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Introduction

Mitch Julis (on the cover) and Josh Friedman are Harvard JD-MBAs who began their careers working under the infamous Michael Milken at Drexel Burnham. They were there at the time Milken was indicted on 98 counts of racketeering and sentenced to 10 years in jail. At Milken's sentencing, Judge Kimba Wood notably told him:

> *You were willing to commit only crimes that were unlikely to be detected. ... When a man of your power in the financial world ... repeatedly conspires to violate, and violates, securities and tax business in order to achieve more power and wealth for himself ... a significant prison term is required.*

After Drexel imploded, Julis and Friedman started their own hedge fund, Canyon Partners. All indications are that they have been wildly successful there, certainly if their lifestyles are any indication. Each has 4-6 mansions in some of the fanciest neighborhoods in America. But how did they make their fortunes? Was it because they were simply very talented businessmen? Or is there something more than meets the eye?

This book is about the discovery of a disturbing pattern regarding Canyon's construction lending operation. Canyon has made numerous construction loans on commercial properties under development, each to be worth $50+ million. Over the past couple decades (or longer), those loans have been approved by Canyon's 5-person investment committee. The committee's members have evolved over the years but two members remained constant: Mitch Julis and Josh Friedman. Interestingly, there was never a vote of the investment committee that was not unanimous. That committee decided which loans to approve and made major decisions regarding each loan during their respective loan terms.

To approve a loan, an Investment Summary was put together to describe the potential loan and project. The approved loans were not particularly risky as the loan-to-values have been at typical industry ratios and only closed after developers spent years or even decades working and investing millions to get the projects shovel-ready (i.e. architectural drawings done, public entitlements obtained, etc.).

So, Canyon did not come in with the construction dollars unless the always precarious pre-development risk was essentially eliminated. Of course, development and construction projects still then have major tasks to complete, such as the building's construction and lease-up to become stabilized real estate investments. Any construction lender knows this, so they price the loan interest rates and fees accordingly, and dole out loan funds in monthly draws. This ensures that the money lent corresponds with the then-completed construction. The lender must then release loan funds in good faith to ensure that the dozens of contractors and subcontractors, material suppliers, architects and others are paid timely each month.

But has Canyon really doled out construction draws in good faith? They must have, right? Why wouldn't they? Certainly a lender does not want their loans to go into default? They wouldn't want construction to stop, or for a brand-new project to become tainted? Surely, they wouldn't want the many trades involved to file liens on the property's title?

An ongoing investigation by Canyon Partners News, Inc., a 501 (c) (3) non-profit corporation, has revealed some really surprising answers to these questions. And they're not what you might expect.

Starting with their internal pre-closing Investment Summaries, there is some language which gives some insight into Canyon's true motives:

> *If a default occurs under the loan, Canyon will be in a position to quickly take title and control the Property at a significant discount to value.*

There is a lot to digest in Canyon's sentence. So let's break it down. *"If a default occurs"* means: if Canyon in their sole discretion writes a letter to the borrower telling them that something (in the roughly 900 single-spaced pages of loan documents that Canyon requires them to sign at closing) has not been met, then the borrower is deemed to be in default, whether the borrower agrees with that determination or not. Remember this not a jury trial in front of a judge with witnesses, evidence, cross-examinations and opening and closing arguments. Rather it is simply Canyon's decision to issue a letter declaring that a borrower is in default.

So now let's examine the rest of the sentence: *"…Canyon will be in a position to quickly take title and control the Property at a significant discount to value."* Wow. So the developer has invested millions, spent years or decades, implemented their education, experiences, expertise, tenacity, and more to get the land, the drawings, the team, the approvals, the numbers to pencil out… but if Canyon unilaterally declares a default, then Canyon can simply *"take title and control"* at a *"significant discount".* That's not possible, right? Friedman and Julis can't just take their borrowers major properties worth $50-$100 million. There must be many protections in place for the borrowers, right? You would think so, but…

Remember, Canyon Partners is a hedge fund, not a bank. That makes all the difference in the world here. Banks have regulators ensuring that proper procedures and laws are followed. Too many defaulted loans can get a bank into trouble. Our banking system's reliability is predicated upon a very low percentage of loans going into default. With hedge funds, no one is watching. And as the lender, if Canyon ends up in court, they get the benefit of the doubt because the judge presumes that it's just like a bank, which certainly doesn't want its loans to be in default or to take title of its borrower's property. Courts think of Canyon as they would banks, just typical lenders who don't want trouble. Judges presume that Canyon merely wants the interest on their loan and their principal repaid. Any judge of course doesn't know, because the borrower doesn't know, that Canyon secretly wants to *"take title and control" "at a significant discount".*

You may wonder that perhaps too much is being read into this sentence, and maybe Canyon doesn't really want to put their borrowers into default and take title to their properties. Possibly that language is just for the rare instances when things legitimately go very wrong. Well, that would be wishful thinking. Because if you review another of Canyon's internal documents, their audited financial statements, there is more troubling language. Those financials boast of "successfully foreclosing" on properties. It's hard to imagine that Citibank (or name any bank) would put "success" and "foreclosure" in the same sentence. For banks, foreclosures are an acknowledgment that something really unfortunate occurred and there was no alternative to get repaid. Conversely, Canyon's audited financials actually have statements stating that they "successfully obtained title to the property through a foreclosure sale" and "successfully foreclosed".

The ongoing investigation by Canyon Partners News Inc. shows that these are not one-offs. Rather

than occasional isolated events of truly troubled construction projects - as one would of course expect to happen from time-to-time - Canyon's own Quarterly Reports indicate that significant percentages of its loans are declared in default and many are foreclosed upon. These default rates appear to be hundreds (or even thousands) of percent higher than industry default rates.
When discovery of their loan history has been sought in litigation, Canyon Partners has fought vehemently to keep that history concealed. So projections are made based upon court records, newspaper articles, hundreds of Canyon's emails, interviews with multiple Canyon borrowers, deposition transcripts, Canyon's own documentation and the fact that many of the foreclosures mentioned in this book were in just one of Canyon's Quarterly Reports.

Canyon continues to take steps to prevent the disclosure of their loan history. By sending out Freedom of Information Act (FOIA) requests, Canyon Partners News Inc. has sought information from some of Canyon's public investors including CalPERS, CALSTRS, State Board of Administration of Florida, Duke University a/k/a DUMAC, Teacher's Retirement System of Texas, Minnesota State Board of Investment and UTIMCO, but any information received was first heavily redacted, apparently under the direction of Canyon Partners.

Still, Canyon Partners News Inc. was able to obtain a considerable amount of information from a FOIA request to the University of Michigan which has further revealed a very disturbing pattern that often goes like this:

First, pre-closing, Canyon lies to prospective borrowers to induce them to close the loan. These range from blatantly lying that they have never foreclosed on a development deal to telling borrowers that Canyon really understands construction and are great to work with when issues undoubtedly arise.

Second, soon after the closing, borrowers are declared in default early and often. The alleged defaults are generally for non-monetary reasons, which means the borrowers were never even late on any loan payments. Developments under construction have literally thousands of tasks to complete and countless issues that arise, but Canyon will magnify or completely manufacture a default to create a problem when there isn't one (that would otherwise be resolved in the ordinary course of the project).

Third, Canyon will say supportive things over the phone and in person - pretending to make accommodations – while requiring the execution of loan amendments and forbearance agreements, which include fully releasing Canyon for all of their bad acts to date. The reassuring talk lulls borrowers into a false sense of security but in actuality allows Canyon to paper their files with documents that have the appearance of a borrower repeatedly defaulting and Canyon being very accommodating.

Canyon often will insist upon immediate artificial deadlines for execution of these documents to prevent the borrower from fully contemplating the ramifications of signing.

Fourth, Canyon extorts their borrowers by withholding the release of loan funds and demanding that borrowers pay default interest. The lifeline of a large-scale construction project is the money to pay for the work each month, so any delays in the release of funds are very damaging. The borrower is put over a barrel to do what Canyon demands especially since the legal system is very unlikely to provide immediate relief and borrowers are certainly not inclined to sue their lenders during a construction project.

Fifth, since the borrower is likely fighting back, Canyon demands that the borrower sign a Pre-Negotiation Agreement to prevent evidence from later being used in court.

Sixth, after getting released, Canyon will resume sending default letters and often demand that borrowers provide them with a springing deed-in-lieu of foreclosure, which allows Canyon, whenever they elect to declare another default, to take title to the borrower's property immediately. Canyon loves when a borrower gives them a deed-in-lieu of foreclosure because it allows them to circumvent the state's legal foreclosure processes.

In some instances, borrowers will get so frustrated that they figure out how to refinance the loan mid-construction and rid themselves of Canyon, but this includes paying to Canyon millions extra due to Minimum Yield Fees required in Canyon's contracts. The Minimum Yield Fee language requires Canyon to get usually 15% of the maximum potential loan amount regardless of when the loan is repaid. For example, if at the time of refinance Canyon has only released draws to date for 15% of the total loan amount, a borrower upon refinancing would have to pay Canyon 15% interest on the full amount of the loan to get the title of their property cleared of Canyon's loan. This example equates to 100% interest on the actual funds lent. In these instances, Canyon is rewarded handsomely by the early loan repayment which directly resulted from the intentional distress caused to their borrower. This explains why Canyon's records of the Internal Rates of Return on many of their loans far exceed the loan interest rate.

Other times to fight back, a borrower will put their entity into bankruptcy (Chapter 11) to refinance with a court's supervision, but Canyon has repeatedly lied to courts about the property's value, condition and debt balance to get the bankruptcy proceeding dismissed or the reorganization prevented. Multiple examples in this book reveal jarringly similar stories from United States Bankruptcy Courts.

Some borrowers end up in trial courts, only to discover that Canyon has been gearing up to litigate even before the loan closed. Canyon has been involved in hundreds of lawsuits and prepares to be in another one during the preparation of loan documents. Before closing, Canyon has selected: the jurisdiction, venue, and their litigation attorneys based on how well the firm is connected to judges at all levels.

Once Canyon elects to file suit, they summon the borrower to their office to try to extort more money from them, secretly sweep all of the money from the borrower's reserve accounts and then file suit while the developer is away from home. All of this is done to make the borrower as penniless and as flat-footed as possible to defend against Canyon's surreptitious lawsuit *"to quickly take title and control the Property at a significant discount to value."*

During lawsuits, Canyon has no problem lying repeatedly to judges and are experts at playing discovery games to prevent the borrower from finding evidence of Canyon's premediated fraud and pattern of committing similar acts against other victims.

Even when seeking to refinance, Canyon has forced borrowers to go to court to simply get a routine payoff letter, and then will delay as long as possible to provide it in order to drive up interest charges and repayment fees. If a payoff letter finally does arrive, it is unsupported and expires almost immediately, thereby making it nearly impossible to get a refinance lender to close. When Canyon is hellbent on capturing the borrower's property, they will make it incredibly difficult for the borrower to ever repay their loan.

So how does this keep happening? One would think that Josh Friedman and Mitch Julis would only have been able to get away with this for so long. Remember Canyon's borrowers are unrelated and don't know each other. Every developer is on their own to fight the battle that Canyon has premeditated and fought countless times. Each unsuspecting borrower is forced to battle with Canyon in isolation. And, Canyon uses a new single-purpose entity with an odd name to be the lender on each loan, so it is virtually impossible to discover their pattern. What Judge Kimba Wood said about Michael Milken is equally apropos about Canyon. They have gotten away with repeatedly stealing properties each worth more than $50 million because these are *"crimes that were unlikely to be detected".*

The stories in this book are eerily similar with borrower after borrower contending that Canyon Partners is a "loan-to-own" operation. The pattern demonstrates that the rampant defaulting of loans is intentional and indicative of a predatory lender. Unmistakably, the problem is the lender, not the borrowers. This book has fifteen (15) stories but there are unquestionably many more.

When Canyon’s former President, Jonathan Roth, left to start his own company a few years ago, his new firm’s website proclaimed on its home page, “Borrowers deserve a relationship with a lender committed to the outcome they seek.” Roth was clearly trying to differentiate himself from Canyon which was not committed to the outcome that borrowers seek. When Roth was asked at his deposition, “Would you say that Canyon was also a company that acted ‘as a lender committed to the outcome borrowers seek’?” Rather than answer and explain his new company’s website, Roth turned to Canyon’s attorney who was representing him and said, “If you’re not going to object to this line of questioning -- “ and successfully avoided ever answering the question.

When one unsuspecting borrower asked Canyon’s Head of Real Estate, Maria Stamolis, why Canyon would not release loan funds (that the borrower was paying interest on) as the project was only 5-6 months from completion, she stared at him and said, “Who do you think you’re dealing with?!”

The law provides that every contract imposes upon each party a duty of good faith in its performance and enforcement. This good faith duty requires that neither party shall do anything which will have the effect of destroying or injuring the right of the other party to receive the fruits of the contract. Typically, the phrase “good faith” is a standard of measuring the state of mind, perceptions, honest beliefs, and intentions of the parties. To act in “good faith” means an honest belief, the absence of malice and the absence of design to defraud or to seek an unconscionable advantage. Clearly, Canyon has not conducted its real estate construction lending operation in good faith.

Many of Canyon’s unwary borrowers lost everything: their property, their money, their time, their reputations and to a large extent, their futures. To put this complete loss in perspective, Madoff’s victims ultimately recovered 88%.

This book is an exposé on the horror stories faced by Canyon’s borrowers, the lives ruined, valuable properties and life savings lost.

Given the vast wealth of Josh Friedman and Mitch Julis, one can only wonder to what end? Certainly they don’t need more mansions. Perhaps it’s just ingrained in them from their Drexel days or maybe it’s just too hard to stop since they’ve perfected their lending scam. Skillful pickpockets are adept at stealing wallets and purses to get a few hundred bucks. Julis and Friedman have similarly perfected taking their borrower’s equity and properties too – it’s just that the loots are a lot bigger.

Hedge Fund Scum is part of an ongoing investigation into Canyon’s repeated victimizing of their borrowers. New editions will be published as new evidence is obtained.