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**EXCLUSIVE: Lawyers say lenders set stage to collect on 'short sales'**

By ZACH FOX - Staff Writer

A "short sale" might not be the end of a homeowner's problems.

The practice, which has exploded in popularity as homeowners struggle to pay their mortgages, is supposed to allow a borrower to sell a home for less than the mortgage amount, walk away, and avoid a credit-killing foreclosure.

Not so fast, say local real estate attorneys.

Lenders appear to be inserting language into short sale contracts that allow them to sue for any "deficiency," or the amount lost by a bank by selling a home for less than the mortgage --- - opening the door to collection agencies and court judgments that can run into the hundreds of thousands of dollars for some North County homeowners.

What's more, the nation's premier credit scoring firm says that short sales and foreclosures are equally damaging to credit scores.

Yet short sales have surged in popularity, as homeowners struggling with falling values and rising unemployment seek a way out.

It's not clear how many short sales in fact fail to protect former homeowners from subsequent collection efforts. But local real estate attorneys and other professionals say such vulnerability may be widespread.

One real estate agent who specializes in short sales, Chris Mackey of Carmel Valley, said about 50 percent of the short sale contracts he has seen include the language before he requests its removal. Banks generally have removed the language, he said.

Major lenders Bank of America Corp., Wells Fargo & Co. and JPMorgan Chase & Co. (owner of the former Washington Mutual) declined comment for this story or, through spokesmen, said officials were unavailable for comment.

However, the North County Times obtained a short sale contract issued by Countrywide Financial Corp., which together with parent company Bank of America services roughly 20 percent of the mortgages in the nation.

The contract warned the homeowner, who owned a house in El Cajon, that Countrywide "may pursue a deficiency judgment for the difference in the payment received and the total balance due ... " The owner, who is still negotiating with the lender, declined through a lawyer to

comment.

Attorneys say such clauses mean that a borrower's troubles might not end with the short sale ---- the lender could sue the borrower for a deficiency at a later date or turn over the unpaid debt to collectors after the short sale closes.

Indeed, under some conditions borrowers may face fewer troubles by letting their properties fall into foreclosure.

Ins and outs

For borrowers who do not know the ins and outs of short sales, "you absolutely should get an agent or somebody who is an expert and help you with the process," said Bart Blechschmidt, a partner with Galuppo & Blechschmidt, a Carlsbad real estate law firm.

Blechschmidt said his firm charges between \$1,000 and \$1,500 to negotiate a short sale.

Keeping up with mortgage payments ---- and thus keeping the house ---- is getting harder for thousands of families in San Diego and Riverside counties, where unemployment rates shot into record territory in March.

Meanwhile, home values have plummeted more than 40 percent since 2006, leaving roughly one-third of San Diego County mortgage holders "under water," or owing more than their homes are worth, according to First American CoreLogic, a data firm. The figure is higher in Southwest Riverside County; three of every four mortgage holders in Lake Elsinore is under water, for example.

Such conditions have led to an increase in the popularity of short sales.

Of about 14,000 properties for sale across the county on one real estate listing service, 5,610 "required lender approval," which usually means they are short sales, according to data provided by Larry Dean, owner of Hansen Realty in Escondido.

In a foreclosure, the homeowner leaves immediately, his credit ruined, and the bank is typically left auctioning an empty house, often at a depressed value and leaving the lender with losses.

Short sales are touted as helpful to both lenders and borrowers: Banks hope to recover more money when homeowners stay put and assist in an orderly sales process. And borrowers hope to suffer less damage to their credit score when banks agree to settle for less than the full mortgage.

All the same to FICO

However, a spokesman for Fair Isaac, creator of the widely used FICO credit score, said its mathematical models make no distinction whatsoever between a short sale and a foreclosure.

Yet short sales do offer a key advantage. Mortgage giant Fannie Mae will back a loan from a borrower two years after a short sale. Borrowers with a foreclosure on their record must wait five years, a Fannie Mae spokeswoman said.

To walk away free and clear, borrowers must make sure all loans are extinguished and debts forgiven, said Blechschmidt, the Carlsbad lawyer.

But in some cases the lender can pursue a deficiency judgment in foreclosure, as well, depending on the type of loan.

Whether the lender pursues a deficiency depends upon a multitude of factors, including the borrower's story or payment history, and whether the loan had been sold to a third-party investor, said Martin McGuinn, a San Diego lawyer who represents banks and debt collectors.

It's possible those lenders won't sue the borrowers at first because "that's why they're in a short sale anyways, they don't have the money," said Susan Anderson, manager of the Coldwell Banker real estate brokerage in Vista. So banks "are saying, 'Down the line, if you have the money, we'll go after it.' "

If done the right way, short sales do allow borrowers to move on free and clear.

Letters, no cases

Despite one report from a real estate agent of an active lawsuit involving a lender suing a borrower, the North County Times couldn't confirm any cases.

And local lawyers who represent borrowers say they haven't heard of any.

"I'm aware of letters, but I don't know where that's gone," said David Bright, a real estate attorney in Escondido. "Stay tuned, fasten your safety belt. We have to wait and see what these lenders do. They might not think it's worth it politically."

But one short sale specialist, real estate agent John Woodall of San Marcos, said he doesn't buy the scares from lawyers that short sales open the door to deficiency when foreclosure would have allowed a free-and-clear walk away.

"I just don't see a judge or jury saying, 'We appreciate you trying to do the right thing, but you still have to pay all the money back,' " Woodall said.

It wasn't clear last week whether homeowners merely face a risk, based on contract language, or real lawsuits. The North County Times has found no local case of a lender suing a borrower after a short sale.

Legal briefing

Borrowers can face deficiency judgments at any point on certain types of loans. But California law allows special privileges for what is known as "purchase money" loans, or the original loan used to purchase the home.

On such mortgages, a bank cannot legally sue the borrower for nonpayment. The bank's only means of recouping the loan is to foreclose on the house.

Therefore, a homeowner late on payments on a purchase money loan cannot face a lawsuit --

-- even if the owner put no money down.

But all bets are off if the borrower refinanced the mortgage. Especially on home equity lines of credit, lenders can sue the borrower for the unpaid amounts following either foreclosure or short sale.

However, lawyers said, if the borrower negotiates a short sale, the bank might issue a contract that says it will agree to sell the house and release the borrower from the "trust deed," the contract saying the borrower must pay back the loan in full.

Lenders might include a clause in a short sale contract that releases the lien but creates the possibility for a lawsuit to collect debts at a later date, said John Brady, a San Diego attorney.

Effectively, lenders will try to transform a purchase-money loan into one in which the bank can sue to collect, Brady said.

"They're being sneaky," he said. "They're trying to keep the door open to be able to collect on any deficiency."

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