SPECIAL REPORT
INSIDER TIPS FOR HOME SELLERS

$49.00

# FORECLOSURE

## What It Really Means And How To Avoid It

Arming yourself with vital information is critical when facing foreclosure. Reading this report could save you time, money and heartache.

NOEL PADILLA

*Doing Business Right*

# Foreclosure

## What it Really Means and How to Avoid It.

Foreclosure wrecks havoc on families, finances and believe it or not health. Honest hard working Americans are losing their homes 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 and with this special report on foreclosure avoidance you too can survive these difficult times. It’s full of information about foreclosure and real solutions like:

- ☑ What is foreclosure and what does it really mean?
- ☑ Options available and how to implement effective strategies.
- ☑ Revealing Short Sales and what it takes to get them approved.
- ☑ Possible consequences of a Short Sale.
- ☑ How foreclosure affects your credit rating.

# What is Foreclosure?

Foreclosure is the process where a bank has the legal right to take possession of a property if the mortgagor (owner) has failed to live up to the commitments as outlined in the mortgage agreement. Usually a missed payment will trigger this process.

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.

> In Florida, formal notice could mean a notice published in a newspaper.

Foreclosure in itself is pretty straight forward. The process doesn't start until after the bank has failed to receive payment and has filed suit to foreclose. In Florida the legal term is Lis Pendens. Lis Pendens is the formal notice that starts the legal process. (Note: In Florida formal notice could mean a notice published in a newspaper-it doesn't necessarily have to be actually served or given to the mortgagor in person.)

Once a Lis Pendens is filed, the mortgagor is required to appear in court to answer to the allegations in the suit (The notice to appear in court is usually when the homeowner first becomes aware of the suit). At this point, the mortgagor can ask the judge for an extension to buy time. Nowadays the extensions are being granted regularly. If the mortgagor didn't respond to the suit at the initial hearing, a judgment against the mortgagor will be found and another date is set for a 'foreclosure sale' or auction of the property, typically 30 days after the judgment.

Florida law allows the homeowner to redeem the property at any time before the auction date. This is known as the ‘Redemption Period’. After a certificate of sale is issued, the right to redemption is lost and the homeowner in effect no longer owns the property.

The entire process from the time the mortgagor missed the first payment to the time the property is actually sold at auction typically is 180 days. It is has been taking longer because the mortgage companies have been back logged from the recent rash of foreclosures. The timeline can be extended considerably by asking the court for extensions.

# What are your options?

Usually when clients call me regarding my services, they have missed a few payments and they are in various states 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:

## Reinstatement

This is where the homeowner reinstates the mortgage by paying up all missed payments and fees and becomes current with the mortgage. After all the fees have been paid up then the homeowner can continue to pay the mortgage payments as they had.

## Forbearance

More commonly known as a re-payment plan, allows the homeowner to negotiate a repayment of missed payments and fees to reinstate the mortgage.

## Sell the Property

If there is equity in the property then the home can be sold and the foreclosure can be "cured" thus avoiding the foreclosure. If the home is worth less than is owed plus sales expenses then a short sale must be negotiated (See the section on “Short Sale Explained”).

## Rent the Property

The property can be rented however the mortgage must be made current. A rental agreement will not stop the foreclosure process.

## Refinance

If the 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, this involves for the bank to agree to foreclose and take the property back without the lengthy process. 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

It cannot avoid the foreclosure but may allow the owner to reorganize debt and stall the foreclosure. Another drawback is that it makes it difficult to sell the property and almost impossible to negotiate with any third parties.

## 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 and a decent credit rating. If the credit has been affected already, then the only real option that can help is the short sale.

# Short Sale Explained

A short sale is a phrase used to describe a sale in which the cost of the product or service being sold is actually more than the sales price of the product or service in question. Another common term to describe a short sale is being 'upside down'. The term short sale has become synonymous with any real estate transaction where the lender is agreeing to accept an amount less than is owed. Short sale has other definitions in the financial sector such as when a financial instrument is sold before it is actually owned. There are other variations of the meaning of short sale but for our purposes we will only discuss real estate transactions.

In real estate, a short sale is a rather lengthy process in which an agreement is made between the bank and seller for the bank to accept a lesser amount than owed. The typical steps in the process are as follows:

## Short Sale Process

- The seller needs to be in a distressed state, most of the time the property is in foreclosure. If a homeowner is current on mortgage payments the bank will not always approve a short sale. The loan is said to be “performing”. This is rapidly changing and nowadays banks are willing to negotiate with even “performing” loans.

- A lengthy package of documents needs to be assembled to prove to the bank that the seller can no longer make payments. Most of these documents are the same ones used to qualify for the loan. You are basically disqualifying the property owner. In addition to those financial documents a hardship letter needs to be drafted explaining what caused the financial hardship. Also market trend reports, recent sales, market analysis, news clippings and other information that can help the bank 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 bank will accept any amount. This is not true. The bank will only accept market value whatever it may be. A detailed record of activity needs to be kept and submitted to the bank 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 bank for approval. Once approved the sales process is continued as any normal real estate transaction would.

Most homeowners don't know that the bank will pay almost all required fees and commissions to all parties on behalf of the seller.

Most homeowners don't know that the bank will pay almost all required fees and commissions to all parties on behalf of the seller. Essentially the homeowner walks away paying nothing. The exception being that the bank may require an appraisal in which case the homeowner might be asked to pay for it. Sometimes when back dues or assessments are owed to a homeowners association, the homeowner is also asked to help pay for some of those fees. Also important to note, in no case may the homeowner walk away with any proceeds from a short sale. In some extreme cases you may negotiate with the bank for the homeowner to receive a small amount (Usually no more than $1500) for moving expenses and 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 bank. These are the most common methods used by the bank to recoup losses.

## Deficiency Judgment

A deficiency judgment is sought by the bank in order to recoup losses. A judge usually grants these fairly easily. However the judgment itself only gives the bank the right to recoup the monies, the process itself has to be undertaken by the bank. This gets expensive and most times they seek the judgment just so they have the flexibility to go after the homeowner in the future. Statute of limitations is typically two years to exercise this option. What has been happening as of late is that the banks are so overwhelmed that they file for the judgment and little else.

## 1099

Another option the bank has is to issue a 1099. A 1099 is an IRS form alerting the IRS that the homeowner has profited from a short sale. That's right the amount that the bank was shorted is treated as a profit to the homeowner. The bank may issue a 1099 or file for a deficiency judgment, 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 bank 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 bank for payment in full. Although this sounds impossible, it does happened fairly regularly. The bank is all too happy to put this expensive endeavor behind them as well. This should always be the main goal of any short sale negotiations.

# To Pay or Not to Pay

Nowadays more and more homeowners are in a quandary. They are not behind on their mortgage nor in any stage of foreclosure, yet they want to sell their home which has dropped in value which would end up being a short sale. Although more and more banks are accepting short sales that are not in default, it is hit or miss. An impending foreclosure really motivates the bank. The thought of yet another non-performing asset does not bode well with the balance sheet so the bank really doesn't want to become a homeowner.

> More banks and more are accepting short sales that are not in default.

So as a homeowner 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 upcoming 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 and you have 1/4 tank of gas and your choice is pay your mortgage or eat and be able to get 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 in 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 he has a portfolio of investment properties and wants to short sell one because it is under performing, good luck. On the other hand, the small time investor with one or two properties may have a fighting chance if you present a good case.

# Credit Implications

As with any financial transaction there are certain credit score implications that come attached. When one gets involved in homeownership 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 homeowner has to file for 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 bank 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 bank is unable to recoup 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 years to come.

For a free confidential consultation or for more information on foreclosures or short sales, contact Realtor Noel Padilla today.

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

***This Special Report Prepared By:***

NOEL PADILLA

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# Short Sale vs. Foreclosure Consequences

| Issue | Foreclosure | Short Sale |
|---|---|---|
| Future Fannie Mae Loan – Primary Residence | A homeowner who loses a home to Foreclosure is ineligible for a Fannie Mae backed mortgage for a period of **5 years**. | A homeowner who successfully negotiates and closes a short sale will be eligible for a Fannie Mae backed mortgage after only **2 years**. |
| Future Fannie Mae Loan – Non Primary | An Investor who allows a property to go to Foreclosure is ineligible for a Fannie Mae backed investment mortgage for a period of **7 years**. | An investor who successfully negotiates and closes a short sale will be eligible for a Fannie Mae backed investment mortgage after only **2 years**. |
| Future Loan with any Mortgage Company | On any future 1003 application, a prospective borrower will have to answer **YES** to question C in Section VIII of the standard 1003 that asks "Have you had property foreclosed upon or given title or deed in lieu thereof in the last 7 years?" this will affect future rates. | There is no similar declaration or question regarding a short sale. |
| Credit Score | Score may be lowered anywhere from **250 to over 300** points. Typically will affect score for over **3 years**. | Only late payments on mortgage will show and after sale mortgage will be reported as paid or negotiated. This will lower the score as little as **50 points** if all other payments are being made. A short sale's affect can be a brief as **12 to 18 months**. |
| Credit History | Foreclosure will remain as a public record on a person's credit history for **10 years or more**. Short sale is **not reported on a credit history**. | There is no specific reporting item for 'short sale'. The loan is typically reported 'paid in full, settled'. |

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| Issue | Foreclosure | Short Sale |
|---|---|---|
| Security Clearances | Foreclosure is the **most challenging issue against a security clearance** outside of a conviction of a serious misdemeanor or felony. If a client has a foreclosure and is a police officer, in the military, in the CIA, Security, or any other position that requires a security clearance in almost all cases clearance will be **revoked and position will be terminated**. | A Short Sale on its own **does not challenge most security clearances**. |
| Current Employment | Employers have the right and are actively checking the credit regularly of all employees who are in sensitive positions. A foreclosure in many cases is ground for immediate **reassignment or termination**. | A short sale is not reported on a credit report and is therefore **not a challenge to employment**. |
| Future Employment | Many employers are requiring credit checks on all job applicants. A foreclosure is one of the most detrimental credit items an applicant can have and in **most cases will challenge employment**. | A short sale is not reported on a credit report and is therefore **not a challenge to employment**. |
| Deficiency Judgment | In **100% of foreclosures** (except in those states where there is no deficiency) the bank has the right to pursue a deficiency judgment. | In some successful short sales it is possible to convince the lender to **give up the right to pursuit a deficiency judgment** against the homeowner. |
| Deficiency Judgment (amount) | In a foreclosure the home will have to go through an REO process if it does not sell at auction. In most cases this will result in a lower sales price and longer time to sale in a declining market. This will result in a higher possible **deficiency judgment**. | In a properly managed short sale the home is sold at a price that should be close to market value and in almost all cases will be better than an REO sale resulting in a **lower deficiency**. |

Noel Padilla lives and works by the same basic philosophy —if you're going to do something, do it right. It is this kind of singular approach that inspires the confidence of his clients and the respect of family and friends alike. Whether you're looking to buy the perfect home or want to maximize your current home sale, Noel is the answer to your real estate needs. For assistance in the Kendall area, call him today.

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