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Foreclosing and Re-Selling Non-Securitized Single Family Residential Real Estate Lien Notes

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I. INTRODUCTION.

Chapter 9 (“Chapter 9”), of the Texas Business and Commerce Code (the “TBCC”), and the terms of any written agreement, govern consensual security interests¹ in personal property and fixtures, and a secured party’s collection or disposition of personal property. Let’s first review some of the definitions used in Chapter 9. A party who grants a security interest is a “debtor;”² a party granted a security interest is a “secured party;”³ personal property burdened with a security interest is “collateral;”⁴ a “security agreement”⁵ is any document that creates a security interest in the collateral; an “obligor”⁶ is a party who owes payment or other performance on an obligation secured by a security interest on the collateral; and a “secondary obligor”⁷ is an party whose obligation is secondary, or who has a right of recourse against a debtor, another obligor, or the property of either.

A security interest “attaches”⁸ to collateral when it becomes enforceable, in that a debtor agrees to create a security interest in the collateral, that agreement is evidenced in some way, most often by a signed security agreement, value has been given, and a debtor has rights in the collateral. A security interest is “perfected”⁹ in collateral when it attaches, and when all applicable perfection requirements are satisfied.

1

TBCC §1.201(35) defines a security interest as an interest in personal property or fixtures that secures payment or performance of an obligation. It includes any interest of a buyer of a promissory note in a transaction that is subject to Chapter 9.

2

TBCC §1.201(28) defines a debtor as: (i) a person having an interest, other than a security interest or other lien, in the collateral, whether or not the person is an obligor; (ii) a seller of accounts, chattel paper, payment intangibles or promissory notes; or (iii) a consignee.

3

TBCC §9.102(73) defines a secured party as including, among others, a person in whose favor a security interest is created or provided for under a security agreement, whether or not any obligation to be secured is outstanding, and a person to whom promissory notes have been sold.

4

TBCC §9.102(12) defines collateral as property, among others, that is subject to a security interest, and promissory notes that have been sold.

5

TBCC §9.102(74).

6

TBCC §9.102(60).

7

TBCC §9.102(72).

8

TBCC §9.203.

9

TBCC §§9.301 - 9.343.

Unless Chapter 9 provides otherwise, “priorities”¹⁰ among conflicting security interests in collateral that have attached and are perfected rank according to priority in time of filing or possession.

This article¹¹ discusses how a Chapter 9 secured party:

- (i) perfects a security interest in;
- (ii) collects;
- (iii) enforces; and
- (iv) disposes of;

both contractual and statutory rights in a non-securitized¹² promissory note¹³ secured by a mortgage¹⁴ in a single family residence (hereinafter, a “real estate secured note”); and then re-sells the notes after acquiring them at a public disposition. The relationship of Chapter 9 security interests in real estate secured notes as negotiable instruments¹⁵ under Chapter 3 (“Chapter 3”) of the TBCC is also discussed.

¹⁰

Ibid.

¹¹

The author has represented secured parties for many years. The sample forms included as Appendices to this article are lender oriented. The author reserves the right to assert positions in opposition to the positions taken by Local Bank in this article applying the law to the facts involved in the other matters.

¹²

For a discussion of the ownership, servicing, transfer and enforcement of a securitized negotiable instrument secured by a residential mortgage, see Mr. G. Tommy Bastian’s “*How Securitization Changed Residential Foreclosures*” article presented at the 2010 State Bar of Texas Advanced Real Estate Law Course.

¹³

A promissory note may be negotiable or non-negotiable. TBCC §9.102(66) defines a promissory note as an instrument that evidences a promise to pay a monetary obligation, does not evidence an order to pay, and that does not contain an acknowledgment by a bank that the bank has received for deposit a sum of money or funds. TBCC §3.104 lists the requirements necessary for a promissory note to be a negotiable note.

¹⁴

TBCC §9.102(55) defines a mortgage as a consensual interest in real property, including fixtures, that secures payment or performance of an obligation.

¹⁵

TBCC §3.104. A negotiable instrument means an unconditional promise or order to pay a fixed amount of money, with or without interest, or other charges described in the promise or order, if it: (i) is payable to bearer or to order at the time it is issued or first comes into possession of a holder; (ii) is payable on demand or at a definite time; and (iii) does not state any other undertaking or instruction by the person promising or ordering payment to do any act in addition to the payment of money, but the promise or order may contain: (1) an undertaking or power to give, maintain, or protect collateral to secure payment; (2) an authorization or power to the holder to confess judgment or realize on or dispose of collateral; or (3) a waiver of the benefit of any law intended for the advantage or protection of an obligor. An instrument is a promissory note if it is a promise and a draft if it is an order. If an instrument falls within

After setting out a fact pattern, the legal principles under Chapter 9 and Chapter 3 applicable to real estate secured notes are discussed and applied to the fact pattern, and practical suggestions, including sample forms, are provided for the reader's consideration and use in the enforcement of a security interest in real estate secured notes, and in re-selling the notes after a public disposition. Sample forms are included.

II. FACT PATTERN - INTRODUCING THE PLAYERS.

A debtor's (the author's hypothetical "Developer") loans with a secured party (the author's hypothetical "Local Bank"), have all matured and are in default.¹⁶ This article assumes that all required notices of default, notices of intention to accelerate, and notices of acceleration have already been provided to Developer, or were waived in the loan documents.

The Developer acquires vacant land, re-subdivides the vacant land into residential lots, constructs single family residences on the residential lots, and owner finances the sale of the single family residences for Homeowners with little to no down payment required, at fixed rates of interest, and with monthly payments amortized over twenty to twenty-five years. Developer obtains loans at Local Bank for each phase of Developer's business. Every real estate secured note held by Developer is secured by a mortgage on the single family residence that Developer constructed and sold to Homeowners.

Developer's loans at Local Bank initially are secured by mortgages on vacant land, on subdivided lots and on unsold residences constructed by Developer on the subdivided lots. Local Bank obtains loan policies when land is acquired, or the land is re-subdivided. Local Bank also either obtains loan policies or construction binders when residences are constructed on the lots. All of Developer's loans are cross-collateralized and cross-defaulted, and Developer grants Local Bank a blanket security interest on all of Developer's real estate secured notes, with Local Bank filing a financing statement with the Texas Secretary of State's Office on all of Developer's real estate secured notes. Local Bank's practice also includes Local Bank taking possession of all real estate secured notes.

Whenever Developer finances the purchase of a residence for a Homeowner, Local Bank usually does not release its mortgage on the residence, but requires that the Developer either execute: (i) a collateral transfer of promissory note and lien document on the specific real estate secured note that is patterned after the promulgated form in the *Texas Real Estate Forms Manual*¹⁷ published by the State Bar of Texas (the

the definition of both, a person entitled to enforce the instrument may treat it as either.

¹⁶

Except for defaults associated with agricultural liens in TBCC §9.606, the TBCC does not define a default, so the secured party and its debtor must agree, usually in a security agreement, on the events that result in a default. See TBCC §9.601, Comment 3.

¹⁷

Form 16-8 in the Forms Manual ("Form 16-8"). A collateral transfer document is usually executed and recorded to document that the original lender used the promissory note as security to borrow money, rather than sell the promissory note outright to a third party. Form 16-8 defines the "collateral" as all of Developer's interest in the real estate secured note and the mortgage. Form 16-8 includes statements that the secured party is the holder of the promissory note, is the sole party with power to appoint a substitute trustee or request the trustee to act, and that any foreclosure action requested by the debtor is void. See TBCC §9.109, Comment 7. Any attempt to obtain or perfect a security interest in the promissory note by complying with non-Chapter 9 law, as by an assignment of record of the

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