

# Addendum “A”

## Loan Modification & Short sale Disclosure

Loan modification is a transaction in which the lender agrees to modify any or some of the terms of a loan. It is where an existing loan is modified, not cancelled. Changes may include: (i) Extending the term of the loan; (ii) changing the monthly payment; (iii) changing the interest rate; (iii) lowering the principal balance; (iv) increasing the principal balance; etc.

A short sale is the sale of your real property at today's market value where the sales price is less than what you may still owe on the real estate loans encumbering the property. Normally, the lender(s) agree to release their security interest(s) in the property to facilitate the sale. Note that the lender is not necessarily agreeing to forgive you of your obligation to pay the unpaid balance on the loan(s) in a short sale. For this reason you should exercise tremendous caution in short selling your property. Many lenders reserve their right to collect the unpaid balance on the loan(s) after the short sale. If it is your desire to extinguish your obligation to pay on the loan(s) encumbering your property after the short sale then you need to make sure that your lender(s) provide you with an agreement in writing memorializing this sentiment. Otherwise, you could be held liable for the unpaid balance on the loan(s).

### **Deficiency Balance**

When your home is worth less than the amount owed on the sum total of the loans encumbering your home then you must concern yourself with the prospect of a deficiency. In such a situation the deficiency can be calculated using the following formula:

Loan Balance less the current value of the home = deficiency.

By way of example, if the client's home is worth \$600,000 and the client owes a total of \$800,000 on her home loans then there would be a deficiency of \$200,000.00. It is possible, under certain circumstances, that the client could become liable for this “deficiency” balance even if the client loses the home (to foreclosure, short sale, or otherwise).

### **Tax Liability**

When confronted with the prospect of a foreclosure you are also confronted with the prospect of a potential tax liability (both to the IRS and to the Franchise Tax Board). There are two components to this tax liability and they are: (i) capital gains tax; and (ii) forgiveness of debt tax. Under certain circumstances you could have tax liability even though you lost the house (due to foreclosure, short sale, or otherwise). Like the deficiency balance, this tax liability could be a large dollar figure. The attorney is not an expert in taxation and the attorney strongly encourages the client to speak with a tax professional.

### **Client Capacity to Pay Toward Housing**

The attorney will be asking that the client prepare a financial worksheet showing what the client can afford to pay each month toward his/her cost of housing. This will be used in evaluating alternatives.

### **CAUTION! - Bank Fraud**

Many borrowers have loans referred to as "stated income" loans. A stated income loan is a form of a mortgage loan program that is part of a family of low document and no document loans, meaning little or no documentation is required for the loan. Normally, a mortgage loan requires lots of documentation including a list of all creditors, last two or three paycheck stubs, W-2's and returns on income tax for the past two years, bank statements going back two or more months, and legal documents in case of a bankruptcy or other family adversity.

A stated income loan is a mortgage loan where the lender does not verify the borrower's income by looking at their pay stubs, W-2 forms, income tax returns, or other records. Instead, borrowers are simply asked to state their income, and taken at their word. These loans are sometimes called "liar loans". The reason stated income loans were at times referred to as liar loans is because many borrowers, and / or their loan brokers, saw these loan programs as an opportunity to purchase real estate by lying about their income / assets. By lying about their income / assets borrowers could qualify for loans they would not otherwise qualify for had they been honest about their finances. If this sounds familiar to you then you may have committed bank fraud.

Bank fraud is defined as follows:

#### **18 U.S.C.A. §1344**

Whoever knowingly executes, or attempts to execute, a scheme or artifice--

**(1)** to defraud a financial institution; or

**(2)** to obtain any of the moneys, funds, credits, assets, securities, or other property owned by, or under the custody or control of, a financial institution, by means of false or fraudulent pretenses, representations, or promises;

shall be fined not more than \$1,000,000 or imprisoned not more than 30 years, or both.

Depending upon the circumstances, there may be violations of State law as well.

In response to a borrower's request for a short sale or loan modification lenders typically ask for financial documentation such as pay stubs, tax returns, bank statements and the like. If you turn over these requested documents to your lender in furtherance of an effort to modify your loan or short sale your property and you are in a stated income loan wherein you lied

about your finances then it may prove to be a catastrophic mistake to turn over your financials to your lender. By turning over your financials you will essentially be helping the bank prove a fraud case against you. There could be both criminal and civil repercussions. By way of example, a debt arising out of fraud can be found to be non-dischargeable in a bankruptcy (meaning your obligation to pay survives the bankruptcy).

### **Concessions by the lender are discretionary with the lender**

If you are looking to modify your loan or if you are looking for a short sale you are ultimately looking for your lender to agree to change the terms of the original contract that you had with them (the loan). Generally, in order to change the terms of an original contract then each party to that original contract must agree to the change. If one party does not agree to the change then there is no change. With regard to loan modifications and short sales the lender has discretion to say “no” to any proposed modification or short sale. In fact, your lender can place conditions upon their approval of any short sale or loan modification (and they frequently do – i.e., they ask for financial disclosure). In that the lender has discretion to say “no” no one can guarantee what terms the bank will provide you with regard to a loan modification or short sale.

Sometimes the client’s desire to keep their home exceeds their concern for their potential liability for a deficiency balance, tax liability or exposure to a bank fraud claim. These clients often ask that the attorney try and negotiate with the lender notwithstanding this risk. Should this situation arise the client acknowledges that the attorney will likely begin making written disclosures to the client advising the client of the potential risks and ask that the client sign subsequent acknowledgments denoting the clients understanding of the risks of the clients choices.

## **IMPORTANT DEADLINES / RIGHTS INCIDENT TO A FORECLOSURE**

### **Reinstatement**

#### *Non-judicial foreclosure*

This form of foreclosure takes place outside of the courts. It involves two letters (notice of default and a notice of sale) and then the property is sold. This is the most common form of foreclosure and if you experience a foreclosure then the odds are that you will most likely experience a non-judicial foreclosure.

When a notice of default has been recorded you have the right to reinstate the delinquent debt and cure the default by the payment of delinquencies and costs at any time until five business days prior to the date of sale if the power of sale under the deed of trust is exercised. Simply stated, you have the right to bring the loan current and you get to keep your property so long as it is done before 5-business days before the sale of the property. If you wait until you are less than five-business days before the sale then you no longer have the right to reinstate your loan. At that point it becomes discretionary with your lender as to whether or not they will allow you to reinstate the loan.

### *Judicial Foreclosure*

This form of foreclosure involves an actual lawsuit. Though judicial foreclosures are uncommon, they do occur. Your right to reinstate your loan (bring the loan current to keep your property) expires upon a decree issued by the court called a “decree of foreclosure”. If you find yourself on the receiving end of a judicial foreclosure then you will need to make constant contact with the Court to find out when the decree of foreclosure will be issued in order to determine when your right of reinstatement will terminate.

### Redemption

#### *Non-judicial foreclosure*

Redemption refers to your right to pay off everything that you owe on the loan before the property is sold and you get to keep your property. In a non-judicial foreclosure your right of redemption (pay-off the loan) expires with the sale of the property.

#### *Judicial Foreclosure*

Your right of redemption (pay off the entire loan to keep the property) expires with the sale of the property. You have no post sale right of redemption unless your lender attempts to obtain a monetary judgment against you for the unpaid balance owing on the loan.

Conversely, if your lender intends to pursue a deficiency judgment against you then you have a post sale right of redemption. If at the sale the sales proceeds are an amount sufficient to payoff your obligation then your right of redemption expires three months after the sale. If the sales proceeds are not enough to pay off your obligation then the right of redemption expires one year after the sale of the property.

### Caution about judicial foreclosures

A judicial foreclosure is a lawsuit wherein you have been named as a defendant. This is a complicated area of law and you are discouraged from trying to exercise self-help to deal with the foreclosure. Trying to determine the timing of your right of redemption and right of reinstatement in a judicial foreclosure will prove to be very challenging. You are strongly encouraged to seek the assistance of an attorney in determining the timing of your right of reinstatement and right of redemption in a judicial foreclosure.

By initialing below the client acknowledges that she has read this addendum and understands the disclosures being made therein.

Date: \_\_\_\_\_

\_\_\_\_\_  
Client's initials

Date: \_\_\_\_\_

\_\_\_\_\_  
Client's initials