

UNDERSTANDING YOUR OPTIONS FOR DELINQUENT LOANS OR NEGATIVE EQUITY

The Pinnacle

By Patrick Casey

July 29, 2009

In today's challenging economic times, many people either have difficulty making their mortgage payments or own property with negative equity. Most people in this situation usually consider either doing a loan modification or letting the property go in foreclosure. However, a homeowner needs to understand all of their options before deciding how they want to proceed. This article will briefly review those options.

The first option is to simply "stay the course", meaning that the person continues to make the monthly mortgage payments. This option works if the person can continue to afford the mortgage payments even if the house has negative equity. Eventually, the real estate market will turn around and housing prices will come up. This option also saves the person's credit rating.

Loan modifications are an option for some individuals, but it is not for everyone. First, you need to meet the lender's qualifications for a loan modification. Second, you have to be able to afford the revised payment amount after the loan modification. Third, loan modifications really only apply to a primary residence and not to investment property. Finally, you need to find a qualified person to help you with a loan modification. You need to thoroughly research any company that holds themselves out as experts in loan modifications. The best place to go is the California Department of Real Estate website, which contains a variety of information on how to avoid a loan modification scam.

A short sale of the property involves selling the property for less than the current amount owed on it. This is a fairly slow process in that it takes lenders a long time to approve a short sale. Even if the lender does approve the short sale, the lender will try to make the borrower's agree to be liable for the deficiency as a condition of the short sale. This last point can be negotiated with some lenders but not all lenders will agree to waive the deficiency.

Another option is a deed in lieu of foreclosure. This means that the borrower deeds the property back to the lender in satisfaction of the debt. The lender has to agree, in writing, to accept the property back; otherwise, it is not an effective deed. There are almost no lenders that will accept a deed in lieu of foreclosure because the lender takes the property subject to all liens recorded against the property (which could include judgment liens, federal or state tax liens, delinquent property tax liens, liens of junior deeds of trust, and other such items). Commercial lenders really will not accept a deed in lieu of foreclosure, but a borrower may be able to negotiate with a private lender to accept a deed in lieu of foreclosure.

The next option is to let the property go into foreclosure. There are two types of foreclosure in California, which are a judicial foreclosure and a nonjudicial foreclosure. A judicial foreclosure means that the lender files a lawsuit against the borrower and asks the court to supervise the sale of the property. In this event, the lender can request that the court issue a deficiency judgment for the outstanding amount owed to the lender after the sale of the property. If the sale occurs through a nonjudicial foreclosure, then the property gets sold at a public auction by the trustee of the deed of trust on the courthouse steps. In that event, the lender cannot obtain a deficiency judgment against the borrower.

The next option is to file for bankruptcy. As a general statement, filing bankruptcy will only delay the inevitable foreclosure on the property by the lender. In certain types of bankruptcy, the bankruptcy court may be able to strip away the lien of a junior deed of trust or work out payment terms with the creditors. This depends upon the type of bankruptcy and the individual situation. A person should consider bankruptcy if they have many unsecured debts in addition to the secured debt that they owe on their house.

Another route is to purchase a new home while a person's credit is still good and then let the old house go into foreclosure. This option only works if the person still has good credit and has enough money (or the ability to borrow enough money from friends and family) to make the down payment on a new house. This situation typically applies to an individual who has substantial negative equity in their house, has a steady income and good credit, and can qualify to purchase another house. Also, the person must be willing to take the negative credit hit of a foreclosure and live with that for many years to come.

One additional option is a short loan refinance. This means that the person either negotiates with the current lender or finds a new lender to agree to enter into a new loan at 100% of the current fair market value of the property. A few lenders are willing to do this so that they can have a "good" loan on their books as opposed to a delinquent loan. The key is that the current lender must be willing to forgive the borrower for the difference between the current loan balance and the current fair market value of the property. Not many lenders are willing to do this but there are cases in which lenders have agreed to a short loan refinance. A lender will only consider doing this if there is a high likelihood that the lender will get repaid for the new loan (ie. the borrower must have good credit).

This is a very brief summary of a homeowner's alternatives if he or she is having problems with their current mortgage. A homeowner needs to get as much information as they can in order to make an educated decision about how they want to proceed. The homeowner should consult an attorney, an accountant or a licensed real estate broker when evaluating these alternatives.

This column is the work product of Lombardo & Gilles, LLP, which has offices in Hollister and Salinas. Patrick Casey is an attorney with Lombardo & Gilles, LLP. You may contact the author at (888) 757-2444 or patrick@lomgil.com. Mail your questions to Patrick Casey, It's the Law, c/o The Pinnacle, 380 San Benito St., Hollister, CA 95023.

