FORECLOSURE

What It Really Means and How to Avoid It

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SHORT SALES & FORECLOSURE RESOURCE

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Foreclosure wrecks havoc on families, finances and, believe it or not, health. Honest, hard working Americans are losing their homes and investment properties at record levels. The early tally reveals that the nationwide foreclosure rate is worse than during the Great Depression, and it's nowhere near an end.

However, there is hope! With this special report on foreclosure avoidance, you, too, can survive these difficult times.

What is Foreclosure?

Foreclosure is defined as: *"The legal process in which mortgaged property is sold to pay a defaulting borrower's debt."* It is a termination of all rights of the homeowner covered by a mortgage. Foreclosure is a process in which the estate becomes the absolute property of the lending institution.

Foreclosure numbers are growing daily. Of the approximate 120 million homes in America, more than 4%, or roughly 4.8 million, are facing foreclosure. Some of these homeowners are able to work their way out of foreclosure, but according to MBA, there were about 500,000 homes that went through foreclosure last year. Foreclosure threatens these homeowners because they are late, or seriously behind, on their mortgage payments.

The foreclosure process begins when the homeowner fails to make payments of the money due on the mortgage at the appointed time. This may be due to several reasons: unemployment, divorce, medical challenges, terms of the loan, frustrations of property management, and even death.

Foreclosure is applied to any method of enforcing payment of the debt secured by a mortgage, by taking and selling the estate. Borrowers and lenders now face a challenging situation. Both seek a compromise that permits a win-win outcome. The borrower to keep his home or business, the lender to keep receiving mortgage payments.

The term "pre-foreclosure" is often confused with the term "foreclosure". Technically, a pre-foreclosure is any homeowner prior to being sued for foreclosure. Pre-foreclosure is often used to describe a home that may end up being foreclosed on, or has entered into the beginning stages of foreclosure. Since foreclosure is a process and not a single event, the term pre-foreclosure is really a misnomer.

Arizona Law

- Both Judicial and Non-Judicial foreclosures occur in Arizona.
- The Trustee, or Lender, must record a Notice of Sale in the Recorder of the County where the property is located.
- Within 5 days after the notice is recorded, the trustee must mail, by certified mail, a copy of the notice of sale to the mortgagor (owner) . Additionally, the notice must appear in a newspaper in the county where the property is located once a week for 4 consecutive weeks, with the last notice being published not less then 10 days prior to the date of the sale. Optionally, it can be done without a breach of the peace, the trustee can post the notice at least 20 days prior to the date of the sale, in some conspicuous place on the property to be sold.
- The owner can redeem the property at any time before the auction date. This is known as the "Redemption Period".
- Once the sale occurs, the right of redemption is lost and the homeowner, in effect, no longer owns the property.
- The entire process from the time the owner missed the first payment to the time the property is actually sold, is typically 6 to 9 months. This can vary with each lender.

A note regarding Deficiency Suits: A lender may not bring a deficiency suit against a person who lost a property that is 2.5 acres or less at a foreclosure, provided the property was a single one-family or a single two-family dwelling. This is so even if the high bid at foreclosure was less that the balance due on the loan. However, in foreclosures against other types of property, a deficiency suit is allowed, but is limited to the difference between the balance owed and the fair market value of the property; and then only if the suit is brought within ninety (90) days of the power of sale foreclosure.

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What are your options?

Usually when clients call me regarding our services, they have missed a few payments and are in various stages of the foreclosure process. I will try to explain what can be done to avoid foreclosure. There are only a few options, and here is a quick list.

Short Sale

When the homeowner owes more than the property is worth (plus sales expenses), a sale can be negotiated and an approval obtained from the bank to accept an amount less than is owed. Most of these options involve negotiation with the bank.

NOTE: ***The average Realtor gets 1 in 10 short sales approved and successfully closed. The average CDPE Realtor gets 8 in 10 short sales approved and successfully closed.***

Loan Modification

For those that want to try and keep their property, a loan modification might make it possible. In a loan modification, the lender typically adjusts the payments on the loan to make payments manageable for the homeowner by decreasing the interest rate and/or amortizing the balance over a longer period of time.

NOTE: ***Use extreme caution before paying any upfront fee for services. Also, at the time of this publication, there are no verified cases in which the lender has forgiven principal due to negative equity.***

Forbearance Agreement

More commonly known as a “Re-payment Plan”. This plan allows the homeowner to negotiate a repayment of missed payments and fees to reinstate the mortgage. This requires a signed agreement.

Refinance

If your credit rating hasn’t been too badly damaged, a refinance may help, especially if the monthly payments can be reduced.

Deed-in-Lieu of Foreclosure

Commonly known as the ‘friendly foreclosure’, they don’t foreclose; the property is simply deeded back to the bank and the owner is released. This requires an affidavit, and there can’t be any second mortgages or judgments. This is not recommended for properties with equity because the owner gives up the right to the property and any equity. This option is technically still a foreclosure and will show up as such on your credit report. Sometimes the bank will forgo any other recourse but that will also have to be negotiated.

Bankruptcy

Foreclosure is stayed. Arrears are termed out over 3-5 years and debtor resumes regular mortgage payments. A drawback is that it makes it difficult to sell the property and almost impossible to negotiate with any third parties. A new law is coming which may force mortgage companies to help.

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Things You Should Never Do

If you fall behind on your mortgage, you may feel pressure to act quickly, before you fully evaluate your options and have an opportunity to select the course of action most appropriate for your situation. At the same time, you will likely be contacted by people who will present you with "solutions" and attempt to persuade you to work with them.

Some of the "solutions" will be legitimate. Unfortunately, there are many who have identified the current mortgage crisis as an opportunity to profit from the misfortune of others. Unless the actual foreclosure sale is so close that you don't have time– as in days, not weeks – take a little time to gather information and solicit input from sources you trust.

So, here are the five things you should **NEVER** do if you fall behind on your mortgage:

#1) Do not act before you have considered your options. Do not feel the need to make any major decisions before you have had a chance to do some homework. Do not succumb to the pressure of those that have an agenda – their own, of course – out of fear. Take time to gather enough information to make an informed decision.

#2) Absolutely do not EVER deed your property to a third party without confirmation your loans have been paid off. If you believe this option is best for you, consult with an attorney – yours. If you deed your property to someone else, they become the one who owns the property – they control it. They can rent it, sell it, move into it, or use it in other ways. What is highly likely is that the new owners won't pay the mortgage. The Lender will still look to you for payments, and, if the payments don't get made, it will be reported on your credit file. You remain the primary party responsible for repayment. The damage to your credit could be devastating.

#3) Do not give a prospective buyer the power to deal directly with your Lender. A buyer looking to work with your Lender to get approval of a sale is looking to purchase your property at a discount – likely a very big discount. Negotiating a Short Sale takes a lot of time under the best of circumstances. When the buyer is attempting to get approval at a price well below the market, there is no telling how long it might take. All the while, the clock is running on the Lender's foreclosure action. If the buyer is unable to get approval at the price they feel they need, the buyer may opt not to buy your home. The buyer's decision not to purchase could come so late in the process that there is not enough time left to pursue other options. It might be too late to avoid foreclosure. In addition, you have no control over the manner in which your financial situation is being represented to your Lender. It is entirely possible that a buyer dealing directly with your Lender could present your file in a way that makes it very difficult to accomplish anything with your Lender later if this deal does not go through.

#4) Do not sell your property at a dramatic discount. Unless the foreclosure sale is less than thirty (30) days away, you have time to get your property sold and save your equity. The property is yours, the equity belongs to you.

#5) Don't "do nothing". A surprising number of people simply allow the foreclosure to run its course. Foreclosure can be avoided. With a bit of effort, you can find a solution that will keep a foreclosure off your credit record.

Short Sale Explained

In real estate, a "short sale" is a rather lengthy process in which an agreement is made between the Lender and the property owner for the Lender to accept a lesser amount than owed. There are other variations of the meaning of short sale, but for our purposes we will only discuss real estate transactions.

The typical steps in the process are as follows:

Short Sale Process

The property owner needs to be in a distressed state, most of the time the property is in foreclosure. If a property owner is current on mortgage payments, the Lender will not always approve a short sale. The loan is said to be "performing". This is rapidly changing, and nowadays Lenders are willing to negotiate even with "performing" loans.

A lengthy package of documents needs to be assembled to prove to the Lender that the property owner can no longer make payments. Most of these documents are the same ones used to qualify for the loan, but this time it is to disqualify the property owner. In addition to those financial documents, a hardship letter needs to be drafted explaining what caused the financial hardship. Also included are: market trend reports, recent sales, market analysis, news clippings and other information that can help the Lender make a better determination as to why they should accept a short sale.

The property has to be put on the market for sale and one must show a concerted effort to sell the property at market value. There is misinformation out there where people believe the Lender will accept any amount. This is not true. The Lender will only accept market value - whatever it may be. A detailed record of activity needs to be kept and submitted to the Lender along with all the other documents.

Once a buyer is found, the purchase contract, along with all the documents already mentioned, is submitted to the Lender for approval. Once approved, the sale process is continued as any normal real estate transaction would.

Most property owners don't know that the Lender will pay almost all required fees and commissions to all parties on behalf of the seller. Essentially, the property owner walks away paying nothing. The exception being that the Lender may require an appraisal, in which case, the property owner may be asked to pay for it. Sometimes, when back dues or assessments are owed to a Homeowners Association, the property owner is also asked to help pay for some of those fees as well. Also important to note: in no case may the property owner walk away with <u>any</u> proceeds from a short sale. In some extreme cases you may negotiate with the Lender for the property owner to receive a small amount (usually no more than $1500) for moving expenses and to help with rent. Again, this is rare and not the norm.

Along with the steps above, diligent communication and follow-up is a must in order to successfully negotiate, process and close a short sale. The entire process can take anywhere from 3-12 months to complete. You can see why it is important to hire a competent Realtor with a knowledgeable team to expedite the process.

Short Sale Consequences

After a short sale has been successfully negotiated, the shortfall can be dealt with in various ways by the Lender. These are the most common methods used by the Lender to re-coup their losses.

Deficiency Judgment

A Lender may exercise their right to a Deficiency Judgment in order to recoup losses. The Judgment itself only gives the Lender the right to re-coup the monies, the process itself has to be undertaken by the Lender. This gets expensive, and most times they seek the Judgment just so they have the flexibility to go after the property owner in the future. Statute of Limitations is typically ten years in AZ to exercise this option. What has been happening as of late, is that the Lenders are so overwhelmed that they file for the Judgment and little else.

1099

Another option the Lender has is to issue a 1099. A 1099 is an IRS form alerting the IRS that the property owner has profited from a short sale. That's right, the amount that the Lender was shorted is treated as a profit to the property owner. The Lender may issue a 1099, or file for a Deficiency Judgment, but they cannot do both. (**Important note:** This provision in the Tax Code has been suspended for short sales involving primary residences through tax year 2009.)

Unsecured Note

The Lender can also negotiate to issue an unsecured note in the amount of the deficiency. This is similar to a credit card or personal loan not collateralized by anything. This is purely an accounting trick in order to give the illusion of getting bad debt off their books. They never expect to see a dime of this loan, but it looks good on the balance sheet to investors when a bad mortgage is replaced by a successful sale and another "performing" loan. Did I hear someone say Enron?

Payment in Full

Last, but not least, is negotiating with the Lender that the Short Sale is payment in full. Although this sounds impossible, it does happen fairly regularly. The Lender is all too happy to put this expensive endeavor behind them as well. This should always be the main goal of any short sale negotiation.

To Pay or Not to Pay

Nowadays, more and more property owners are in a quandary. They are not behind on their mortgage, nor in any stage of foreclosure, yet they want to short sale. Although more and more Lenders are accepting short sales that are not in default, it is hit or miss. An impending foreclosure really motivates the Lender. The thought of yet another non-performing asset does not bode well with the balance sheet, and the Lender really doesn't want to become a property owner.

So, as a property owner in this situation, what are your options?

Well for one, keep paying as agreed and wait for the market to turn around. If that isn't an option because of an up-coming ARM reset, forced relocation, or other outside circumstance out of your control, then you have some tough choices to make. You have to look at your monthly expenses and arrange them according to priority and see if paying your mortgage makes logical and economical sense. For example, if your refrigerator is empty, you have ¼ tank of gas and your choice is to pay your mortgage - or eat and be able to work, then the answer should be obvious.

I would never advise anyone to miss mortgage payments for the sole purpose of gaining leverage for negotiating a short sale. This is the same type of thinking that got us into this mess to begin with. There is nothing wrong with not paying your bills - if you can't. It's using it as a strategy for some other reason is what I have a problem with.

Owners of investment property may have a tougher time, but it really depends on the individual's finances. If they have a portfolio of investment properties and want to short sell one because it is under performing, good luck. On the other hand, the small investor, with one or two properties, may have a fighting chance if you present a good case. The Lenders are going to want evidence of a financial hardship - not just a bad investment. If your investment is creating hardship, then there is a strong case for consideration.

Credit Implications

As with any financial transaction, there are certain credit score implications that come attached. When one gets involved in property ownership, or investment property, you hope to build your credit score in the hopes of moving on to bigger and better things in the future. The caveat is if something goes amiss the opposite effect is the result.

2 Years vs. 10 Years

Your credit will be marred whether you decide to let the bank foreclose or the property is sold via a short sale. However, you can begin effective credit rating recovery after 2 years with a short sale. A foreclosure will adversely affect your credit score for up to 10 years. Often times, after a foreclosure, the property owner has to file bankruptcy—the proverbial double whammy.

Lifetime Yes

There are only two things that follow you for the rest of your life: a felony conviction and a foreclosure. True, after 10 years it will drop off your credit report, however, almost every lending institution has the magic question – *"Have you ever had a foreclosure?"* If you've had one, you must answer yes, answering no could be considered fraud, and that would open you up to a host of other legal problems.

50 vs. 300

A short sale can shave as little as 50 points off your credit score. Only the late payments are reported. A foreclosure will take 300 points off for each loan foreclosure. Properties with two mortgages can see the owner lose up to 600 points off their credit score. You can see why a bankruptcy filing soon follows a foreclosure.

Foreclosure Deficiency

After a foreclosure, the Lender will sell the property to recoup their losses. The proceeds of the sale will be subtracted from what was owed plus **all** expenses. (Holding costs, attorney's fees, repair costs, etc.) If the Lender is unable to re-coup all their losses, they have the right to file suit against the former owner for the shortfall. So just because they took back the property, all is not said and done. The foreclosure can haunt you for many years to come.

FAQ's

How do I know if I qualify for a short sale?
If you answer "yes" to any of the questions below, then you may qualify for a short sale.

* Are you behind on your mortgage or facing foreclosure?
* Are you in a financial hardship of any kind? This can include, but is not limited to: relocation, loss of income or job, divorce, illness or death in the family, house in need of major repairs, increased bills or expenses?
* Has your mortgage payments depleted your savings?
* Are you in a situation where your property MUST be sold?
* Can you not sell your property due to a mortgage balance greater than your property value?

Who pays for a short sale?
Your Lender will pay all the Realtor commissions, as well as the closing costs.

Doesn't a short sale take a lot of work?
Not for you. We will ask that you gather certain financial information and complete some forms, then we will handle the process of selling the property along with the negotiations and details with your Lender for the short sale.

How do I benefit from a short sale?
A short sale helps to relieve the stress of being in foreclosure. You can rid yourself of your mortgage payment and move forward with your life. The property owners that are helped are tremendously thankful to be relieved of the burden that an impending foreclosure caused. A short sale also prevents additional damage to your credit.

I want to do a short sale, but I have a 2nd Mortgage. Does this make me ineligible?
No, not at all. Both of your Lenders will need to be satisfied in some way to complete the short sale. Many short sales do involve 1st and 2nd lien holders (Lenders).

Do I have to have missed a payment to qualify?
No, not necessarily. Some Lenders will accept short sale offers from sellers who have never missed a payment. Most Lenders, however, don't seem to pay much attention to a seller who has not missed a payment.

Will I have to pay income taxes for the 'shortfall' (the difference between the short sale sales price and the original debt)?
Consult your Tax Attorney or Qualified CPA.

Do I have to "qualify" for a short sale?
Different Realtors® have different opinions about this. My opinion is *YES*. Lenders want to know that sellers are in a hardship situation before they qualify for a short sale. Just like when you "qualified" for your mortgage, you now "qualify" for your short sale.

I just missed a payment and I know I will miss more...how long does the foreclosure process take and is there time for a short sale?
Yes. Typically, it takes 3-4 months before the Lender issues a Notice of Trustee Sale. From that point, you have approximately 3 months.

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We sincerely hope this report was beneficial to you. Make the right decision to explore your options. For a free confidential consultation, or for more information on foreclosures and short sales, contact Jason Campagna today!

You should always seek advice of professionals. A team consisting of a competent attorney, accountant and a Realtor® is irreplaceable.

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