination on behalf of another for compensation.

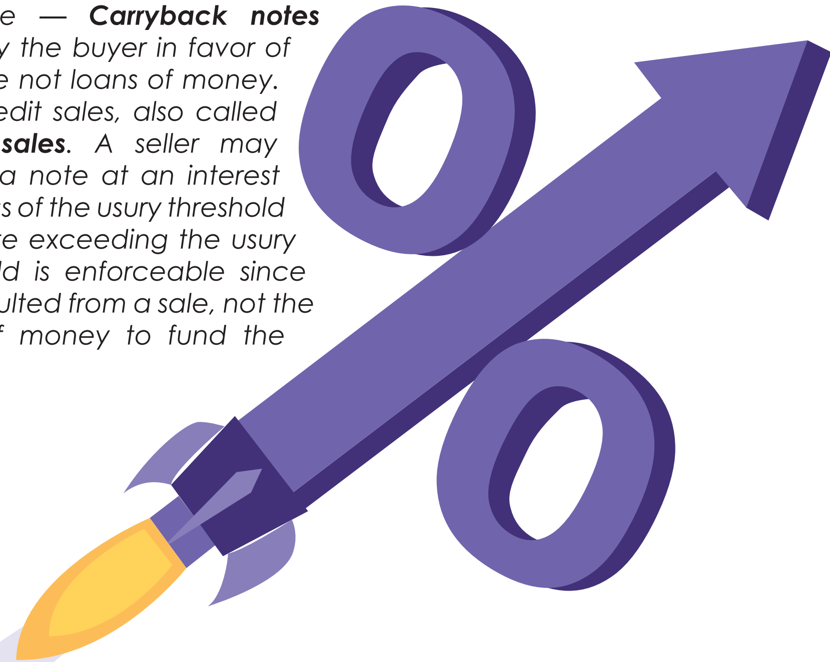
Restricted real estate mortgages are all mortgages made by private party or hard money lenders which are neither made nor arranged by a broker.

Private lenders include corporations, LLCs, partnerships and individuals. These entities are controlled by usury limitations on annual earnings unless operating under an *exempt* classification, such as a personal property broker or real estate broker.

The most common *restricted mortgage* involves hard money lenders, unlicensed by the DRE and unassisted by a DRE-licensed broker, who make loans secured or unsecured by a mortgage.

Friends and acquaintances fall victim to this usury law when helping themselves by helping a friend. The purpose is genuine, usually to avoid a foreclosure on the friend's home. Often the documentation is a grant deed/leaseback with option or some other security device other than a trust deed to secure the debt, evidenced by a note. Nonetheless, it is a mortgage and usurious when earnings on the funds exceed the annual ceiling — no broker was involved as a principal making or as an agent arranging the mortgage.

*Editor's note — **Carryback notes** executed by the buyer in favor of the seller are not loans of money. They are credit sales, also called **installment sales**. A seller may carry back a note at an interest rate in excess of the usury threshold rate. The rate exceeding the usury law threshold is enforceable since the debt resulted from a sale, not the advance of money to fund the purchase.*



Hard money lending

Hard money lenders, also known as **private lenders**, are lenders who make short-term mortgages from their own funds, called a **hard money mortgage**. Private lenders are not institutional lenders. [See **RPI** e-book *Mortgage Loan Lending*, Chapter 40]

A hard money mortgage, commonly referred to as a **bridge loan**, is typically a short-term commercial-purpose mortgage secured by real estate that has a mortgage term of three years or less, often one year.

These short-term mortgages generally have *higher interest rates* and **upfront costs** in the form of origination or discount points. The borrower pays the MLB fee, not the lender. But the fee most often is the discount amount or points the borrower pays. Further, the reasons for lending are not usually based on traditional credit guidelines as are mortgages by institutional lenders but rely solely on the value the property might have in a **foreclosure** scenario.

Hard money mortgages are commonly used to fund real estate purchases by investors who rehabilitate property for resale, called **flipping**, when they or the property does not qualify for conventional financing.

Often, hard money mortgages are evidenced by a **straight note**. A *straight note* does not call for the property owner to make periodic payments while completing repairs and the property is marketed for sale or refinancing is located to retain long-term ownership. When due, all principal plus accrued interest is paid in a single lump-sum payment. [See **RPI** Form 423]

Working with hard money lenders with or without an MLO endorsement

Hard money lending opens doors for MLO-endorsed DRE licensees. It's also an opportunity for DRE licensees who do not have an MLO endorsement. Commercial mortgages arranged by DRE licensees may encumber any type of property from owner-occupied SFRs to land, from income property to a tenant's leasehold interest, and even a lien on a trust deed note the borrower assigns as collateral. No MLO endorsement required.

It is the borrower's purpose for their use of the funds that distinguishes a consumer mortgage from all other mortgages. The purpose of a consumer mortgage origination is to fund a buyer's purchase of an SFR to fourplex for use as their home or to refinance a consumer mortgage on the home they occupy. The MLB needs to confirm in writing the borrower's intended use of the net proceeds from a commercial mortgage. [See **RPI** Form 202-2]

Consider an MLB who enters into a **listing agreement**, employed to arrange a loan secured by the borrower's income producing real estate. [See **RPI** Form 104]

The MLB prepares a loan package and solicits a hard money lender who agrees to fund the mortgage sought by the borrower. The lender receives the borrower's note as evidence of the debt and a **trust deed** lien on real estate as security for repayment in the event of default on the note.

The hard money lender handles the collection of payments on the note. Later, the lender wants to sell the trust deed note and contacts the MLB.

The MLB knows **trust deed investors** willing to purchase the lender's trust deed note. The MLB, acting as authorized by their DRE license as a **trust deed broker**, negotiates the sale of the trust deed note.

The originating lender receives cash and the trust deed investor is assigned the note and trust deed. Further, the MLB enters into a **loan servicing agreement** with the investor to handle collection on the trust deed note — for a fee. [See **RPI** Form 237]

The owner of the real estate securing the mortgage is notified of the **assignment** of the trust deed note to the new mortgage holder. The property owner is also advised to make future payments to the broker under the *loan servicing agreement*. [Calif. Civil Code §2937(a); Calif. Commercial Code §9318(3); see **RPI** Form 238]

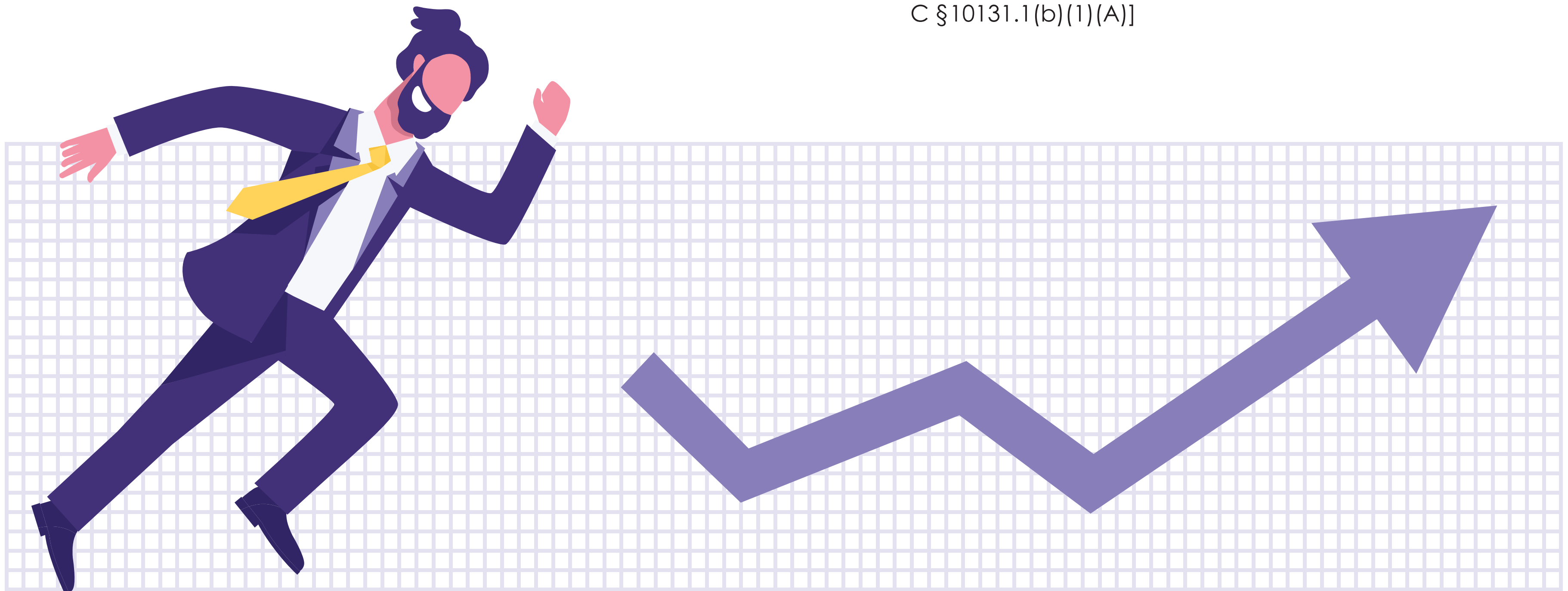
A **trust deed dealer** is in the business of buying and selling trust deed notes and land sales contracts for their own account, sometimes called **flipping paper**.

Unlike a trust deed broker, a trust deed dealer acts solely as a principal. A trust deed dealer buying and selling trust deed notes is required to hold a DRE broker license when they buy, sell or exchange eight or more trust deed notes during a calendar year without retaining a broker to negotiate the assignments. [Bus & P C §10131.1]

Here, the dealer is required to also hold a **broker license** even though they do not act as an agent for anyone.

Conversely, an individual is *not* a trust deed dealer and need not be a licensed DRE broker when they:

- resell trust deeds to the public through a DRE-licensed broker; [Bus & P C §10131.1(b)(1)(B)] or
- hold the paper they buy as a long-term investment. [Bus & P C §10131.1(b)(1)(A)]



Expand your real estate practice, pivot with the market

firsttuesday forecasts **mortgage industry employment** to precipitously decline roughly 50% in 2023-2024 from the 2021 level.

MLOs who continue applying the same approach to earning income developed during the recovery, expansion and pandemic distortions since the 2008 recession will be first in line for a rapid career exit.

In other words, leaning on home **refinancing** and **single family residence (SFR**) purchase-assist mortgage originations, i.e., federally controlled *consumer mortgages*, will quickly leave an MLO with empty pockets in the mid-2020s.

To survive the decline, MLOs holding a DRE license need to expand and adapt their practice to work with:

- REO properties; [see Chapter 3: Working with REO properties]
- sellers-in-foreclosures for mortgage workouts and short sales;
- non-traditional consumer mortgage originations; [see Chapter 2: Buyers' agents and underwater homeowners] and
- commercial mortgages made by hard-money private mortgage lenders to fund income property owners and buyers.

DRE licensees without an MLO endorsement also need to take note of these **survival strategies**. Brokers and agents still have time to pivot and cater to recession period demands of homebuyers and income property investors and capture a chunk of their fast-developing market.