

The Horrible Truth About Deficiency Judgments and Short Sales

By: Kim Cook

We just got acceptance on another short sale! “Whoop-dee-do, so what?”, you say. Investors and realtors everywhere are getting short sales accepted nowadays. Yeah, but are they protecting their homeowners from a possible deficiency judgment? Are they leaving their homeowners in a better position than how they found them?

If you are one of those savvy realtors or investors who knows how to negotiate short sales (and you obviously are since you are reading John Adams’ newspaper), then you know to protect your homeowner from the dreaded deficiency judgment created by the short payoff. And, you work hard to make the deal a win-win-win for all involved.

Lately, I find myself working harder to protect my homeowner from the deficiency judgment or from having to sign a promissory note than I do trying to get the contract accepted.

Case in point: The Powells on Black Road. The Powells built and had lived in their dream home for years. They had a first mortgage of \$240,000 and a HELOC (Home Equity Line of Credit) of \$125,000. Their son got married and moved across the street and life was good. But life changes as life does, and Mrs. Powell was diagnosed with brain cancer. Their dream home and all the gardening and pretty flowers were neglected as doctor visits, hospital stays and radiation treatments took priority.

The Powells called us for help and, with declining values, deferred maintenance and weeds reaching an all-time high, we had no choice but to negotiate a short sale with their lender. We partnered with our realtor, listed the property as a Retail Short Sale, and weeks later received an offer for \$195,000.

Since the first mortgage lender was not receiving full-debt payoff, they only allowed the junior \$2,000 toward the HELOC. Bank of America (the HELOC lienholder) wanted the Powells to sign a promissory note for the remaining balance of \$123,000. But, Bank of America had one problem – me. Though I was receiving a nice paycheck for structuring the deal, I liked the Powells and refused to leave them holding the bag.

I took the Powell’s hardship letters and financial statements straight to the “powers that be” at Bank of America. I got shuffled around from supervisor to manager to district manager to CEO and back to supervisor, but I would not give up.

Unfortunately, the Powells had previously told BOA that the HELOC was used to pay for their son’s wedding and other miscellaneous personal debt. Doodie! Armed with that piece of wonderful information, BOA was in a much better negotiating position than I was, but I don’t like being told *no*.

A few weeks later, I managed to negotiate a deal with BOA that was satisfactory to them and doable for the Powells. BOA agreed to accept \$2,000 to release its lien on the property, therefore allowing the sale to close. The Powells agreed to sign a promissory note for a greatly reduced amount of \$32,000 at 0% interest with payments of \$100 per month starting one year from the date of closing. A true win-win-win for all involved.

In our industry, there are “savvy” experts - those who want a win-win situation for all involved - and there are “scammers” - those who are in it to win it at any cost and everyone else be danged. I continue to receive calls from homeowners who have been the victims of a “*short sale expert*” whose obvious main goal was to garner a paycheck, not help the distressed homeowner. Don’t misunderstand me – there is nothing wrong with getting a paycheck. I like those myself. I just feel better about getting the paycheck if I’ve left the homeowner in a better position than how I found him.

When negotiating a short sale, don’t assume that the lender will write the deficiency off as a loss. Ask the lender how they, or the investor on the loan, plan to treat the deficiency. Will they pursue the deficiency in collections, demand the homeowner sign a promissory note, or will they issue a 1099C (Cancellation of Debt)? Keep in mind, the lender can only do one.

Always ask the lender to waive their rights to pursue the homeowner for the deficiency. You want the Acceptance Letter to read, “**account settled - not paid in full.**” That verbiage is a sure sign that the lender or investor on the loan will not pursue the homeowner for the deficiency.

However, if the Acceptance Letter reads, “**ABC Bank agrees to release its lien on the property....**”, then chances are good the lender or investor will pursue in collections.

The pursuit of deficiency depends a great deal on the type of loan as well. For example: HUD never pursues for deficiency, so if your homeowner has an FHA loan, he will not have to worry about the collections department calling him after the house is sold.

More often than not, if your homeowner has a Fannie Mae or Freddie Mac loan, they will be asked to contribute to closing. If the lender asks the seller to contribute to closing – *and the seller can* – then ask the lender to accept the contribution in return for waiving their rights to pursue the deficiency.

If the homeowner has a HELOC, then you might as well tell your homeowner to expect to sign a promissory note for the remaining balance. Banks look at HELOCs much differently than they do a regular mortgage or loan. It has been my experience however, that everything in life is negotiable. And deficiencies from a HELOC can always be negotiated to more “borrower-friendly” terms.

Remember - everything in life is negotiable. All you have to do is ask. Happy shorting!

