

DILEMMAS & SOLUTIONS for DISTRESSED PROPERTIES

THE FOLLOWING IS MATERIAL FROM A REAL ESTATE CLASS MICHELLE RECENTLY TOOK. DUE TO THE VOLATILITY OF TODAY'S REAL ESTATE MARKET, PLAYERS AND POLICIES CONTINUE TO EVOLVE, THUS, THE MATERIAL PROVIDED MAY NOT BE PERFECTLY COMPLETE OR ACCURATE. THIS INFORMATION IS PROVIDED FOR EDUCATIONAL PURPOSES ONLY. IT IS RECOMMENDED THAT YOU CONSULT A REAL ESTATE ATTORNEY AND/OR ACCOUNTANT AND/OR BANKER.

There are many options for homeowners who are in distress. Each has consequences that should be considered carefully. Those options may include:

- 1. Refinance**
- 2. Sale**
- 3. Lender Workout**
- 4. Short Sale**
- 5. Foreclosure**
- 6. Bankruptcy**

OPTIONS AND THEIR CONSEQUENCES

REFINANCE

If a homeowner is current and wishes to stay in the home but may have future trouble paying their payments they may consider refinancing to a 30 or 15 year fixed-rate mortgage via Home Affordable Refinance, a part of the Making Home Affordable Initiative started in early 2009.

Eligibility Criteria for Home Affordable Refinance Program HARP

Home	<ul style="list-style-type: none">✓ Owner occupied✓ Property is a one-to-four unit residence
Existing Mortgage	<ul style="list-style-type: none">✓ Owned or backed by Fannie or Freddie✓ Loan-to-value ratio is greater than 80% but less than 125%
Borrower	<ul style="list-style-type: none">✓ Current on their existing loan payments✓ Has verifiable income to support new payment

More information can be found at the following website:
www.MakingHomeAffordable.gov

MAKING HOME AFFORDABLE.gov HELP FOR AMERICA'S HOMEOWNERS

ABOUT | ELIGIBILITY | LOAN LOOK UP | FIND A COUNSELOR | REQUEST A MODIFICATION | RESOURCES | AUDIO AND VIDEO | EN ESPAÑOL

Are You Eligible?

Please use the self-assessment tools provided on this website to see if you are among the 7 to 9 million homeowners who may be able to benefit from **Making Home Affordable**.

Find out if you are eligible ▶

1 2 3 4

Learn About Making Home Affordable

Refinancing
Many homeowners pay their mortgages on time but are not able to refinance to take advantage of today's lower mortgage rates perhaps due to a decrease in the value of their home.

Modification

If you're having trouble getting a straight answer in connection with the Making Home Affordable program, call 1-888-995-HOPE and they will be able to get you the help you need.

888-995-HOPE
Homeowner's HOPE Hotline

SELL AND BRING CASH TO CLOSING

Many homeowners do not have the cash to take advantage of this option and cure a deficiency at closing. By curing deficiencies at closing a borrower can avoid the negative consequences of credit report damage a short sale or foreclosure brings. In any event, property owners should be encouraged to seek appropriate tax and legal help before liquidating some assets to bring the necessary cash to closing

LENDER WORKOUT

If the problem is only temporary several options exist for the borrower. They include:

- **Reinstatement:** Your lender is always willing to discuss accepting the total amount owed in a lump sum by a specific date. Forbearance may accompany this option.
- **Forbearance** - Your lender may allow you to reduce or suspend payments for a short period of time and then agree to another option to bring your loan current. A forbearance option is often combined with a reinstatement when you know you will have enough money to bring the account current at a specific time. If you enter into a forbearance agreement, get it in writing from your lender, make certain you understand the agreement, and be sure you can meet your new financial obligations.

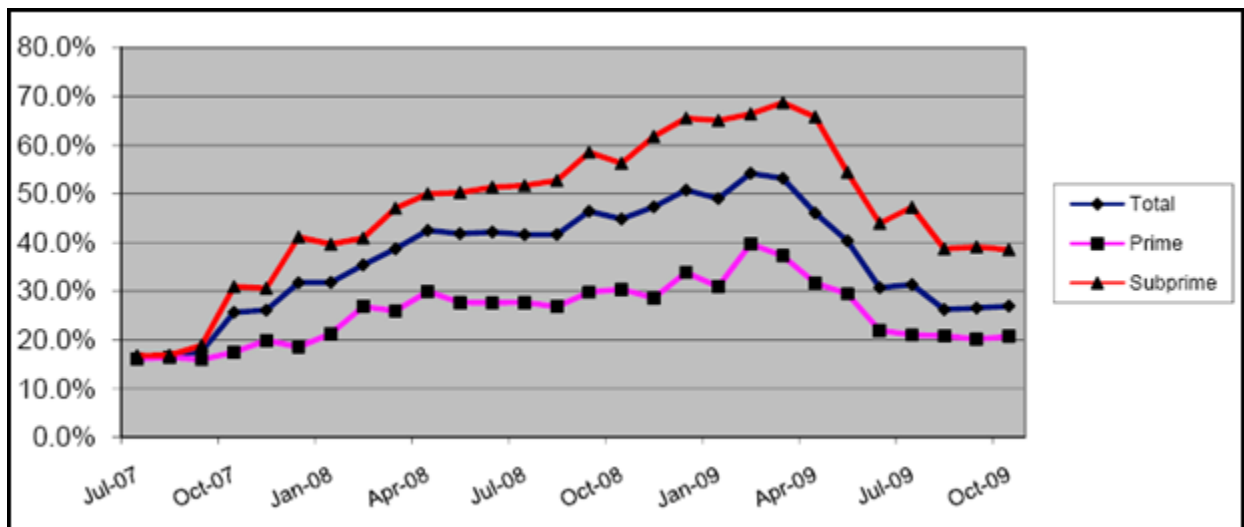
The Appendix contains an excellent article regarding forbearance agreements

- **Repayment plan:** You may be able to get an agreement to resume making your regular monthly payments, plus a portion of the past due payments each month until you are caught up.

If it appears that the situation is long-term or will permanently affect the owner's ability to bring their account current:

- **Loan modification** - If you can make payments on your loan, but don't have enough money to bring your account current or you can't afford your current payment, some lenders may be willing to change the terms of your mortgage. For example they may:
 - Add the missed payments to the existing loan balance.
 - Change the interest rate, including making an adjustable rate into a fixed rate.
 - Extend the number of years you have to repay.
- **Pre-foreclosure sale** - If you cannot afford your mortgage, selling your property prior to the foreclosure sale may be your best option to avoid a foreclosure and keep your equity. Work with your lender to minimize deficiency balances.
- **Bankruptcy** - In some circumstances bankruptcy, particularly filing under Chapter 13, may save your home from foreclosure. To consider this option, consult with a lawyer as soon as possible. Some legal sources can be found on the [NH Based Legal Assistance](#) webpage.
- **Deed-in-lieu of foreclosure** - Use this as a last resort. Your lender may be willing to accept your property in lieu of foreclosure. Giving your home back to the lender will hurt your credit, but avoids a foreclosure.

Loan Modifications as a percentage of Workout Options: July 2007 to October 2009



Source: www.hopenow.com

Homeowners who experience changes in income or other life circumstances may seek loan modification through Home Affordable Modification, a part of the Making Home Affordable Program. This is a voluntary program for lenders.

Eligibility criteria for Home Affordable Modification

Home	<ul style="list-style-type: none">✓ Owner occupied✓ Property is a one-to-four unit residence
Existing Mortgage	<ul style="list-style-type: none">✓ Unpaid principal balance that is less than \$729,750 for single family residences and higher for duplex through 4-plexes.✓ Loan was originated on or before January 1, 2009✓ Payments (PITI) exceed 31% of borrower's gross monthly income
Borrower	<ul style="list-style-type: none">✓ Experiences a change in income or other financial difficulties✓ At risk of imminent default or is in default

The steps to a loan modification:

1. Lender determines if an interest rate reduction to as low as 2% will bring the borrower's PITI payment to no greater than 31% of their gross monthly income
2. Lender determines that a loan modification is less expensive than not modifying the loan
3. Borrowers have a 3 month trial period to determine they can make the new payments
4. If successful the lender makes a 5 year interest rate modification

Remember: Assisting a borrower in modifying their loan, even for free, requires a Mortgage Loan Originators license in Idaho issued by the Idaho Department of Finance. Direct the borrowers to their loan servicer or a licensed loan modifier.

SHORT SALE

Definition: A sale of the property in which the sales price is less than the amount owed to the lender(s) and the property owner is unable or unwilling to pay the deficiency at closing. The underlying lender(s) must agree to the provisions of the sale. A short sale avoids foreclosure on the property.

CREDIT DAMAGE: SHORT SALE VS. FORECLOSURE

Although many think a short sale is always preferable to a foreclosure, the circumstances of each sale and the seller's financial condition should dictate which of these two options is best. The advantages to a short sale can be mentioned:

1. Surrounding neighborhood and community are impacted less negatively
2. The seller's credit is negatively impacted less

Much debate exists as to the final impact of short sales vs. foreclosures on a borrower's credit. Although everyone agrees a foreclosure has more negative impact on the borrower's credit, just how much worse depends on a few factors. The following graph speaks to this issue by examining the effects of various mistakes a borrower can make. Note: A short sale falls under the category of Debt Settlement.

DAMAGE POINTS: HOW MISTAKES AFFECT FICO SCORES		
Credit mistake	If your score is 680	If your score is 780
Maxed-out card	Down 10 to 30 pts.	Down 25 to 45 pts.
30-day late payment	Down 60 to 80 pts.	Down 90 to 110 pts.
Debt settlement	Down 45 to 65 pts.	Down 105 to 125 pts.
Foreclosure	Down 85 to 105 pts.	Down 140 to 160 pts.
Bankruptcy	Down 130 to 150 pts.	Down 220 to 240 pts.

Source: FICO

Agents can help sellers improve the impact of a short sale by negotiating with the lender to agree to report to credit bureaus one of the following:

1. Paid in full/Paid as agreed (Will often require a small loan to repay some of lender loss)
2. Paid – settled
3. Paid – unrated

Fannie Mae will grant a new loan to borrowers in ____ years after a short sale or foreclosure

QUALIFYING THE SELLER

Not every seller is a qualified short sale candidate. Agents should be careful to choose their potential short sales listing carefully. Many factors contribute to making a seller a good short sale candidate. They include:

IS THERE A HARDSHIP?

Homeowners must demonstrate that there is a valid hardship associated with their circumstance. The seller has to have reasons that change their ability to make the payments. Valid hardships can be any of the following:

- ✓ Job loss
- ✓ Income reduction
- ✓ Business failure
- ✓ Illness and/or medical costs
- ✓ Death of a spouse
- ✓ Divorce
- ✓ Natural disasters

Hardship is not defined as loss of market value and equity and is not valid reasons to sell short.

IS THERE ENOUGH TIME?

NEWS FLASH!: Short sales take longer than regular sales to accomplish. Check to see if there are a couple of months between now and when the foreclosure sales date is scheduled. In Idaho if the Trustee's Sale Date has not been officially scheduled then you have at least 4 months and usually longer to negotiate a short sale. Some experienced agents will turn down short sale listing if there is less than 2 months to the foreclosure sale date.

WHAT IS OWED AGAINST THE PROPERTY?

Determine how many loans are against the property and what the balance of each is. Sellers should be able to help you with this. Each lien holder represents a challenge to negotiating a short sale. The more that is owed the more the loss lender(s) will be asked to take. Depending on the lender, some are unwilling to negotiate their payoff balance if there are other lenders involved. Additionally, check to see if there are unpaid HOA dues that add a potential new wrinkle to the sale.

WILL THEY CONTACT OTHER PROFESSIONALS?

A very important step for the agent is to stress to homeowners the needs for additional professional help, such as legal and tax advice. Sellers in distress may be reluctant to consider this option as too expensive. Tax and legal ramifications are very possible in any distressed sale and sellers should be made aware of this potential. At minimum agents are advised to have the seller sign documentation that they were strongly encouraged to seek this help before entering into any contract for a distressed sale. See Appendix for an example of such a disclosure.

Idaho Bar Association has a \$35.00 half hour, in office consultation with a member lawyer as a public service.

www.usfn.org is the website for the U.S. Foreclosure Network and can help them locate attorneys who specialize in bankruptcy and foreclosure laws.

DEALING WITH THE LOSS

When a lender allows for short sale they are taking a loss known as a deficiency. Lenders deal with the deficiency in different ways. Typically the loss is dealt with through forgiveness or collection. After that, tax implications come into play.

Forgiveness or Collection:

Sellers are understandably interested in having the lender forgive the loss. If the lender agrees to forgive the deficiency *it must be in writing* and include specific language addressing this issue. The language may need to be reviewed, if not even drafted, by legal counsel to ensure the possibility for seeking repayment of the deficiency is forever waived by the lender.

In Idaho lenders have up to 5 years to seek a deficiency judgment for a short sale loss. Even though lenders now appear overwhelmed with files to work, do not be fooled into thinking they will forget about their options. Many industry professionals are concerned that in the future when the hard times have passed and things are more normal, lenders may indeed go after these judgments. Some reports state that lenders are selling their rights to deficiency judgments to collection agencies and investors for a fraction of their value allowing those parties to seek the full amount allowed by law and start collecting.

Many times a lender will try and get the defaulting seller to agree to repayment plan for the amount of the deficiency. This collection should be agreed to by your seller so there is no surprise down the road.

Taxation:

In an effort to kick U.S. taxpayers while they are down, the IRS will consider any debt forgiveness from a short sale or foreclosure as imputed income (read: regular wage income). This additional income will have unpleasant consequences for the seller when they file their annual tax return. However, if the property qualifies as their seller's principal residence then taxation of the forgiven debt may not occur.

Mortgage Debt Relief and Emergency Economic Stabilization Act of 2007 provides that taxpayers no longer have to pay income taxes on the debt relief if:

- ✓ The property was their principal residence 2 of the last 5 years
- ✓ The forgiven loss is under \$1,000,000 for a single taxpayer and under \$2,000,000 for a married couple
- ✓ The debt was forgiven in the years 2007-2012
- ✓ The debt forgiven was used to buy, build or improve the principal residence

Forgiven debt for short sales and foreclosure for any other property will carry the obligation of the seller to report the extra 'income' to the IRS.

NOTE: Licensees should exercise caution in explaining these provisions to sellers. Qualified tax professionals should be consulted to answer more complex questions for the seller.

Forms 1099-A or 1099-C are issued by lenders to report the income tax consequences of a foreclosure, short sale, abandonment or deed in lieu of foreclosure. If a lender acquires the property and does not cancel any debt, Form 1099-A is issued. If the lender cancels part or all of the debt, Form 1099-C is issued.

When a non-recourse debt is canceled in exchange for the property the transfer is treated as a sale. The amount realized from the sale is the greater of the sales price of the property or the unpaid debt. Where the debt is recourse, the transaction is split, into two parts:

1. A taxable disposition of the property; and
2. To the extent the fair market value (FMV) of the property is less than the unpaid debt, either a continuing debt obligation is owed to the lender or the remainder of the debt is discharged.

The gain or loss on the taxable disposition portion is the difference between the property's FMV and the taxpayer's adjusted basis. If the lender cancels the remainder of the debt, the borrower will have cancellation of debt income (CODI) equal to the difference between the amount of the debt and the property's FMV.

SHORT SALE TIPS

1. The purchase and sales agreements between the buyer and the sellers must state the contract is contingent upon lender(s) approval of the short sale provisions. See Appendix 2 for sample language.
2. **When does the buyer pay the earnest money deposit?** If using the RE-21 form the broker is required to deposit it either 'upon receipt' or 'upon acceptance'. This 'upon acceptance' is defined as the seller acceptance, not their lender. If the buyer wishes to pay the deposit otherwise the contract must state so, like "upon written lender acceptance of the offer."
3. **Is the lender to be shown all offers to purchase?** Per the Idaho Real Estate Commission, the lender must be asked their preference. Idaho law requires the seller to be presented all offers signed by a buyer 'as soon as practicable'. Even though the lender(s) is not the seller, IREC considers failure to ask any lender considering a short sale their policy as potentially defrauding a lender.
4. **When does the buyer have to do their home inspection?** As most buyers are unwilling to pay money for a home inspection until they know the lender(s) has accepted their offer, the standard language in the RE-21 (Section 10) contract does not provide for the inspection performance timeline to be extended unless it is specifically added.
5. **Should we use the RE-44 Short Sale Addendum?** Although not required, many use it because it does many of the things mentioned in this section. It provides language making the entire contract contingent upon lender approval allows either buyer or seller to rescind the agreement at any time prior to lender written acceptance and extends the performance timeline for items like home inspections to start when the lender has accepted the agreement.

6. **As listing agent when should I contact the seller's lender?** As soon as you take the listing. Banks handle short sales differently and some will allow work to be done prior to having a buyer under contract. In any event find out what constitutes an entire package for submittal and start working on it now. Important: FHA short sales are to be started upon property listed for sale. No relative may be paid as agents. (FHA)
7. **Only work with good short sale candidates.** Many agents will tell you stories of clocking in many hours of hard, frustrating work trying to market and close a short sale only to find in the end the seller uncooperative or unwilling to do their part. Prequalifying a seller is as important as prequalifying buyers in any market or circumstance, especially short sale sellers. **NOT ALL SELLERS ARE APPROPRIATE SHORT SALE CANDIDATES!** Don't just list anyone. See Appendix for a list of questions to ask potential sellers considering a short sale.
8. NAR has HUD's announcement of the HAFA program at:
https://www.hmpadmin.com/portal/docs/hamp_servicer/sd0909.pdf

FORECLOSURE

If the lender is unwilling to explore alternatives to a short sale a foreclosure may be a lender's next, and final, step.

Definition: the proceeding, by a creditor, to regain property or other collateral following a default on mortgage payments.

REAL ESTATE SECURITY

Two Parts of Real Estate Loans

Every loan for real estate is made up of 2 elements: a Note and a Security Instrument. The note is simply the borrower's personal promise to repay the loan under specific terms and conditions. Items like interest rate, how many payments, when are the payments due and late charges are all elements of the typical note. But a note itself does not attach to any property. If there was only a note in a real estate loan and borrower defaulted, the lender would have to seek repayment in other ways than a foreclosure. If the lender wishes to seize the property so they can resell it to pay the note they need specific permission to do so. The security instrument gives them that permission.

The security instrument portion of the loan is the part that attaches the real estate involved to the promissory note to repay the debt. The security instrument has the rules of the loan like requirements to maintain the property in good condition, pay the property taxes on time and maintain an insurance policy. One very important part of the security instrument is the rule that the borrower repay the promissory note as agreed. Buried deep inside a security instrument are the provisions for the lender's remedy should the borrower not follow any of the rules. These default and remedy provisions include the lenders ability to foreclosure on the property if they wish. These foreclosure procedures vary depending on the type of security instrument is being used, but in the end mean one thing: The lender seizes the property so they can use it to get money to repay the borrower's debt.

Note	+	Deed of Trust	=	Real Estate Loan
Note	+	Mortgage	=	Real Estate Loan
Note	+	Contract for Deed	=	Real Estate Loan

Deeds of Trust

Even though most people call their home loan and mortgage, it probably is a Deed of Trust. In the history of real estate security instruments the Deed of Trust is the baby. Mortgages and Contracts for Deed have been around much longer. In most respects they look and act the same. The main differences appear when a foreclosure action starts. States like Idaho adopted the Deed of Trust to streamline the foreclosure process lenders use in the event of a default by the borrower.

Deed of Trust gets its name from the theoretical transfer that occurs upon its execution. Technically a borrower deeds the property 'in trust' to a trustee (In Idaho a title company or attorney). If all of the rules of the loan are followed the trustee does nothing. Once the loan is paid in full the trustee reconveys the property back to the borrower who owns it outright.

If the lender (Beneficiary of the trust) experiences a violation of the Deed of Trust rules a 'default' has occurred. The lender orders the Trustee to initiate a foreclosure procedure. After the statutory period of time, during which the borrower may cure the default and get back in good graces with the lender, the Trustee holds a public auction for the property in an attempt to recoup the amount owed them. All of this happens without the courts and lawyers. After the public sale the defaulting borrower has no rights or claim on the property.

Mortgages

Although a mortgage may be used as the security instrument to finance any property in Idaho, mortgages are required to be used in certain circumstances. The following exhibit shows the rules:

Property Size	Use	Security Instrument
40+ acres	Agriculture	Mortgage
Less Than 80 acres	Non-agriculture	Deed of Trust or Mortgage
Any size in a city	Any	Deed of Trust or Mortgage

There is no Trustee in a mortgage. The owner of the property is the borrower who grants the lender the right to foreclose if the payments are not made. If that occurs the lender is required to use the court system to foreclose. This proceeding is called a judicial foreclosure and is more time-consuming, expensive and typically longer to accomplish.

Contracts for Deed (Land Sales Contracts)

Another method used to finance property is a Contract for Deed and was the original style used. In a Contract for Deed, the buyer and seller agree to the loan terms and that the seller will remain the legal owner of the property during the time the borrower makes payments. The buyer gets to move onto the property and treat it as their own. Once they have made the last payment the seller then deeds the property to the buyer. If the buyer misses a payment the seller has permission, because they are the legal owner, to reenter the property and immediately seize it by throwing the buyer off. There is no system or rules designed to protect each party. Courts do not like Contracts for Deed because of this possibility of the borrower 'forfeiting' their rights, money, effort, equity and 'equitable title ownership'. For this reason Contracts for Deed are discouraged in Idaho.

PRIORITY

Priority is the concept to lining up those parties who have an interest in real property to determine who is first in line and who is last. This is important because in the event of a property sale, whether forced or voluntary, the party in 'first' position is paid first; the party in 'second' position is paid next and so on down the line. If there isn't enough money to pay them all the most junior party in the priority line is left out. If there isn't enough money to even pay all of the first party, still all the rest are wiped out. Priority becomes critical in a foreclosure or short sale.

Example:

Bill owns property he bought in March 2003 for \$350,000. He now has three loans with Deeds of Trust on the property as follows:

Bank	Recording Date	Amount
US Bank	March 15, 2003	\$275,000
Wells Fargo	August 27, 2005	\$60,000
Beneficial Finance	February 12, 2007	\$25,000

If US Bank forecloses and Wells Fargo and Beneficial Finance do nothing, their interest in the property will be foreclosed out, meaning their loans are wiped out. They would, in certain circumstances, have access to some of the sale proceeds, but only if there is enough.

Imagine that US Bank forecloses and the sale proceeds are \$300,000. Who gets what? The proceeds would be distributed as follows:

Bank	Amount
US Bank	\$275,000
Wells Fargo	\$25,000
Beneficial Finance	\$0
Total	\$300,000

What would happen if the highest bidder paid \$400,000 at the sale? Here is how the proceeds would be distributed:

Bank	Amount
US Bank	\$275,000
Wells Fargo	\$60,000
Beneficial Finance	\$25,000
Owner Bill	\$40,000
Total	\$400,000

NON-JUDICIAL FORECLOSURE PROCESS

This procedure must be followed for a Trustee to issue a Trustee's Deed at a foreclosure sale for a Deed of Trust.

GETTING STARTED

The first actual step taken in most circumstances is not required by law. A "Notice of Intent to Foreclose" is sent to the defaulting borrower as a last attempt to alert them that they are serious and are proceeding to a foreclosure. This non-required letter will stipulate an amount needed to bring the loan current and a date by which that amount is due by.

THE NOTICE OF DEFAULT

The first formal, required step is for the Trustee to prepare and file a Notice of Default. Idaho code requires that the Notice of Default be recorded in the county the property is located and contain certain elements like the borrowers name, legal description, deed recording number and statement of the nature of the breach.

TRUSTEE'S SALE GUARANTEE

This document, also referred to as a TSG, is issued by the title company conducting the sale. The TSG shows all the liens and encumbrances recorded against the property. It guarantees that title will pass at the foreclosure sale free of all encumbrances that are junior to the foreclosing lien. The TSG also serves to notify all junior lien holders of the foreclosure action just starting.

NOTICE OF TRUSTEE'S SALE

Once the TSG is completed and reviewed by the lender, the Trustee then sets the date and time for the foreclosure sale. This information is contained in the Notice of Trustee's Sale.

There are several required elements of a Notice of trustee's Sale. They include:

1. The sale must be held at least 120 days following the date of mailing of the Notice of Trustee's sale.
2. It must be held between 9:00 AM and 4:00 PM
3. It must be held in the county the property is located
4. Names of the trustor (borrower), trustee and beneficiary
5. Legal description
6. Book and page of the loan records or the recorder's instrument number
7. The type of default
8. Amounts owing on the loan

NOTICE

The Notice of Trustee's sale is then publicized in three ways:

1. **Mailing** - The trustee is required to mail by registered or certified mail
2. **Posting/Service** – At least three attempts to personally deliver to an adult occupant of the property must be made at least 30 days prior to the sale date. If no one can be located the notice must be taped on the property or stake
3. **Publication** – A newspaper of general circulation in the county the property is located must carry the notice once per week for four weeks with the last time at least 30 days prior to the sale

REINSTATEMENT RIGHTS

The borrower, or any junior lien holder, has the right to bring the loan current by repaying not only the late payments, but the late charges, penalties and costs of the Trustee to this point. Up to the 115th day after the filing of the Notice of Default, all lenders must allow this reinstatement.

POSTPONEMENTS

The foreclosing lender may elect to postpone the sale. If the lender is considering a short sale or forbearance agreement with the borrower they will delay the sale to grant enough time to put those agreements in place. If they do, they are not required to restart the process from the start if they decide to foreclose after all. Idaho code allows for a postponement of up to 30 days from the original sale date. The only requirement is that the Trustee announces the new sale date and time at the original sale date and time. This process may continue indefinitely, with a new postponement being announced at each sale.

CONDUCTING THE SALE

The law requires the sale be held in public. Most of the time a title company lobby or conference room is used. Title companies also pre-qualify attendees to determine if the plan to bid or just watch the proceedings. If they intend to bid, then they must provide evidence of good funds to do so. Cash or a cashier's check will be required.

At the appointed time and place the Trustee will 'call' the sale. They start by reading statements required by law. Then the bidding begins. The first bid is typically a credit bid entered by the lender. Although the lender will usually bid the entire amount owed to them, they may bid any amount they wish. Anyone else may bid as well.

If the lender entered a credit bid lower than the true amount owed to them, they may continue by increasing their bid up to the amount owed to them. If they bid higher than the amount owed them, then they must provide cash for the difference.

Like any auction, the final high bid is the winner. If no one outbids the lender, the lender becomes the winner without having to pay any cash. They now own and control the

property and will hire a local real estate broker to list the property for sale as an REO (Real Estate Owned). If the high bidder is a third party they then control the property.

If a third party is the successful bidder the sale proceeds are distributed in the following order:

1. Sale expenses, reasonable attorney's fees, and trustee's fees
2. The loan that brought about the foreclosure sale, up to their amount owed
3. The junior lien holders in priority order, up to their amount owed
4. The former owner of the property

Example

1. Citibank holds a first lien deed of Trust for \$150,000
2. Chase Mortgage holds a second lien position for \$35,000
3. At the sale, Citibank enters a credit bid of \$150,000, Chase Mortgage then bids \$160,000 and a private party bids \$165,000.
4. The private party becomes the owner and the funds are distributed as follows:

Total Received	\$165,000
Distributions:	
Trustee's Fees/Cost	\$3,000
Citibank	\$150,000
Chase Mortgage	\$12,000
Former Owner	\$0

REDEMPTION

Once a sale is held the former owner has no rights to get the property back, even if they happen to come up with the money. Junior lienholders also do not have any redemption rights after a Trustee's sale. For this reason, along with the streamlined foreclosure process, is why lenders who can use a Deed of Trust for a real estate loan will insist on it.

POSSESSION RIGHTS

Idaho law allows for the new owner of the property possession 10 days after the sale. If the property is vacant the new owner may immediately possess. A new federal law in 2009 allows certain occupants who did not have ownership interests to have their leases honored for 90 days after the sale. On May 20, 2009, President Obama signed the "*Protecting Tenants at Foreclosure Act of 2009*." This legislation provided that leases would survive a foreclosure -- meaning the tenant could stay at least until the end of the lease, and that month-to-month tenants would be entitled to 90 days' notice before having to move out

(this notice period is longer than any state's non-foreclosure notice period, a real boon to tenants).

An exception was carved out for the buyer who intends to live on the property -- this buyer may terminate a lease with 90 days' notice.

FORBEARANCE AGREEMENTS

At any point in the foreclosure process the lender and the borrower may elect to enter into an agreement to work out the delinquency. These agreements are called forbearance.

Typically, the delinquent amount is spread out over a period of time. In the mean time the lender either halts the sale entirely or postpones numerous times. See Appendix 1 for an article regarding forbearance agreements.

JUDICIAL FORECLOSURE PROCESS

If a mortgage is used as the security instrument the streamlined foreclosure rules are not available to the lender. Instead the court system must be utilized. With this system comes the obvious disadvantage of cost, time and hassle. There are a few similarities between this and a non-judicial foreclosure, but most aspects are very different.

THE PROCESS

Because most real estate loans use Deeds of Trust and not Mortgages, we will limit the discussion regarding judicial foreclosures. The basic facts are these:

1. Commences with a the filing of a standard lawsuit complete with attorneys, judges in black robes, court rooms, witnesses, evidence and rules or civil procedure
2. No statutory time period but ranges from 45 days to years to complete
3. Judge awards the lender a judgment and orders the asset to be sold to satisfy the judgment
4. Sheriff calls the sale
5. Highest bidder must pay cash but receives only a certificate of sale, not a deed
6. Original borrower has a redemption period in which to buy back their property
 - a. 6 months for properties under 20 acres in size
 - b. 12 months for properties 20 acres and larger
7. Defaulting borrower has the right to possession during the redemption period
8. Junior lienholders have the right to redeem during this period as well
9. Once the redemption period has expired the sheriff deeds the property to the new owner

DETERMING DEFICIENCY

Because most foreclosures experience a deficiency, it is necessary to know how these are handled in a judicial foreclosure as well. A deficiency makes no difference to a buyer of a distressed property. However, a deficiency should be very important to any seller. Unlike a short sale, there are legal rules that help establish the amount of a deficiency. A lender is able to seek a deficiency judgment for either a judicial or non-judicial foreclosure. A deficiency in a judicial foreclosure usually happens during the same lawsuit foreclose.

Idaho code limits the deficiency to the difference of the SMALLER of these two computations:

1. The amount bid at the foreclosure sale and the amount owed or
2. The fair market value the date of the sale and the amount owed

Example 1

US Bank loan balance	\$275,000
Fair market value	\$200,000
Winning bid at sale	\$200,000
Owner deficiency	\$75,000

Example 2

US Bank loan balance	\$275,000
Fair market value	\$200,000
Winning bid at sale	\$275,000
Owner deficiency	\$0

Example 3

US Bank loan balance	\$275,000
Fair market value	\$200,000
Winning bid at sale	\$150,000
Owner deficiency	\$75,000

PAYING A DEFICIANCY

If the lender indeed has the right to a deficiency judgment Idaho law allows a very short window of opportunity for the lender to pursue one. Unlike a short sale where the lender who takes a loss has up to 5 years to seek a deficiency judgment against the former borrower for their loss, in a foreclosure the lender has just 90 days to do so. Remember, if the lender bids the amount owed at the sale and then later takes a loss selling the property as an REO they are barred from seeking any deficiency. Many industry observers are of the opinion that lenders typically bids their loan balances at the sale and are, therefore unable to seek deficiency judgments. However, smaller, local lenders are usually well aware of the legal provisions and are more apt to bid an amount lower than their loan balance with the intention of seeking a judgment after the foreclosure sale.

As always, strongly advise any seller to seek appropriate legal counsel before determining which route of best for them.

JR. LIENS

Junior lienholders rights to the property as security for their loans are wiped out at a foreclosure sale but their ability to seek a deficiency judgment is not.

Junior lienholders in a non-judicial foreclosure would have to seek their judgment within 90 days after the sale date.

A junior lienholder in a judicial foreclosure can seek a deficiency in the same lawsuit or bring their own. The junior lienholder has the right to pay off the first and include that amount in what they are owed. They would then pursue their own foreclosure (most notes provide that a lender can advance funds to protect the security and add the amount advanced to their balance).

BANKRUPTCY

Any agent working with distressed sellers is probably aware that bankruptcy could enter the picture. Even though our real estate licenses do not make us attorneys, we should be aware of any aspect of a sale that impacts buyers and sellers. Distressed sellers may use bankruptcy to help them work through their financial circumstances.

Once a property owner files for bankruptcy an automatic 'stay' is imposed on all creditors. The stay prohibits any collection activity or other actions adverse to the borrowers, including the voluntary or involuntary sale of their properties.

PURPOSE OF THE LAW

Bankruptcy is a legal procedure designed both to protect an individual or business that can't meet its financial obligations and to protect the creditors involved.

Once the bankruptcy proceeding ends, the borrower is no longer liable. In legal terms, the court has discharged the borrower from the debts. The borrower then starts over again with a clean financial slate, but the record of the bankruptcy will remain on the borrower's credit record for up to ten years.

TYPES OF BANKRUPTCY:

1. **Chapter 7** – Sometimes referred to as a 'straight bankruptcy,' a chapter 7 generally results in a debtors discharge from their debts established before filing for bankruptcy. They retain some exempt property to allow a better chance for a fresh start but will have their nonexempt property distributed to the unsecured creditors on a pro rata basis. Real estate loans are secured loans and the possibility of keeping the property after a bankruptcy is low. If there is equity in the property the courts will look to it to discharge the secured debt attached to the asset. If there is no equity in the property the courts could release the property from the bankruptcy proceedings and allow the secured creditor to use the foreclosure process to seek repayment.
2. **Chapter 11** – Typically used by businesses who wish to continue operations, a chapter 11 is very expensive and time consuming. The debtor proposes a reorganization plan that the creditor have a vote on. If the debtor is unable to get the plan approved they will turn to chapter 7 protection.
3. **Chapter 13** – Sometimes referred to as the 'wage earner plan', chapter 13 bankruptcy works with the courts to consolidate, prioritize and, in some cases, reduce debts. Instead of juggling your bills and creditors, chapter 13 bankruptcy allows you to make one monthly payment to your court-appointed trustee who will handle all of your creditors. The chapter 13 process, along with the automatic stay, may put a stop to foreclosure, repossession, lawsuits and creditor harassment. For the duration of your repayment plan, typically 3-5 years, you should have the breathing room and protection that allow you to eliminate your debt. Chapter 13 bankruptcy is a debt repayment proceeding. The debtor turns over a specified portion of future earnings to a chapter 13 trustee, who then distributes the money according to a confirmed plan to creditors who have filed bona fide claims. The method of determining the dividend distribution is determined by the chapter 13

plan, which is filed with and confirmed or not confirmed, by the Bankruptcy Court. If the debtor completes the plan, the debtor receives a discharge of all dischargeable debts

HOW BANKRUPTCY AFFECTS SELLING REAL ESTATE

Any seller and their agent will find that a property owner filing for bankruptcy will impact a sale. Sometimes it may only delay the process and other times it may totally halt the sale.

IF THE PROPERTY IS NOT IN FORECLOSURE

A bankruptcy filing prohibits the debtor from taking *any* action with their assets without approval from the BK court. A sale would have to be approved as part of the bankruptcy before it would be valid. If your seller has, or is contemplating filing for bankruptcy additional information would be advisable for any agent to get. Once filed, a third party becomes a necessary element of a transaction and closing: the bankruptcy court. Courts have been known to rescind and unwind closed transactions that occurred not only during a bankruptcy filing, but even transactions closed a certain period of time before the debtor filed.

IF THE PROPERTY IS IN FORECLOSURE

Bankruptcy is often filed shortly before a foreclosure sale. Title companies have learned to call the courts right before calling a sale in ensure the defaulting owner has not filed for bankruptcy protection. If filed the foreclosure sale will not happen right then. Depending on the chapter used the foreclosure of the property may occur differently.

1. **Chapter 7** - A debtor may not change or discharge a secured creditor under a chapter 7. So they either come up with the money necessary to bring the loan current or a new foreclosure date will be scheduled. Idaho law allows an expedited time frame once a property is released from bankruptcy.
2. **Chapter 13** - Under the plan approved in a chapter 13 bankruptcies the borrower is entitled to possession and as long as they make the payments as approved in the plan the lender is prohibited from foreclosing on the property. If they fail to make payments as agreed the lender can file a motion with the court and proceed to foreclose.

APPENDIX 1

Sample Short Sale Contract Language (NAR Example)

A. SHORT SALE APPROVAL. This Agreement is contingent upon Seller's receipt of written consent from all existing secured lenders and lienholders ("Short-Sale Lenders"), no later than 5:00 P.M. on _____ (date) ("Short-Sale Contingency Date"), to reduce their respective loan balances by an amount sufficient to permit the proceeds from the sale of the Property to pay the existing balances on loans secured by the Property, real property taxes, brokerage commissions, closing costs, and other monetary obligations the Agreement requires Seller to pay at Close Of Escrow (including, but not limited to, escrow charges, title charges, documentary transfer taxes, prorations, retrofit costs and Repairs) without requiring Seller to place any funds into escrow. If Seller fails to give Buyer written notice of all existing Short-Sale Lenders' consent by the Short-Sale Contingency Date, either Seller or Buyer may cancel the Agreement in writing, and Buyer shall be entitled to a return of any deposit. Seller shall reasonably cooperate with existing Short-Sale Lenders in the short-sale process.

B. TIME PERIODS. Time periods in the Agreement for inspections, contingencies, covenants and other obligations shall begin: (i) as specified in the Agreement; (ii) (if checked) the day after Seller delivers to Buyer a written notice of Short-Sale Lenders' consent; or (iii) (if checked) Other _____ .

C. NO ASSURANCE OF LENDER APPROVAL. Buyer and Seller understand that Short-Sale Lenders (i) are not obligated to accept a short-sale; (ii) may require Seller to forward any other offer received; and (iii) may accept other offers. Additionally, Short-Sale Lenders may require that, in order to obtain their approval for a short sale, some terms of the Agreement, such as the Close of Escrow, be amended or that Seller sign a personal note or some other obligation for all or a portion of the amount of the secured debt reduction. Buyer and Seller do not have to agree to any of Short-Sale Lenders' proposed terms. Buyer, Seller and Brokers do not have control over whether Short-Sale Lenders will consent to a short-sale, or any act, omission, or decision by any Short-Sale Lender in the short-sale process.

D. BUYER AND SELLER COSTS. Buyer and Seller acknowledge that each may incur costs in connection with rights or obligations under the Agreement. These costs may include, but are not limited to, payments for loan applications, inspections, appraisals, and other reports. Such costs will be the sole responsibility of the party incurring them, if Short-Sale Lenders do not consent to the transaction or either party cancels pursuant to the Agreement.

E. OTHER OFFERS. Unless otherwise agreed in writing, Seller may continue to market the Property despite acceptance of Buyer's offer, and to present to Short-Sale Lender(s) any additional offers that are received on the Property.

F. CREDIT, LEGAL AND TAX ADVICE. Seller is informed that a short-sale may have credit or legal consequences and may result in taxable income to Seller. **Seller is advised to seek advice from an attorney, certified public accountant or other expert regarding such potential consequences of a short-sale.**

By signing below, Buyer and Seller each acknowledge that they have read, understand, accept and have received a copy of this Short Sale Addendum.

APPENDIX 2

Sample Short Sale Advisory Language

SHORT SALE ADVISORY

Dear Clients,

As your real estate agent representing you in the sale of your home, it is our legal duty to advise you to consult with an attorney, accountant or other qualified professional where particular facts or circumstances merit the need or use of a particular professional. The real estate listing for which we represent you involves a "short-sale" of your home. The term short-sale refers to a situation where the net proceeds from the sale of your home will not be sufficient to pay the outstanding debt on the home and you are unable to pay the remaining balance of the deficiency.

When sellers find themselves in a short-sale situation, it is necessary to negotiate with all secured lenders to agree to take less than what the lender is owed and to agree to release the lender's lienhold interest so the seller can sell the home. Short-sale transactions are an example of a unique set of circumstances that merit consulting with professionals. Legal and tax consequences arise when secured lenders agree to release their lienhold interest on a home and accept less than what the seller owes on the loan. For example:

- The lien holder or holders may agree to release their lien so that you can sell the home, but will not forgive you of the remaining debt you still owe; or
- If the lien holder forgives you of the remaining debt you still owe, that amount may be considered taxable income.

The examples above and the potential legal and tax consequences may require professional advice to ensure you understand the obligations that may arise from a short-sale. Additionally, the examples above represent only a few of the scenarios where you should consult with an attorney or an accountant with regard to this short-sale transaction. Other circumstances may also warrant consulting with a professional as to your specific transaction and needs. We cannot provide you legal, accounting, tax or credit counseling advice and recommend that you contact the appropriate professional to answer any questions you have.

Receipt of Short-Sale Advisory Acknowledged:

Name

Date

Name

Date

APPENDIX 3

Sample Short Sale Acknowledgement Language

Short Sale Acknowledgement

Property Address: _____

In a Short Sale the Seller's lender agrees to accept less than what is owed on the loan for a property. As such, it requires lender approval. It is important to understand that a short sale can negatively impact a Seller's credit. **All parties are advised to speak to an Attorney and/or Tax Accountant regarding the effects of a Short Sale.**

Please note that the property will continue to be on the market until the lender accepts an offer.

The following is a partial list of potential situations that you all parties should be aware of and could affect a short sale:

1. After the lender received the Short Sale packet, the lender will require at least thirty days to approval the Short Sale. Often the lender requires that the sale must close within thirty days after approval.
2. The Seller will receive no cash from this transaction. Any funds usually due to the Seller will be paid to the lender (s).
3. The Seller will not include any personal property in this sale. Any personal property sale must be conducted directly between the Buyer and Seller outside of this real estate transaction.
4. The Seller has no additional cash and will be unable to pay for and closing costs, including but not limited to, the Buyer's appraisal or a home warranty.
5. The Seller is unable to pay for or perform any repairs and/or maintaining the property. This is an "AS IS, WHERE IS" sale. If the Buyer would like to turn on the utilities for any inspections, the Buyer must arrange for this and pay for those utility costs.
6. The lender may negotiate a lower commission percentage. In the event that 50% of the commissions is less than the amount advertised, the Selling Agent will receive 50% of the actual brokers commission paid by the lender excluding any loss mitigation fees.

Closing Costs: As a rule, the buyer in any Short Sale must pay all negotiable expenses. Please Do Not specify in your offer that the Seller will pay any of the following costs: Home warranty fees, Buyers appraisal, Inspections, Tax service fees, Discount points, Survey costs, HOA transfer fees, Septic inspection fees, Buyers pre-paid items, Buyers lender fees (unless FHA or VA requires seller to pay)

By signing this disclosure, you acknowledge that you have read and understand these situations. All parties further agree to indemnify and hold the real estate brokers and their representatives harmless from all liability, claims, demands, damages and costs.

_____ Seller's Signature	_____ Date	_____ Buyer's Signature	_____ Date
_____ Seller's Signature	_____ Date	_____ Buyer's Signature	_____ Date
_____ Seller's Agent	_____ Date	_____ Buyer's Agent	_____ Date

APPENDIX 4

Short Sale Advisory

Seller's Name: _____

Date: _____

Property Address: _____

Seller has expressed an interest in selling the aforementioned property to list as a short-sale. The term short-sale refers to a situation where the net proceeds from the sale of the property will not be sufficient to pay the outstanding debt on the property and seller is unable to pay the remaining balance of the deficiency.

Agent has advised Seller that legal and/or tax consequences may arise when lenders agree to release their lien on the property and accept less than what the Seller owes. To ensure that Seller understands the obligations that may arise from a short-sale, Agent advises Seller to seek professional advice from an attorney, accountant, and/or other qualified professional. Agent cannot provide Seller with legal, accounting, tax, or credit counseling advice and recommends that Seller contact the appropriate professional to answer any questions regarding these matters.

The following options may be available to the Seller in addition to a short sale:

REFINANCE: Replace the existing loan(s) with new and more favorable terms

SELL AND BRING CASH TO CLOSING: By curing deficiencies at closing a borrower can avoid the negative consequences of credit report damage a short sale or foreclosure may cause.

LOAN MODIFICATION: Lender may be willing to change the terms of your mortgage, such as adding missed payments to the existing loan balance, reducing the interest rate or changing an adjustable rate to a fixed rate, or perhaps extend the number of years to repay the loan.

FORBEARANCE: Lender may reduce or suspend payments for a period of time and then agree to another option to bring the loan current.

SHORT SALE: A sale of the property in which the sales price is less than the amount owed to the lender(s) and the property owner is unable or unwilling to pay the deficiency at closing. The underlying lender(s) must agree to the provisions of the sale. A short sale avoids foreclosure on the property.

DEED-IN-LIEU OF FORECLOSURE: Lender may be willing to accept your property in lieu of foreclosure.

FORECLOSURE: Lender takes back the property or it may be sold to a 3rd party at public auction.

BANKRUPTCY: A legal procedure designed both to protect an individual or business that can't meet its financial obligations and to protect the creditors involved.

WALK AWAY: By walking away, property will ultimately be foreclosed upon.

Seller hereby acknowledges receipt of a copy of this form:

Seller: _____ Date: _____

Seller: _____ Date: _____

Agent: _____ Date: _____

APPENDIX 5

Sample Short Sale Authorization Form

Authorization to Release Information

Dated: _____

TO: _____

Borrowers: _____

Property: _____ Loan Number: _____

We, the undersigned, hereby authorize you to release information regarding the above-referenced loan to _____ and/or their agents or assigns.

This form may be duplicated in blank and/or sent via facsimile transmission. This authorization is a continuing authorization for said parties to receive information about my loan, including duplicates of any notices sent to me regarding my loan.

Borrower:

Sign: x _____

DOB: _____

Print Name:

SSN: _____

Mother's Maiden Name: _____

Borrower:

Sign: x _____

DOB: _____

Print Name:

SSN: _____

Mother's Maiden Name: _____

APPENDIX 6

Seller Short Sale Checklist

Will the seller follow through with attorney recommendations?	Yes	No
Will the seller complete their portion of the short sale package?	Yes	No
Will the seller keep you informed of lender communications?	Yes	No
Does the seller have an actual hardship?	Yes	No
Does the seller have assets?	Yes	No
-If so, is the seller willing to use them if required by the lender?	Yes	No
Is the seller current with homeowners' association fees?	Yes	No
-If not, is the seller able to become and remain current?	Yes	No
Does the seller have realistic expectations of the current market?	Yes	No
Does the seller understand how long the short sale may take?	Yes	No
Is the seller motivated to get out of their situation?	Yes	No
Will the seller allow you to discuss lien situation with buyer's representatives?	Yes	No
Will the property be listed for an adequate amount of time?	Yes	No
Has the seller agreed to a for sale sign?	Yes	No
Has the seller agreed to a key box?	Yes	No
Will the property be easy to show?	Yes	No
Is the seller willing to do what is required so that the property shows well?	Yes	No
Will the seller agree to price the property realistically?	Yes	No

STOP!!!!

Any "No" answers to the above questions?

If there are, seriously consider **not** taking this listing

