

Residential Real Estate Options for Distressed Borrowers

A. Loan Modification or Refinance

Are you considering a home loan modification or refinance to make your monthly residence mortgage payments affordable? If so, consider the following tips:

Some important basic requirements for a loan modification are that 1) the home is your primary residence; 2) you have experienced a financial hardship, such as a job loss; and 3) your first mortgage (including principal, interest, taxes, insurance and homeowners association dues, total more than 31% of your current gross income (pre-tax monthly income.) There are, of course, other relevant criteria. Further, some financial institutions and loan servicers have authorized modifications when not all the above criteria are met.

Lenders are inundated with requests for modifications or refinancing. Thus, don't be surprised if it takes an extended period of time for the financial institution or loan servicer to tell you whether you qualify for a modification or refinancing and/or provide you with new terms.

In order for the financial institution or loan servicer to determine your eligibility, you will be requested to complete forms and provide information about you and your finances, such as account balances and monthly payments on debts other than your mortgage, such as car loans. Even though it will require time and effort on your part, it is important that the forms be completed fully and accurately.

You will be requested to provide documents. You can expect to be requested to provide your two most recent pay stubs and/or documentation from other sources of income. You can also be asked to provide your two most recent bank statements and your most recent tax return. In the alternative, you may be asked to complete a form authorizing the lender to acquire your most recently filed tax returns.

Every document you submit should have your loan number written on it somewhere. Of course, keep copies of everything you submit, including copies of any cover letters or faxes.

Once you have submitted all the necessary documents, you will need to make regular calls to the financial institution or loan servicer inquiring into the status of your request for modification or refinancing. You should call approximately once a week. Always keep a log of your calls, recording the date and time of the call. Get the name of the person you speak with and

record what the person told you about the status of your application. You may wish to discuss it with a loan modification representative you speak with in a future call. You can expect to speak with a different person every time you call.

You can expect to be requested to provide updated documentation during the process. However, as you proceed through the process, keep in mind that Perseverance and Persistence Prevails.

B. Short Sale

If you find you do not qualify for, your lender will not approve a modification or refinance, or modification terms are not ones with which you can live, a “short sale” might be a viable alternative. A short sale is selling your home for less than the amount owed on the mortgage. It can avoid a foreclosure and possibly does less damage to your credit score. A short sale requires the approval of the lender(s). Any short sale contract includes a contingency provision providing that the lender must approve the sale. The proceeds from the sale of the property go to the lender(s).

A consideration in deciding whether a short sale is right for you is whether your loan is a “recourse” or “nonrecourse” loan. If the loan is a nonrecourse, the sale is treated as if the property was sold for the balance of the mortgage, and your loan is paid.

If the loan is a recourse loan, although the loan is secured by the residence or property, you are personally liable for the difference between the sales price and the balance on the loan unless the lender forgives the difference in writing.

In California, most loans or mortgages used to purchase a residence are nonrecourse loans. However, if the loan was taken out to refinance your mortgage, it is probably not a nonrecourse loan. If you do not know if your loan is a recourse or nonrecourse loan, an attorney can advise you.

If your loan was not used to purchase, build or substantially improve your principal residence (a nonrecourse loan), the lender may still forgive the balance of the loan. For tax purposes, the balance forgiven is treated as income. However, the Mortgage Debt Relief Act of 2007, which has been extended to include the 2012 tax year, provides some tax relief. When the lender forgives the balance or cancels the remainder of a nonrecourse loan on your principal residence, any amounts over the amount of the old mortgage principal just before refinancing may not be taxed as ordinary income by the federal government. In other words, it is possible the amount forgiven will not be taxed as ordinary income.

On April 12, 2010, Governor Schwarzenegger signed SB 401 (Wolk),

which is relief legislation for cancellation of loans on a qualified principal residence. The legislation is called the Conformity Act of 2010 and conforms California law, with some modifications, to the federal mortgage forgiveness debt relief act. It too applies through 2012. A significant modification or difference between the federal act and the state act is that the debt relief that can be excluded from taxable income is limited to \$250,000 for married individuals or registered domestic partners filing separate returns and \$500,000 for individuals, rather than the amount of the qualified principal residence indebtedness of the federal exclusion.*

With a short sale, borrowers eligible for the federal Home Affordable Modification Program, but who did not qualify for a modification or were unable to sustain payments under a trial period plan or modification, may qualify for up to \$1,500.00 to cover relocation expenses

A real estate agent or broker experienced in short sales should handle the short sale transaction for you. However, you should arrange for an attorney to review all the transaction documents to be sure that you are protected. Provisions required by the lender, resulting in some unpleasant surprises, can be found in the documents of some transactions. For example, provisions providing that you agree to pay deficiencies and/or fees can be included in the transaction documents.

C. Deed-in Lieu of Foreclosure

A deed in lieu of foreclosure transfers ownership in the property to the lender, thereby avoiding a foreclosure. In exchange, the lender cancels the loan. You should make a written offer to negotiate a deed in lieu of foreclosure. Any agreement reached should result in a written agreement in which the lender promises not to initiate foreclosure proceedings or to terminate any existing foreclosure proceedings. If the loan is a recourse loan, an attempt to negotiate a forgiveness of the amount of the loan that isn't covered by the proceeds from the sale of the property should be made. The agreement to forgive any deficiency should be included in the written agreement.

One of the reasons the lender would agree to a deed in lieu of foreclosure is the lender can avoid the costs of a foreclosure. For you, a deed in lieu of foreclosure can result in more favorable terms than a foreclosure, and arguably, the deed in lieu has a less adverse impact on your credit rating.

Also, as with the short sale, borrowers eligible for the federal Home Affordable Modification Program, but who did not qualify for a modification or were unable to sustain payments under a trial period plan or modification, may qualify for up to \$1,500.00 to cover relocation expenses

D. Walk-Away

A walk-away allows the foreclosure process to run its course. Interestingly, although called a walk-away, you may remain in the home, paying nothing until the foreclosure process is complete and you are compelled to leave.

However, a walk-away is a poor option if the loan is a recourse loan. If the loan is a recourse loan, you will owe the difference between the foreclosure proceeds and the amount owed on the loan. Additionally, if you have an expectation of purchasing another home in the future, if you have walked-away, you can expect it to take a significantly longer period of time before you will qualify for another mortgage, longer than a deed in lieu and even longer than a short sale.

* This discussion is not intended to give tax advice and you should always consult a tax expert to evaluate your particular circumstances.

Patricia Wendleton's specializes in civil litigation with substantial trial and appellate experience. She has a diverse legal background, with expertise in construction defect litigation, construction contracts and their indemnity provisions, construction site injuries and insurance coverage issues. She also advises employers in employment and labor law and represents employees in labor matters.

To learn more about Patricia's specialties of law, please view her profile under attorneys. If you would like to speak with Patricia, please call 408-369-0800.

By: Patricia Wendleton