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Insights

Four Things to Know When Buying a Loan

Article
06.19.2017

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Have you considered buying a loan from another lender? Maybe the loan is secured by a piece of real estate you would like to own. Or maybe it's just a good investment opportunity. In any case, do you know what you need to look for when evaluating the loan and loan documents to ensure that you will be able to enforce them later?

Here are four things that you should consider:

1. **Does the seller have the original note?**

   If you later have to enforce the loan through legal proceedings, you will be required to produce the original note and file it with the court before a judgment is awarded (and if bringing a foreclosure lawsuit, you will have to swear to the location of the original note at the very beginning of the lawsuit). Therefore it is critical that you obtain the original note when buying the loan.

   If the original note has been lost, that is not fatal, but you will need to obtain an affidavit from the seller (or whomever actually lost the note) stating the circumstances that led to the loss along with a full copy of the note.

2. **Is the note payable to the seller?**

   While this one sounds easy, it is not uncommon for a loan to have changed hands several times, with the documentation of those transfers being something short of ideal.

   To enforce the note after you buy it, you will need to demonstrate a clear chain of assignments (called indorsements or allonges) from the original lender all the way to the seller, who will then further assign it to you. If there is any break in that chain, the borrower will be able to challenge your "standing" to sue, making it much more difficult to recover on your investment.

3. **Is the loan in default?**

   The status of the loan at the time you purchase it can be critical. No matter how well you review the available documents and circumstances, you can never be 100% sure of the defenses a borrower may raise when you go to enforce the loan later.

   As the purchaser of the loan, you will step into the shoes of the prior lender (or lenders) and be subject to any defenses the borrower could have raised against them. However, if you bought the loan before it was in default, you may be able to avoid many of those defenses under the "holder in due course" doctrine.

   Additionally, if the loan was ever held by a bank that was shut down by the FDIC, you may be able to obtain some of the same protections.

4. **Does the seller have a well-documented payment history?**

   Finally, it is important to remember that if you have to bring a lawsuit to recover your investment, the burden of proof is on you. While establishing the existence of the loan documents and that the borrower breached them may be fairly simple, establishing the amount that is actually due may be more difficult. This can particularly be the case when the prior lender did not keep accurate records of the payments it received and how it applied those payments.

   You will eventually need to admit the payment history into evidence in a lawsuit, so having a well-documented history is critical. Without it, you leave open the possibility of the borrower asserting that less or nothing is owed without any ability to refute those claims.

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