



**GARRETT HEMANN ROBERTSON P.C.**

# **TROUBLED SELLERS**

## **What You Should Know**

**Gordon R. Hanna ■ J. Wesley Raborn ■ Eric W. Jamieson**

Willamette Professional Center • 1011 Commercial St. NE, Suite 210  
Mailing Address: P. O. Box 749 • Salem, Oregon 97308-0749  
(503) 581-1501 • 1-800-581-1501 • Fax (503) 581-5891 • [www.ghrlawyers.com](http://www.ghrlawyers.com)



# FORECLOSURE

- Residential Foreclosure depends on the type of security
  - Trust Deed – by far the most common
    - Foreclosure in court or by trustee's sale
    - If a residential trust deed, no deficiency
    - Residential Trust Deed is one on a residence having four or fewer units and occupied by the grantor or a member of the grantor's immediate family.
    - Only natural people (not entities) have residences



# FORECLOSURE (Cont)

- Builders may be able to clear several houses without deficiency by timing their moving and defaults. Residential nature of trust deed is determined when foreclosure commenced.
- Builders using an entity for tax purposes cannot avoid the deficiency if the entity is the borrower or grantor of the trust deed
- Execution on assets before the foreclosure sale is okay.



# FORECLOSURE (Cont)

- Guarantors are not released unless bank bids entire debt
- Trustee Sale can be cured by payment of amounts past due within five days of sale
- Court Action results in sheriff's sale and rights of redemption. Not used much for that reason.
- Rights of Redemption can be sold.
- Redemption Right can interfere with resale



# FORECLOSURE (Cont)

- Land Sale Contract
  - Choice of Remedies:
    - Strict or judicial foreclosure – like a foreclosure in court under a trust deed. Redemption rights for property owner
    - Forfeiture – akin to the trustee’s sale. Redemption only until forfeiture complete.
    - Specific Performance – Court remedy with no right of redemption
    - All seldom used by institutional lenders



# FORECLOSURE (Cont)

- Mortgages
  - No longer widely used
  - If a purchase money mortgage, no deficiency



# EFFECT OF FORECLOSURE

- Subsequent Interests are removed from title
  - Owner's interest is removed
  - Judgments against owner are removed
  - Subsequent liens are removed – second (or later) encumbrances
  - Notes are not satisfied and debt remains due
  - Collection actions will occur – perhaps later



# SURVIVING OBLIGATIONS

- Notes Secured by Foreclosed Liens
- Foreclosed Judgments
- Deficiency Judgments – if any
- PMI Subrogated Amounts
- Loan Guarantor Subrogations
- Potential Tax Obligations – discussed later



# MODIFICATION PROGRAMS

- Moving target-loan modification qualifications.
- Eligibility
  - 1.) 1<sup>st</sup> lien conventional mortgage originated before 1/1/09 (105% CMV rule);
  - 2.) no previous modification on HMP;
  - 3.) loan is delinquent, default or foreclosure, or reasonably foreseeable;
  - 4.) loan secured by 1-4 unit property, with principal residence;
  - 5.) property can not be vacant or condemned;
  - 6.) 90-day financial hardship documentation (Form 1021)
  - 7.) **payment ratio of 31% of mortgage to income;**
  - 8.) servicer cannot require borrower to waive legal rights;
  - 9.) borrowers in bankruptcy may be eligible;
  - 10.) borrower agrees to set up escrow for taxes and insurance;
  - 11.) mortgage loans subject to full recourse;
  - 12.) application to servicer by 12/31/2012.



# SHORT SALES

- What Are They
  - This is a sale where the existing lien holders agree to allow a sale for less than the sum due under the loan
  - They are generally implemented through negotiation with the holders of the liens
  - The terms vary depending on the lender, the situation of the borrower, and the condition and location of the residence.



# HOMES WITH SINGLE LOAN

- A Single Lender is easier to work with and more likely to result in a successful short sale
- Many Lenders or servicers have online criteria for short sales. Be sure to check.
- Check with the title company for things like tax liens and judgments
- The more people to deal with the less likely a successful result



# SELLERS WITH MULTIPLE LOANS

- Too many encumbrances make a short sale nearly impossible.
- Generally, there must be something for everyone
- If the Seller only has sale proceeds, hard to get them to go around.
- Tax liens make things very, very difficult
- What is the incentive to cooperate?



# IMPACT OF THE SHORT SALE

- Does the Short Sale clear the debt?
  - It should for any first lien holder of a residence
- Does one or more lender want to continue to pursue collection?
- What are the alternatives:
  - Bankruptcy
  - Abandonment
  - Foreclosure



# HB 3630 ANTI-SCAM LAWS (Foreclosure Consultants)

- The Warning Signs of A Scam
  - Saw your home on foreclosure notice and called you.
  - Pressure to sign a contract;
  - Prohibition on contacting your lender;
  - Up-front personal information requests;
  - Up-front excessive fee to apply;
  - A “Guarantee” to stop the foreclosure;
  - Stop paying your lender, pay us!;
  - We are experienced in this area of stopping foreclosures.



# HB 3630 ANTI-SCAM LAWS (Equity Conveyances In Foreclosure)

- Revises the Oregon Unfair Trade Practice Act
- Two main applications:
  - “foreclosure consultants” and “equity purchasers”
- Applies only to residential real property in foreclosure.
  - One to four single-family dwelling;
  - Owner-occupied dwelling; **and**
  - Notice of default has been recorded.



# HB 3630 ANTI-SCAM LAWS (Foreclosure Consultants)

- What is a “Foreclosure Consultant”?
  - “any person that directly or through association with another makes a solicitation, representation or offer to a homeowner to perform, for or with intent to receive compensation from or on behalf of the homeowner, a service that...will accomplish **one or more** of the following:



# HB 3630 ANTI-SCAM LAWS (Foreclosure Consultants)

- 1.) Prevent, postpone, or stop a foreclosure sale
- 2.) Obtain a forbearance from a beneficiary or mortgagee;
- 3.) Assist the homeowner in exercising a right of redemption;
- 4.) Obtain an extension of the period within which the homeowner may reinstate the homeowner's obligation;
- 5.) Obtain the waiver of an acceleration clause that is contained in a promissory note or contract and secured by a deed of trust or mortgage on the residence;
- 6.) Assist the homeowner in obtaining a loan or advance of funds; **OR**
- 7.) Avoid or ameliorate an impairment of the homeowner's credit resulting from a recorded notice of foreclosure or default



# HB 3630 ANTI-SCAM LAWS (Foreclosure Consultants)

- Exclusion: A real estate licensee or an escrow agent, **if acting with the scope of that license.**
- Define the scope of license with your client in addition to your general realtor agreement.
- Do you have clear scope of representation letter to your client?



# HB 3630 ANTI-SCAM LAWS (Foreclosure Consultants)

- Foreclosure Consultants must have the required written contractual language.
  - Must be in “plain language”;
  - Consumer must get the contract 24-hours before signing;
  - Full disclosure of fees and parties involved;
  - Can not require consumer to waive certain rights;
  - Right to cancel at any time, but must pay valid fees and costs incurred



# HB 3630 Anti-Scam Laws (Equity Conveyances In Foreclosure)

- Main purposes is to stop the fraudulent transfer or possession of residential properties in foreclosure from the homeowners to “equity purchasers”
- Equity purchaser: any transfer of legal or equitable interest in the residential property in foreclosure).



# HB 3630 ANTI-SCAM LAWS

## (Equity Conveyances In Foreclosure)

- Applies only to “equity conveyances”
  - “the transfer of an interest in a residence in foreclosure by an equity seller to an equity purchaser, or to another person acting in association with the equity purchaser, that allows the equity purchaser or other person legal or equitable title to all or part of the residential property; AND
  - A subsequent conveyance, or agreement for conveyance, of an interest in the residential property from the equity purchaser or person acting in association with the equity purchaser to the equity seller to allow the equity seller to possess the property during, or after termination of, the foreclosure process.”



# HB 3630 ANTI-SCAM LAWS

## (Equity Conveyances In Foreclosure)

- Exemption: Most realtors will not be considered “equity purchasers”.
- However, if you: (1) lend money; (2) take an equity interest in the property; (3) you work in concert with an equity purchaser(4) give foreclosure consultant advise; (5) unknowingly work with a fraudulent financial consultant, you may fall outside the exception to the UTPA for licensed realtors.



# HB 3630 ANTI-SCAM LAWS (Equity Conveyances In Foreclosure)

- Like foreclosure consultation, equity conveyances require certain written contractual terms defined by statute.



# BANKRUPTCY

- Fresh Start of the Debtor
  - Discharge removes all debt
  - Can reaffirm debts but must be in the best interest of the debtor
  - Can negotiate to retain assets
  - Exceptions to discharge
    - Certain taxes – payroll and income within a time limit
    - Intentional Torts



# BANKRUPTCY (Cont)

- Relief from stay
- Listing Agreements are executory contracts and can be voided
- Listing for the estate requires court approval
- Selling from the estate requires court approval and allows upset bids



# BANKRUPTCY (Cont)

- Modification in Bankruptcy not allowed on residential mortgages
- This may be changing
- Chapter 13 plans will allow cure over a period of time – including cure by sale
- Must make payments during cure period



# BANKRUPTCY AVOIDANCE (Cont)

- Stay in home and make all other payments
  - May increase debt to mortgage holder but will eliminate other debt (potentially)
- Pay the Second lien first
  - May remove debt prior to foreclosure
- Work out plan with the lender
  - Hard to figure out who to talk to – most servicers are overwhelmed



# BANKRUPTCY AVOIDANCE (Cont)

- Deed in Lieu of Foreclosure
- Plan for Alternate Housing
  - Reserve enough money for a first month rent and deposit
  - Talk to rental company in advance
  - Make sure it will be cheaper to rent
- Take care of the house and don't commit waste



# BANKRUPTCY AVOIDANCE (Cont)

- Short Sales and other disposals



# CREDIT IMPLICATIONS

- Credit Reporting Processes
  - Direct Reporters – banks, servicers, etc
  - Indirect Reports –
    - Court records
    - Deeds in lieu of foreclosure
      - Don't use that label
    - Other public records
- Duty to Disclose Credit Issues in Future Applications
  - False Statements are a crime
- Bonding



# CREDIT IMPLICATIONS

## (Your Credit Report)

- Most sales are contingent on financing
  - Pre-approval letter, credit report, income, cash to close.
- Fair Credit Reporting Act (FCRA) regulates the collection, dissemination, and use of consumer credit information.
- HB 3630 crossover – Credit Report damaged by disclosure of confidential information to scam artists! (foreclosure consultant)
- Consumer reporting agencies, which are entities that collect and disseminate information about consumers to be used for credit evaluation and certain other purposes, have a number of responsibilities under FCRA.
- A credit score is a numerical index which represents an estimate of an individual's financial creditworthiness. Lenders use credit scores to determine credit limits and interest rates.



# CREDIT SCORING

- 30-year fixed mortgage
  - 760-850 4.509% \$1,522
  - 700-759 4.731% \$1,562
  - 680-699 4.908% \$1,594
  - 660-679 5.122% \$1,633
  - 640-659 5.552% \$1,713
  - 620-639 6.098% \$1,818



# CREDIT IMPLICATIONS

## (Effect on Credit Report)

- Foreclosures vs. Short Sale on Credit Score
  - The damage to the FICO score is currently the same-about 200-300 points. The overall effect:
    - Interest rate on loans;
    - Premium on Insurance policies;
    - Down payment requirements increase;
    - Higher application fees;
    - Monthly payments;
    - Risk adverse lending.
  - However, short sales should allow the seller to purchase a new home with reasonable interest rates in about 2 years;
  - Foreclosure-5-7 years.
  - Bankruptcy-10 years
  - Consider the Times! A two-year look back.



# CREDIT IMPLICATIONS

## (Mortgage Underwriting Guidelines)

- **Fannie Mae issued the following underwriting guidelines revised June 2008:**
- **Bankruptcy** - 4 years from either the dismissal or discharge date
- **Bankruptcy (Chapter 13)** - 2 years from the discharge date or 4 years from the dismissal date
- **Bankruptcy (Multiple Filings)** - 5 years from the most recent dismissal or discharge date for borrowers with more than one filing in the past 7 years
- **Foreclosure** - 5 years from the completion date. In addition, for the years 5 to 7 following the completion date the purchase of a principal residence is permitted with a minimum 10% down and 680 FICO score. The purchase of a second or investment property is not permitted for 7 years. Limited cash out refinances are permitted for all occupancy types. Cash out refinances are not permitted for any occupancy type.
- **Deed-in-Lieu of Foreclosure** - 4 year period from the date the deed-in-lieu is executed. In addition, for the years 3 to 7 following the execution date the borrower may purchase a property secured by a principal residence, second home or investment property with the greater of 10 percent minimum down payment or the minimum down payment required for the transaction. Limited cash out and cash out refinance transactions secured by a principal residence, second home or investment property are permitted pursuant to the eligibility requirements in effect at that time.
- **Pre-foreclosure (Short Sale)** - 2 years from the completion date (no exceptions or extenuating circumstances).



# SELLER FINANCING

- Often used in times of financial upheaval
- “Creative Financing” and “Creative Lawsuits”
- Credit Investigation of Buyer
  - Financial Statement
  - Credit Report
- Choice of Instrument
  - Trust deed and note
  - Land sale contract
  - Mortgage



# SELLER FINANCING (Cont)

- Lease Option
- Option



# SELLER FINANCING (Cont)

- Key Concepts
  - Match Obligations – will payments from new buyer pay the old obligations
  - Confirm Title – can title be cleared through the payments – are there other liens or likely liens in the future
  - Use Collection Escrow – insures there is no fight about balances and documents are ready when balance paid



# SELLER FINANCING (Cont)

- Risk Disclosure
  - Seller will have to pay lender whether payments received or not
  - Buyer Bankruptcy can put Seller in bind
  - Potential Deficiency if not in the residence at commencement of foreclosure
  - Due on Sale Provisions can trigger default
    - Lease with option
    - Separate lease and option to different people



# SELLER FINANCING (Cont)

- Key Question: If the bank won't take the risk, why is it okay for your client to take the risk?



# TAX IMPLICATIONS

- Gross Income
  - In general, includes “all income from whatever source derived”
- Short Sale or Foreclosure
  - Income from Sale of Real Property
  - Income from Discharge of Indebtedness



# TAX IMPLICATIONS

- Income from Sale of Property
  - Taxable to extent sales price exceeds cost basis
  - Reported on Form 1099-S filed by either Escrow Company, Lender, Broker or Buyer
  - Exclusions from income for certain transactions
    - Sale of principal residence (up to \$250,000 per taxpayer)
  - Deferral of tax if acquire “like kind” property



# TAX IMPLICATIONS

- Income from Discharge of Indebtedness
  - If creditor cancels debt, cancelled amount treated as income
  - Reported on Form 1099-C by Lender
  - Exclusions from gross income
    - Bankrupt Seller
    - Insolvent Seller (total debt exceeds total value of assets)
    - Qualified Personal Residence Indebtedness (to acquire, build or improve personal residence)
  - Exclusions Claimed on Form 982 by Taxpayer



# TAX IMPLICATIONS

- Facts:
  - Purchased house for \$200,000 in June of 1998
  - Home equity loan in May of 2005 when house is worth \$500,000
  - First and second mortgages against house totaling \$350,000
  - Sell house in May of 2009 for \$300,000
  
- Taxable Income from Short Sale?
  - Net sale price of \$300,000, less cost basis of \$200,000, results in \$100,000 of taxable gain
  - If the house is principal residence, gain may be excluded under Federal Exclusion from Sale of Principal Residence (up to \$250,000 per taxpayer)
  - If the house was purchased as investment asset, \$100,000 gain may be included in gross income unless other exclusion or deferral



# TAX IMPLICATIONS

- Taxable Income from Foreclosure
  - If “sale price” is amount of loan, taxable gain to extent loan amount exceeds cost basis of property
  - If “sale price” is fair market value of house, potential discharge of indebtedness income to extent loan amount exceeds fair market value of house
  - Seller bankrupt? Seller insolvent?
  - Principal residence? Investment property?



# TAX IMPLICATIONS

- Taxable Income from Discharge of Indebtedness?
  - Indebtedness of \$350,000, net sale price of \$300,000, leaves \$50,000 of debt
  - Seller needs to come up with way to repay \$50,000
  - If lender will forgive some or all of \$50,000, Seller may have discharge of indebtedness income
  - Seller may exclude discharge of indebtedness income if:
    - Seller has filed for Bankruptcy (Chapter 11)
    - Seller is insolvent
    - \$350,000 first and second mortgage is “qualified personal residence indebtedness”



# TAX IMPLICATIONS

- When to consult tax professional:
  - Bank is foreclosing on property
  - Seller is considering “short sale” of property
  - Seller is insolvent
  - Seller has filed bankruptcy



# Legal Advice: When in doubt...

Contact your Attorney



GARRETT HEMANN ROBERTSON P.C.

