

A Short Sale May Not Mean You're Home Free

By [RUTH SIMON](#)

Financially troubled borrowers may think that foreclosure or a short sale of their home means their mortgage woes are over.

Not necessarily.

Some homeowners are finding that when they sell their homes for less than the outstanding mortgages -- a so-called short sale -- their mortgage companies are going after them for some or all of the difference. Mortgage companies are also sometimes taking legal action to recover unpaid amounts after a foreclosure is completed.

In a growing number of cases, holders of mortgages or home-equity loans are requiring borrowers in short sales to sign a promissory note, which is a written promise to pay back a loan or debt. Real-estate agents and attorneys say they have seen an increase in requests for promissory notes as mortgage companies look to short sales as an alternative to foreclosure.

In many states, lenders have always had the right to pursue former homeowners for unpaid mortgage debt. Yet until recently, most borrowers who ran into trouble were able to refinance or sell their homes and pay off their loans. Now, falling home prices are widening the gap between home values and mortgage balances, and the number of homeowners who can't make their mortgage payments is rising as the economy has weakened. More than 3.8 million homes will be lost in 2009 and 2010 because borrowers can't make their mortgage payments, according to forecasts from Moody's [Economy.com](#).

It's Payback Time

Mortgage companies are sometimes going after unpaid debt after a short sale or foreclosure. Here are some factors they may consider:

- How big was the unpaid debt?
- Was the property purchased as an investment?
- What are the borrower's assets and income?
- What is the policy of the investor or mortgage insurer?

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Some borrowers are surprised to find themselves on the hook. Jodie Byrd sold her home in the Los Angeles area in a short sale last summer after her husband lost his job and the couple realized they wouldn't be able to make their mortgage payments. The sale price covered the \$685,000 mortgage, but their lender, Washington Mutual Co., then began pursuing them for the \$21,600 balance on their second mortgage.

Ms. Byrd says a clause in their contract gave Washington Mutual the right to pursue the debt, but adds that her real-estate agent said that wasn't likely to happen. The couple eventually settled the claim for \$4,000.

A spokesman for [J.P. Morgan Chase](#) & Co., which acquired Washington Mutual last year, says it's the company's policy not to comment on individual cases. Speaking generally, he says, "a short sale may resolve the first mortgage, but the second mortgage ... would be a separate negotiation with the lender or servicer."

Some experts say that mortgage companies may pursue leftover debt, or "deficiencies," in greater numbers as the housing market settles. Lenders are "doing everything possible to work with their borrowers and trying to bring stability back to the lending and real-estate market," says Marc Ben-Ezra, an attorney in Ft. Lauderdale, Fla., who represents mortgage companies in foreclosures. "However, the ability to get a deficiency judgment is a valuable right that I think lenders will pursue aggressively in the future as the market stabilizes."

One-Year Moratorium

HSBC Finance, part of the North America unit of [HSBC Holdings](#) PLC, has implemented a one-year moratorium on the collection of deficiency balances for short sales and foreclosures that occur after April 1, "given the current economic environment," a company spokeswoman says.

Other mortgage servicers say their actions are often dictated by their contracts with investors or mortgage insurers. [Bank of America](#) Corp., for example, will "attempt to seek a promissory note whenever it is feasible" in a short sale "in the interest of protecting investors and shareholders from the losses," a spokeswoman says. In the case of a foreclosure, the investor or insurer "is generally the one who pursues the deficiency, but we do ourselves on some-bank-owned assets," she says.

Not every troubled borrower is hit with such a claim. Often, mortgage companies don't go after borrowers for unpaid amounts either because state laws prohibit or limit such actions or the cost outweighs the potential return. Borrowers subject to a deficiency may also elect to file for bankruptcy in an effort to have the debt discharged.

How a borrower is treated can depend on mortgage company policy, the size of the unpaid debt, whether the borrower has a job or other assets, or whether the home was bought as an investment. "If there isn't a financial hardship ... that's where the investor or mortgage insurer will go after the homeowner for more," says David Knight, a senior vice president at [Wells Fargo](#) & Co.'s home-mortgage unit.

A [PMI Group](#) Inc. spokesman says the mortgage insurer "primarily target[s] borrowers who are not experiencing hardship -- but those who simply elected to walk away from the property due to its decline in value."

Promissory Notes

Still, the number of short-sale agreements that are made with strings attached is increasing. In the past month and a half, "every short sale I have has had a promissory note or gives the lender the right to collect a deficiency," says Pamela Simmons, an attorney in Soquel, Calif., who represents financially troubled homeowners. Often, the terms are buried in the sale contract, she says.

Regina Rivard, a real-estate consultant in Apollo Beach, Fla., has completed 22 short sales in the past six months. In half of them, the holder of the first or second mortgage required that the borrower sign a promissory note or retained the right to pursue the deficiency. The amounts borrowers were obliged to pay ranged from a few thousand dollars to as much as \$100,000, she says.

Some borrowers are balking. Mack Ransom, a mortgage broker in Ashland, Ore., recently brought Countrywide Financial Corp. a short-sale offer for \$279,000 -- well below the roughly \$415,000 he owes on his two mortgages. Countrywide countered that it would accept a \$310,000 bid, provided Mr. Ransom signed a \$48,000 promissory note, he says. Mr. Ransom rejected that offer and is pursuing a different short sale.

"I would take the foreclosure and the credit hit over that," he says. A spokeswoman for Bank of America, which acquired Countrywide last year, declined to comment on a specific case, but said: "The company will ask the borrower to sign a promissory note during the short-sale process if dictated by investor guidelines."

Going to Court

Other borrowers who have already gone through foreclosure are being taken to court by mortgage companies for unpaid debt, though such actions are still relatively uncommon. In Lee County, Fla., deficiency actions have increased in the past six months, with most filed by holders of second mortgages, says Charlie Green, clerk of Lee County Circuit Court. "The sale of the property was not enough to cover the total amount that was owed on the note or notes," says Mr. Green, who recently began tracking such filings in response to the increase.

Dunstant King, a cab driver in Boston, refinanced his mortgage in 2007, thinking it would save him money. Instead, his payments increased as the economy slowed. In January, Mr. King, who had a \$290,400 mortgage and a \$72,600 home-equity loan, lost his home to foreclosure. In February, a lawsuit seeking \$92,000 was filed in Suffolk County, Mass., Superior Court on behalf of the loan pool that holds the second mortgage, according to court records.

"I don't have the money to pay them," says Mr. King. "Business is really bad." His attorney, David Dineen of Greater Boston Legal Services, says, "We believe Mr. King has legal defenses" to avoid that debt.

A spokesman for [Deutsche Bank](#) AG, the trustee for the loan pool, says that the decision to file the lawsuit was made by the mortgage-servicing company, Franklin Credit Management Corp. Franklin executives did not respond to requests for comment.

Blake Brewer, an attorney in Independence, Ohio, is currently representing a borrower who completed a short sale with the approval of his lender, National City Corp. The following year, Mr. Brewer's client was sued for the \$65,000 loan balance, plus accrued interest, on his home-equity line of credit. The borrower "fully believed National City understood they weren't going to get paid," says Mr. Brewer.

A spokesman for [PNC](#) Corp., which acquired National City late last year, said the company's policy is not to comment on pending litigation.