Mortgage lenders pursue homeowners even after foreclosure

By Les Christie, staff writer, CNN Money.com, Wednesday February 3, 2010, 8:18 am EST

As terrible as it is to lose your house to foreclosure, at least it's a relief to put your biggest financial headache behind you, right?

Wrong.

Former homeowners may still be on the hook if there's a difference between what they owed on their mortgage and what the bank could sell it for at auction. And these "deficiency judgments" are ticking time bombs that can explode years after borrowers lose their homes.

It can even happen to people who got their bank to approve them selling their home for less than it is worth.

Vanessa Corey, for example, short sold her Fredericksburg, Va., home in April 2008. She and her husband built the house in 2004, but setbacks, both personal (divorce) and professional (housing bust), made it impossible for the real estate agent to keep her home. So she negotiated the short sale and thought that was the end of it.

"My understanding was that the deficiency was negotiated away," she said. "Then, last November, I got a letter from a lawyer telling me I owed my lender $65,000. I had to declare bankruptcy. There was no way I could pay it. "

Many homeowners are now in the same boat. And not just those who took out bigger loans than thoy could afford or who did so called "liar loans" where they didn't have to verify their income.

Because of falling home prices, borrowers who always paid their mortgage but who have run into unforeseen circumstances like unemployment or a job transfer can no longer sell their homes for what they owe. As a result, they are being forced to short sell or foreclose and are getting caught up in deficiency judgments.

"After the banks foreclose, it's very common now to have large deficiencies with houses not worth the balances owed," said Don Lampe, a North Carolina real estate attorney.

Lenders mostly declined comment. Although Corey's lender, BB&T did indicate it was pursuing more deficiency judgments.

"They follow the rise and fall of foreclosures," said the spokeswoman, who would not discuss Corey's account.

Can they come after you?

Whether banks can and will pursue deficiency judgments depends on many factors, including what state the borrower lives in and whether there's a second mortgage or other liens. But if borrowers ignore the possibility of deficiencies, it could haunt them.

"Once they have a judgment, they can pursue you anywhere," said Richard Zaretsky, a board-certified real estate attorney in West Palm Beach, Fla. "They can ask for financial records, have your wages garnished and, if you fail to respond, a judge can put you in jail."

In the case of foreclosure, lenders can pursue deficiencies in more than 30 states, including Florida, New York and Texas, according to the U.S. Foreclosure Network, an organization of mortgage law firms.

Some states, such as California, are "nonrecourse" and don't allow deficiency judgments. But, even there, if the if the original loan was refinanced, some or all of it may be subject to claims.

Deficiency judgments on short sales and deeds-in-lieu can happen in many more places. In these cases, extinguishing the debt is often a matter of negotiating with the bank.

But even when lenders are willing, many borrowers may not be aware that they have to ask for release. So, if you are pursuing a short sale, be sure your attorney asks the bank to release you from any further obligation.

"People shouldn't have a false sense of security that a deficiency judgment may not be later sought," Zaretsky said.

He expects many will be filed over the next few years, based on the fact that banks have sold many of these accounts to collection agencies and other third parties, at discount.

"The parties who bought those notes wouldn't have paid money for them unless they had the intention of acting," Zaretsky said.

Ticking time bomb

What can be scary is that the judgments don't have to be obtained immediately. Lenders or collection agencies may wait until debtors have recovered financially before they swoop in. In Florida, the bank can wait up to five years to file. Once the court grants a judgment, the lender has 20 years there to collect, with interest.

It doesn't have to be a large amount of debt for a lender or collection agency to come after borrowers. Richard Varno and his wife short sold their Nashville home back in 2004 after he lost his job.

It wasn't until 2008, when the second lien holder asked him for $25,000, that he realized he still was liable.

"I told them, 'Hey, you guys released the title,'" he said. "As far as I know, I'm off the hook."

He wasn't. Releasing title does not necessarily end the debt. It's complicated because of variations in state law, but, generally, a mortgage has two parts: a pledge of collateral, represented by the home, and a promise to pay off the loan.

Lenders may release property liens in order to facilitate short sales without releasing borrowers from their obligations to pay under the promissory notes. The secured debt can convert to an unsecured one after the sale.

Zaretsky had one client who was so relieved to have arranged a short sale that he signed every paper his real estate agent shoved at him, even a confession that clearly stated he still owed the debt.

"He had no idea what he was doing," said Zaretsky. "All the lender had to do was go to court to convert the confession into a deficiency judgment. "

Lenders are also very inconsistent. One of Zaretsky's short-sale clients was ready, willing and able to pay, but the bank did not even ask. Another lender always reserves the right to pursue the deficiency.

Strategic defaults

Sometimes lenders go after borrowers walking away from their homes if they have other assets, according to Florida real estate attorney Larry Tolchinsky.

"Banks are pulling credit reports to see if it's a strategic default," he said. "If you're behind on all your other payments, you're okay. But if you're not, they'll come after you. "

If borrowers have any doubts about their risks, they should seek legal advice. Or, at least, call non-profit organizations such as NeighborWorks for advice. According to Doug Robinson, a NeighborWorks spokesman, its counselors always try to negotiate away deficiencies when they facilitate short sales or deeds-in-lieu.

"We don't favor any short-sale contracts that leave any deficiency that can be pursued," he said.

Robinson himself knows what can happen. He paid off a deficiency after his own New Jersey house went through foreclosure 11 years ago.