

Foreclosure Risk - 3 June 2010

Foreclosure has oft-unforeseen risk: lawsuits from lenders

FORT LAUDERDALE, Fla. – June 3, 2010 – Before Larry Thomas unloaded his Pompano Beach, Fla., home last fall for a fraction of what he paid, he cut a deal that will keep him from worrying about a huge debt hanging over his head.

Thomas insisted that his lender, American Home Mortgage Servicing, agree not to come after him for the estimated \$174,000 he still owed on his two mortgages. "I feel incredible relief," the 32-year-old restaurant manager said last week.

Others may not be as fortunate.

Lenders will file a tidal wave of lawsuits against homeowners in the next few years as a way to recoup losses when home sales or foreclosure auctions don't result in enough money to pay the mortgages in full, real estate and legal analysts say.

"It will be a dramatic problem because the borrowers will not know it's coming," said Frank Alexander, a law professor at Emory University in Atlanta.

Laws vary from state to state. In Florida, banks have five years from the date of the sale to file for so-called deficiency judgments and up to 20 years to collect. Lenders can garnish wages or make claims on borrowers' assets.

Before the housing meltdown, few lenders filed these lawsuits. Foreclosures and short sales – selling for less than the mortgage amount – were relatively rare at the time, and many of the homeowners didn't have sufficient assets to make it worth the banks' time and expense.

But following the heady days of the housing boom that spawned millionaire investors seemingly overnight, it's not uncommon for borrowers to default on mortgages while still holding lucrative investments.

As the next wave of the housing crisis plays out, those most in danger of getting slapped with lawsuits include angry homeowners who ransack properties they're losing in foreclosure and borrowers who walk away from "underwater" mortgages. In both cases, analysts say, banks will want to discourage other people from such behavior.

More than four in 10 homeowners said they would consider abandoning properties that are underwater, or worth less than the mortgages, according to a national online survey released last week by real estate firms Trulia and RealtyTrac.

Mortgage companies typically won't sue homeowners who negotiate in good faith or those who default on their loans because of job losses or other unforeseen circumstances, said Anthony Manno, an executive with Steelbridge Real Estate Services. The Miami-based company works with lenders on the resale of foreclosed homes.

Still, borrowers shouldn't rely on a lender's verbal commitment, Manno said. "Get something in writing."

Critics insist that spite will play a role in some of these lawsuits. Lenders deny it.

"We certainly would not do that," said Russell Greene, president of Grand Bank & Trust of Florida in West Palm Beach. "It's a business decision – not an emotional decision. It's very time-consuming to take someone to court."

Even if lenders don't pursue the judgments, they could sell mortgage debt to collection agencies at deep discounts. And it will be those debt collectors that will hound borrowers, said Shari Olefson, a Fort Lauderdale real estate lawyer.

"They paid money to be able to hassle you," she said.

Thomas, the former Pompano Beach homeowner, said he didn't have money for a downpayment but was approved for 100 percent financing on two loans in spring 2006. He bought a three-bedroom home for \$245,000.

Thomas said he soon became responsible for the entire mortgage after his roommate lost his job. That became even more difficult after Thomas took a pay cut.

So he attempted a short sale, eventually finding plenty of prospective buyers interested in a property that had plummeted nearly 70 percent in value. He and American Home Mortgage accepted one offer for \$80,000. After closing costs, the lender netted about \$71,000, said his Fort Lauderdale lawyer, Joe Kohn.

But before the sale closed, Kohn had American Home Mortgage waive its right to collect on the remaining mortgage debt.

Christine Sullivan, a spokeswoman for the lender, wrote in an e-mail that she can't discuss Thomas' case because of privacy issues. But when homeowners seeking short sales demonstrate legitimate hardship, "we provide a full release of liability, and we do not pursue deficiency judgments."

Some banks say they won't file a lawsuit, though they aren't willing to put that in writing, Kohn said.

"I have no choice but to accept that," he said. "Even when you play by the rules, banks don't always do what we'd like."

Under new government guidelines for short sales that took effect this spring, lenders aren't supposed to hold homeowners responsible for any remaining mortgage debt. But not all short sales fall under the guidelines, while some lenders choose not to implement them, Kohn said.

A forgiven mortgage balance through 2012 is not considered taxable income on a primary residence as long as the debt was used to buy or improve the house. But borrowers who walk away from investment properties risk having to pay federal income taxes on the forgiven amount.

Homeowners who hand their properties back to the bank through so-called deeds in lieu of foreclosure also should make sure they won't be on the hook for any mortgage debt.

With friends facing deficiency judgments, Thomas said he's grateful he sought legal advice on how to avoid a lawsuit. He now rents a home west of Boca Raton, but he just found out the owner is in foreclosure.

"I've escaped my own problem, only to inherit someone else's," Thomas said. "But this is nothing. It's just a matter of picking up the pieces and moving on to the next rental."

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