- Promissory note
- Assignment or endorsement of the promissory note
- Title insurance policy or endorsement of the existing title policy.

Unless exempt, escrow agents are licensed by the Department of Business Oversight (DBO). An MLB is exempt when conducting loan escrows incidental to his or her loan brokerage business. As a result of this exemption, the MLB will frequently conduct escrows. Because the escrow holder should remain in a neutral position, you may wish to consider using an escrow agent other than the MLB, particularly when the MLB is either the borrower (or related to the borrower) or the note holder (or related to the note holder).

Escrow "closes" when all the conditions of the escrow instructions have been waived or satisfied, the instruments have been recorded, and the funds have been disbursed. You should receive a closing statement describing to whom and how the funds and the documents were disbursed.

5. Documents and instruments describing, evidencing, and securing the loan or purchase of the promissory note

Your trust deed **investment** will either be secured by a "**whole**" (only one lender or note holder) or a "**fractionalized**" (more than one lender or note holder) deed of trust. "Fractionalized" promissory notes and deeds of trust, when negotiated by an MLB, are subject to regulation by the DRE, which enforces the Real Estate Law, and the DBO, which enforces the Securities Law.

The Real Estate Law includes what is known as the "multi-lender law." This law imposes certain

restrictions including: (a) no more than 10 lenders or note holders (you and your spouse would count as one lender or note holder on a single investment); (b) the MLB must service your loan and have a written agreement with you to that effect, or the MLB and you must arrange for loan servicing by a person who is either properly licensed as a real estate broker or exempt from licensing by law; (c) defined loan-to- value ratios, based on the type of property being used as collateral, are generally not to be exceeded; (d) you may not invest more than 10% of your net worth or your annual income; (e) your loan must be directly secured by the Property and may not be indirectly secured through another promissory note and deed of trust (**collateralization**); (f) the MLB may not "self-deal" except in limited circumstances; (g) the deed of trust may not include a provision for subordination to a subsequent deed of trust; (h) with certain exceptions, the promissory note may not be one of a series of notes secured by liens on separate parcels of real property in one subdivision or contiguous subdivisions; and (i) your interest and the interests of other lenders or note holders must be recorded and identical in their underlying terms so that each note holder receives his or her proportionate share of the principal and interest. (There may, however, be different selling prices for interests in an existing note if the differences are reasonably related to changes in the market value of the loan which occur between sales of the interests.)

Licensed brokers can also offer these "fractionalized" promissory notes through an offering that has been qualified and registered by the Department of
Business Oversight (DBO) and have obtained a permit. Pooling of investors' funds are not allowed except as authorized with a DBO permit. Licensed brokers can also offer

"fractionalized" promissory notes through

private placements as authorized by the Corporate Securities Law. If a permit or private placement is used, the "multi-lender law" will not apply. A broker should advise you under which of these authorities the offering is being made to you. If not you should ask!

The documents and instruments will be substantially the same whether your investment is in a whole or fractionalized promissory note and deed of trust. When funding a loan or purchasing a promissory note you should receive: the promissory note; the deed of trust; the assignment of deed of trust and assignment or endorsement of promissory note (if applicable); the preliminary report; the appraisal report; the loan application and related documents previously described; and the policy of title insurance describing the coverage you selected.

In addition, if the loan is negotiated by an MLB you should receive a lender/purchaser disclosure statement (LPDS) prepared in accordance with California law. A properly completed LPDS will identify: the MLB and his or her representative; the amount and terms of the loan to be funded or purchased; whether the loan terms include a balloon payment; any servicing arrangements; and information about the borrower, including employment, income, credit history, and credit references.

The LPDS will also disclose to you the status of all existing encumbrances or liens against the Property, including whether any payments are delinquent, whether any notices of default (NOD) or notices of trustee’s sale (NOS) have been recorded, and whether there are any bankruptcy proceedings or active lawsuits involving the borrower or the Property.

You will also receive, as a part of the LPDS, information about the Property, including its address and/or assessor’s parcel number and

legal description (if available); the age, size, and type of construction of any building improvements; an appraisal or, if you (the lender or note purchaser) have waived the appraisal, the MLB's written estimate of market value. When the Property's income is the primary source of payment of the debt service, you will receive income and expense information.

Further, the LPDS will list the encumbrances and liens which are to remain against the Property and those encumbrances and liens which are expected or anticipated after your loan has been funded or the promissory note has been purchased. The loan- to-value ratio should be calculated for you so that you may determine the borrower's equity and the protective equity in the Property (remember, they are different).

Finally, the LPDS will identify the MLB's capacity in the transaction: whether he or she is acting merely as an agent in arranging the loan or the sale of the promissory note; or whether the MLB or some related entity is the owner and/or seller of an existing promissory note or the borrower of the loan funds.

If the loan is fractionalized, the LPDS will include:

- The name and address of the escrow holder.
- The anticipated closing date.
- Descriptions and estimated amounts of the costs payable by the lender (or purchaser) and borrower (or seller).
- For the sale of an existing note: the aggregate sale price; the percent of the premium over, or discount from, the principal balance plus accrued/unpaid interest; and the effective rate of return if the note is paid according to its terms.
- The estimated closing date of a loan

origi- nation.

- The MLB's explanation if certain statutory loan- to-value limitations are exceeded. [Business and Professions Code Section 10238(h)]
- The MLB's (or his/her affiliate's) interest as a principal in the transaction, as limited by stat- ute. [Business and Professions Code Section 10238(e)]
- Any other information known to the MLB and necessary to clarify information in the LPDS.

There are also special rules that apply to fractionalized loans for the purpose of construction or rehabilitation. In order for the loan-to-value ratio to be based on the completed, or built-out, value of the property, 1) the broker must use an independent third-party escrow- holder to handle the funds, 2) the loan must be fully funded, 3) there must be a comprehensive and detailed draw schedule, 4) a qualified independent person must verify work completed, 5) an appraisal must be done by a qualified independent appraiser, 6) the documents must include a description of what actions can be taken in the event the project fails, and 7) the entire loan amount cannot exceed $2,500,000.00. [Business and Professions Code Section 10238(h)(4)]

If the fractionalized loan is secured by more than one property, you are entitled to an addendum to the LPDS detailing how the loan-to-value ratio has been apportioned for each property securing the loan and the amount of equity in each property securing the loan. These cannot exceed the required maximum for each type of property. [Business and Professions Code Section 10238(h)(5)]

Just as you (the lender) are entitled to receive a

lender/ purchaser disclosure statement, an MLB must give a borrower a statement known as the Mortgage Loan Disclosure Statement (MLDS). The MLDS explains the fees, costs, expenses and loan origination fees or commissions which the borrower will pay to the MLB or to others in connection with the loan. There could be an exception to receipt of the MLDS if the loan is a federally related loan and the borrower receives the appropriate Truth-in-Lending disclosures and a Good Faith Estimate conformed to California disclosure requirements.

Another disclosure statement that may appear with your loan documents is a federal Truth-in-Lending disclosure statement, which is required when applicable, pursuant to the federal Truth-in-Lending Act and Regulation Z.

An MLB acting only as an arranger of credit is not generally subject to the disclosure requirements of Regulation Z which are imposed upon creditors (lenders and note holders). However, many MLBs act as both lenders and arrangers or hold themselves out to be lenders and, therefore, may qualify as creditors under this federal law.

Even private parties may qualify as creditors under Regulation Z after a certain volume of loans have been funded or promissory notes have been purchased. While you may not be a creditor by definition, either the MLB or another lender or note holder on a fractionalized deed of trust may be. If so, the borrower should receive a federal disclosure statement and a notice of the right to cancel the transaction within a specified period of time if the Property is the residence of the borrower.

The Truth-in-Lending Act (TILA) was amended in 1994 with respect to loans, other than purchase money loans, secured by the borrower's principal dwelling. The amendment places some restrictions on

creditors, requires them to make additional disclosures, and permits consumers to cancel certain transactions. A creditor is defined for purposes of this amendment as someone who originates, in any 12-month period, more than one loan subject to this amendment or any such loan(s) negotiated through a mortgage broker. Rules to implement the amendment were effective October 1, 1995 and affect all described mortgage transactions having rates or fees above a certain percentage or amount. These mortgage transactions are referred to as "high rate/high fee" or "Section 32" loans. A loan is considered to be a "high rate" loan if the APR exceeds by 8 points or more on a first-lien loan or 10 points or more on a second-lien loan, the yield on Treasury Securities having a similar maturity. A "high fee" loan is one for which the total points and fees exceed the greater of 8% of the loan amount or, as of 1-1-06, $528.00. (Note that this dollar figure is adjusted annually on January 1 by the annual percentage change in the Consumer Price Index as measured on the preceding June 1.) The TILA regulations are enforced by the Federal Trade Commission (FTC). Persons having any questions regarding "high rate/high fee" loans or Regulation Z should contact the FTC.

California also has a consumer protection law covering high rate/high fee loans. With certain exceptions, loans for consumer purposes that are secured by a borrower's principal residence of 1 to 4 units and are within the current FannieMae single-family conforming loan limit are covered by the law if 1) the APR exceeds by 8 points or more the yield on Treasury Securities having a similar term, or 2) the total points and fees, as defined, payable by the consumer at or before closing exceed 6 percent of the loan amount. The law establishes specified limitations on loan terms and prohibited practices. With the exception of an as- signee that is a holder in due course, a