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Lenders Pursue Mortgage Payoffs Long After Homeowners Default

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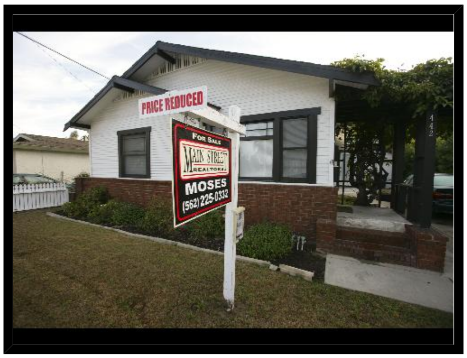
By Kathleen M. Howley



Jan. 28 (Bloomberg) -- When John King stopped making payments on his home in Coral Gables, Florida, two years ago, he assumed the **foreclosure** ended his mortgage contract, he said. Last month, a Miami-Dade County court gave collectors permission to pursue him for $44,000 stemming from the **default**.

King is among a rising number of borrowers who are learning that they can be on the hook for years after losing their homes. Amid a crisis that stripped $6.4 trillion, or 28 percent, from the value of **U.S. residential real estate** since the 2006 peak, lenders are exercising their rights to pursue unpaid mortgage balances. To get their money, they can seize wages, tap bank accounts and put liens on other assets held by debtors.

“The big dogs get a bailout, and the little man gets no mercy,” said King, 39, referring to the U.S. government’s rescue of banks and other financial institutions.

While there are no statistics on the number of deficiency judgments approved by courts, the **Federal Deposit Insurance Corp.** tracks the amount banks collect after defaulted loans were written off.

These **mortgage recoveries** rose 48 percent to a record $1.01 billion in the first nine months of last year compared with the year-earlier period, according to the Washington-based regulator. Recoveries on defaulted home-equity loans almost doubled to $392 million, the FDIC data shows.

The figures don’t include money retrieved by trusts overseeing mortgage-backed securities, such as the one that holds the loan on King’s former home, or efforts by distressed- asset funds and companies that buy **bad loans** to profit from collection rights. Judgments such as the one levied against King usually tack on court fees, fines and interest.

‘Next Big Crisis’

Deficiency judgments were rare in the 15 years since the last real estate slump, said Ben Hillard, a former investment banker who now is a real estate and corporate attorney at **Hillard & Rogers** in Largo, Florida.

“The banks have been too underwater with foreclosures to spend much time on deficiency judgments, but that’s beginning to change,” Hillard said in an interview. “This is going to be the next big crisis.”

Almost 4.5 percent of mortgaged U.S. homes were in foreclosure during the third quarter, the highest rate in the 37 years of tracking the data, the Mortgage Bankers Association said Nov. 19. A record one in every 10 mortgages was at least one payment overdue in the same period, the Washington-based trade group reported.

The Obama administration is seeking to modify as many as 4 million loans by 2012 to prevent foreclosures through the Home Affordable Modification Program, which cuts monthly payments to about a third of borrowers' income. By the end of December, the program was responsible for more than 850,000 modifications, the Treasury Department said in a **Jan. 15 report**.

20-Year Window

The federal government spent **$230 billion** in the year ended in September to support homeowners, according to the Congressional Budget Office in Washington. Those efforts didn't help people who had already walked away from their houses.

In states such as Florida, courts give mortgage holders as long as five years to seek a deficiency judgment and, if granted, up to 20 years to collect. Usually, they have the option of renewing the judgment if it's not paid off within 20 years.

About a third of U.S. states, including California and Arizona, prohibit collection efforts on primary residences after foreclosure. In some cases, homeowners waive that protection if they refinance. Most states allow collection on unpaid home equity loans.

Depression-Era Protections

The laws in states that protect some borrowers stem from the Great Depression in the 1930s, when a lack of bidders at foreclosure auctions caused deficiencies that, with added fees and interest, sometimes were bigger than the original loan amount, according to a 1934 Virginia Law Review **article** by Sol Phillips Perlman. Today, many courts measure the shortfall using a property's market value at the time of foreclosure rather than auction results.

The likeliest candidates for deficiency judgments are so- called rational defaults, said **Larry Tolchinsky**, a real estate attorney in Hallandale Beach, Florida. In those cases, people who are current on their mortgages decide to walk away from a property because its **value** has sunk so far below their loan balance they have no hope of recouping the loss.

About 21 percent of American homeowners owe more on their mortgages than their properties are worth, according to Zillow.com, a Seattle-based real estate data firm.

"Walking away from a property comes with a cost, especially for people who otherwise have good credit," Tolchinsky said in an interview. "The bank is going to pull your credit report, and if you're current on your other bills they are going to come after you and potentially ruin you."

Fine Print

It's not just foreclosures that can trigger debt collections. Short sales also may lead to deficiency judgments years after former homeowners have moved on, according to Hillard, the attorney in Largo. In a short sale, **lenders** agree to let borrowers sell a home for less than the mortgage balance.

"Banks are being very careful to preserve their rights, either outright in the short sale agreement or by using vague language that leaves that door open," Hillard said. About 90 percent of people who do a short sale think they are "off the hook."

That was the case when two of his clients, Brigitte and John Howard, sold their home in New Port Richey, Florida, almost two years ago without using a lawyer to check the bank's short- sale agreement.

$20,000 Shock

"We got a call out of the blue saying we owed $20,000," said Brigitte Howard, 45. "It was a shock. There was no mention in the short-sale contract that the bank might come after us for the difference."

The money King owes to the Soundview Home Loan asset-backed security that holds the mortgage on his former Coral Gables condominium consists of $38,000 for unpaid principal and almost $6,000 in legal fees and interest accrued prior to the ruling. According to the judgment, the security can charge 8 percent interest until he pays off the debt.

King, who said his default was caused by a reduction in his income, now rents near Fort Lauderdale, Florida, where he teaches ballroom dancing.

"I thought the foreclosure was the worst of a bad situation, but it's not," said King. "The people who got sucked into the real estate bubble are still paying for it, even after they've taken our homes."

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