

The U. S. Housing Crisis

Options & Resources for CA Homeowners

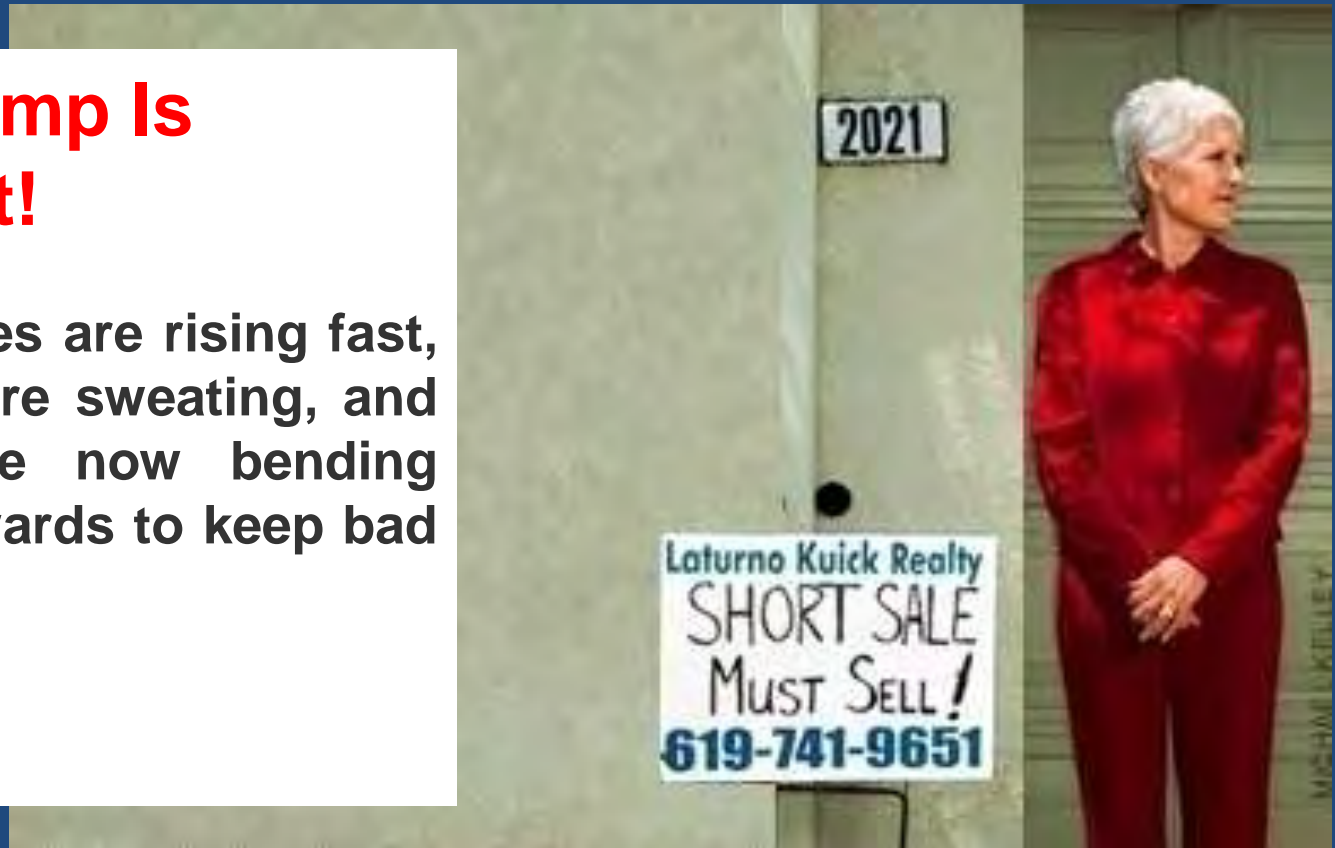


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This Slump Is Different!

Foreclosures are rising fast, investors are sweating, and lenders are now bending over backwards to keep bad loans alive



So, the Questions

- This recession is different! This is not a normal recession!
- What **options** are available to homeowners?
- What **resources** are available to homeowners?
- My answer to Q # 2: **the greatest resource is you!**
 - Before making any decision, educate yourself
 - Understand your options
 - Consult with a HUD Certified Housing Counselor
 - Consult with a real estate, bankruptcy and tax attorney
 - **How do you find these people? See next slide**

Free Help is Available

You Do Not Need To Pay for Counseling

- Government and community programs: **Free HUD counselors**
 - 1800-569-4287 or 1888-995-HOPE (4673)
 - Go to MakingHomeAffordable.gov; go HUD.gov
 - Local HUD Office – 619-557-5305
 - **Community Housing Works** – 619- 282-6647; chw.org
 - HousingCollaborative.org: Free Home Clinics – free volunteer attorneys
- Call loan servicer to learn Gov't programs they participate in
 - *Caution*: lender is a debt collector; represents the investor who owns the loan - not the homeowner

Suggested Guidelines

When To Keep Your House?

- Monthly cost of ownership is roughly the same as renting
- You are less than 10% underwater
- You have a need for credit
- You could rent the home to cover monthly costs
- The single most important consideration
 - Can you afford the house?

I See Owners Likely to Default When

- They are substantially underwater
- They pay a lot more each month than cost to rent
- They are struggling to make ends meet
- They are using credit cards to stay afloat
- Dipping into savings or retirement
- They need to move for a good reason, e.g., job

Good News – Money Problems are Fixable

- **Bad News - many buy into foreclosure rescue scams**
 - Sad: They typically have little chance of keeping home
 - **Latest scam:** *pay 10K, join class action, get a free house*
 - **Old scams:** *Loan modifications; deed house to investor*
 - “Con artists are selling false hope” Wayne Bell, DRE
- **Red flags:** file complaints w/ CA AG: oag.ca.gov/consumers
 - Do they require up front fees?
 - Is the promise too good to be true? *E.g., promise free house*
- **Do not sue institutional lenders!**
 - You are throwing your money away!

The Bankruptcy Option

- Paying the mortgage & expenses with savings, credit cards & living beyond our means is unsustainable
- 1 out of 7 Americans file BK each year
 - More file for BK than divorce or graduate from college/YR
- **Bankruptcy works well in two situations**
 - 1.) **You are overwhelmed with debt**
 - 2.) **Refinanced mortgage, took substantial money out and can no longer afford payments even if make good salary**
- Probably not an option if you can make sufficient progress paying off the debt; if so, a short sale may be a better option

Chapter 7 option - *liquidation* lose property – but get a fresh start

- Can discharge *recourse* debt in a chapter 7
 - E.g., REFI loans or home equity lines of credit
- Liens remain; lender forecloses; lose house
- Can do a short sale after CH 7; extend time in home
 - Debt that is discharged in a chapter 7 is not taxable
 - So, ensure you do the bankruptcy before the short sale
- Effect on Credit: Bankruptcy can improve credit scores - people drowning in debt have terrible credit anyway
 - May get good loan to buy home in 2 years; good car loan in less time
-

Chapter 13: *reorganization*

Keep House - if successful

- E.G. assume value is 200K, 1st lien: 250K, 2nd: 50K
- If 2nd loan is underwater, lien can be stripped
 - Debt is now unsecured - like credit card debt
 - Borrower pays off debts over 3 to 5 years
- **Pros:**
 - Debt discharged is not taxable
 - Creditors cannot sue debtor during process
- **Cons:** Most 13s are unsuccessful
 - An alternative to a 13: negotiate with creditors

Home Affordable Modification Program

#1 Q: “Why Won’t Lender Work With Me?”

- HAMP applies to owner occupied homes
- Payment on first loan to be no more than 31% of gross monthly household income
 - “Waterfall”: to get to 31%, lower interest rate down to 2%, extend term to 40 years, finally, put part of principal aside
- Typically takes seven months or more to get decision
- 75% of borrowers who apply do not get loan mods
- Of those who get mods, 50% default in one year

HAMP Issues

- Voluntary program, servicer driven
- **Second lien holders typically don't participate**
- Many borrowers given **trial mods**; pay religiously, strung along & then told "No"
- **Dual tracking**: loan mod/foreclosure track at same time
 - **I am mediating case where loan mod given and the bank foreclosed**
- **Net Present Value Test** – go to CheckMyNPV.com
- **Few principal write downs**

Short Sales

- **Good news:** Lenders are approving short sales
- In 2009, Treasury Department announcement
 - Short Sales are a better outcome for communities, lenders and borrowers
- **SSs become # 1 & the most successful loss mitigation & foreclosure prevention program**
- They have increased by 600% since 2007

What is a Short Sale?

- Borrower owes more than the home is worth & lender accepts a discounted loan payoff to accommodate the sale
 - E.g., seller has a loan balance of 500K; value has fallen and buyer is willing to pay only \$350K; lender accepts & agrees to a “short payoff”
- Short sales occur in two situations:
 - Seller bought home at top of market; value fell
 - Seller bought home years ago, took money out and value fell
- Homeowner/borrower is in financial distress or has hardship
 - Typical borrower defaults on loan payments
- New category of seller – not in financial distress
- Transaction must be “arms length”

Borrower Q: How Do I Benefit?

- Avoid a foreclosure on your credit report
- No longer have the burden of a house cannot afford
- Get fresh start, cut losses, put financial house order
- **Can stay in home till close of escrow**
 - Live “rent free” and hopefully, put money aside
- Ability to participate as a decision maker
- **Settle recourse debt**; 1st lender will give the 2nd \$.\$\$
- **Ability to purchase home in 2 to 3 years**
- Cost to hire a Realtor is \$0; plus, a graceful exit

Do Communities Benefit?

- **Foreclosures crush home prices**
 - Short sales sell at current market values
 - Foreclosed homes typically sell at a big (28%) discount
 - **One foreclosed home can reduce property values for everybody in the area**
 - A cluster of foreclosed homes cause greater declines, crime, \$ burdens for local governments, significant social and economic devastation
- **Owners generally stay till close of escrow**
 - Communities avoid vacant homes
 - Experience less crime
 - Minimize physically distressed properties

Senate Bill 931; Senate Bill 458

Deficiency judgments in CA prohibited after short sales

- CA lenders who approve short sales must release the borrower from any deficiency
 - Applies to senior and junior liens
 - Applies to owner occupied and investor properties
 - Applies to both refinance & purchase money loans
- Lenders cannot require borrowers to pay any compensation in exchange for short sale approval
- But a borrower can make a voluntary contribution in hopes of getting a short sale
- Lenders are permitted to ask others for contributions including other lenders, agents, relatives, buyers etc.

After a short sale; Common Question

“How Long Before I Can Get a Good Loan to Buy a House?”

- After foreclosure, the wait is seven years
- FHA: wait 3 years & get FHA loan, 3.5% down
- Fannie Mae: 2 YRS with 20% down
 - 3 YRS with 10% down
 - 2 YRS, 10% down with “special circumstances”
- **Married couple:** 1 person signed loan; affects credit for that person, not non signing spouse; so, non signing spouse may be eligible for a loan at this time

Tax Issues – Short Sales

See IRS tax tip 2011-44

- Debt that is forgiven is ordinary income
 - If you borrow money to buy, build or improve your principal residence, exempt from taxes on DDI
- But if borrow beyond the purchase price (HELOC or refinance) debt that is forgiven is ordinary income
 - Exceptions: **Debt discharge income not taxable if**
 - The debt is discharged in a bankruptcy or insolvent

Insolvency

- **Definition: Your liabilities are greater than assets**
- **Rule: can escape taxes up to extent of your insolvency**
 - E.g., If one's liabilities are 500K and assets are 300K, the 200K difference is the extent of the insolvency
 - Thus, if person has 250K in debt canceled, 200k is forgiven and 50K is taxable

Debt Discharge Income not a problem UNLESS

- Do a cash out refinance beyond purchase price of home
- Open and/or use a home equity line of credit after purchase property
- Lose vacation home or investment property - Federal and State legislation forgiving DDI does not apply to these

Refinancing Options

- **Home Affordable Refinance Plan - HARP**
 - Applies to Fannie & Freddie loans only
 - Can refinance up to 125% Loan To Value
 - Get a 30 year fixed amortized loan at today's loan interest rate
 - Need good credit & sufficient income
 - 838,000 borrowers refinanced to date, far short of the hoped for 4 to 5 million
- **On 9/8, President Obama announced millions more would be able to REFI under HARP**

Lessons Learned

A Nation Burdened by Debt

- Easy credit & low interest rates fueled a spending spree by Americans
- All kinds of debt have increased but the biggest problem are mortgages
- Those with financial problems include people of all backgrounds not just those who got bad mortgages
- Indebted consumers cannot drive economic recovery
- Indebted consumers cannot save for retirement or save to educate their children

Biggest Mistakes

- **Biggest mistake: Spending too much for a house!**
 - System directs us to lenders; “Wow! I am qualified for X”
 - **We let lenders tell us how much we can borrow!**
 - Lenders & Realtors are sales people - not CFPs
- **Not understanding the mortgage when you buy a house**
 - We may look at 100 houses and take first loan offered
 - **Basic questions:** What are the payments? Are payments fixed or adjustable? Is there better deal out there?
- **Use house as ATM: If take equity out, 1 in 4 chance of losing it**
 - Many who bought homes years ago and took money out lost homes

Biggest Mistakes continued

- Buying and keeping rental property w/negative cash flow
- Buying house we can afford & not keeping it
 - People owned house for 30 YRS: Best Investment

How Much House Can I Afford?

- Avoid Realtor Math! NAR is an advocacy group
- Spend 2 to 2.5 times your annual income on a home mortgage
 - Common in SD to buy homes 10 times income
- 50/30/20 plan
 - spend no more than 50% of income on necessities
 - spend no more than 30% on discretionary purchases
 - invest 20% of income each month
- Consider the price rent ratios

Price Rent Ratios

Price of home divided by annual cost of rent

- When ratio is below 15, lean toward buying
 - Monthly costs to buy now less than cost to rent
 - LA, Miami, Minneapolis, PX, Las Vegas, Tampa, St. Louis, Atlanta (ration is now at 13)
- If the ratio is at 10 or below, house is a steal
- If ratio is at 20 or above clearly cheaper to rent than buy; in SD & SF pay premium to buy
 - *San Diego: 22; Silicon Valley & Bay area: over 30*

Buying vs. Renting

What is Wrong with Renting?

- *Real Estate Economics*, Johnson & Beracha
 - **Renting is more affordable in most cities**
 - “I was shocked at how often renters won”
 - Higher cost to buy is offset only if home gains in value (3.25% annually) & buyer stays 8 years
- **Big Q: If you rent, what will you do with the money you save? Invest it? Or, Spend it?**
 - If buy with amortized loan, can pay off house

The Wisdom of John Dickens

- *Annual income 20 pounds; annual expenses 19; result: happiness*
- *Annual income 20 pounds; annual expenses 21; result: misery*

Thank You!

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