UNDERWATER / UPSIDE DOWN, SHORTSALE, FORECLOSURE, REO

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None of these terms sound very comfortable or desirable – and in the real estate world, they're not. They're bad, very, very bad. But, bad things sometimes happen to good people. So if you find yourself having to deal with one of these "states" of being, don't let it devastate you. Life goes on.

Underwater simply refers to the financial wellbeing of the relationship of what a property is worth burdened by how much is owed on it. If the debt is going to exceed the income from the sale of a property it is referred to as being "underwater" (presumably a disrespectful reference to drowning in debt). Some people use the term **upside down** – same thing as underwater. The value to equity relationship is said to be upside down.

One way that many people found themselves underwater was when the real estate market bubble burst. Homes were purchased in the summer of 2006 at their peak price and in a very short period of time – seemingly overnight - the resale value dropped more than the amount of equity that was established with the down payment made at the time of purchase. Some of those homes have still not recovered their equity to any significant degree.

Another common scenario is when homeowners have a good equity position, don't plan on selling and moving anytime in the foreseeable future, don't have a lot of cash, and have some need or reason to pull equity out of their homes. This may be accomplished through refinancing the entire mortgage, or by just taking out a second mortgage, or a home equity line of credit (HELOC). Maybe it's that vacation of a lifetime, seed money for a business startup, college tuition for the kids, unexpected medical expenses, loss of job, etc. Typically, at the time, it doesn't seem like an irresponsible decision. And then, something prevents paying down that new debt as planned, real estate values have not increased as anticipated, and sooner than expected the need to move arises and the reality of being underwater or just barely afloat is realized. A very large number of households are currently in this category. And, if they don't have the cash to bail themselves out at settlement on the sale of their existing homes – much less adequate cash for the down payment and closing costs for the purchase of a new home – they aren't going anywhere.

A **short sale** is simply when the underwater condition exists and the decision to sell the home is made – voluntarily or involuntarily – it doesn't really matter. It just literally means that the funds at settlement are going to come up "short" of what will be needed to pay of any and all loans against the property and all closing or settlement costs. When that is the situation, one of two things must happen. The homeowner can write a check to pay for the balance remaining, or they might be able to negotiate a deal with their lender(s) to accomplish a short sale where the lender(s) agree to accept less than the amount owed and still permit the sale. Needless to say, nobody wants to do this. The banks don't like losing money. Homeowners don't like losing money – nor does it help their financial profile. Credit scores are going to take a big tumble. (This writer's FICO score went from 840 to 400 overnight because of a short sale on my residence). It also means that you will probably have to transition from home "owner" to being a tenant. Credit score recovery takes a long time – even when there are no other credit issues. (It took me four years to have my score climb back to 700 and purchase a new home).

One more rung down the ladder of bad things to happen with real estate debt brings us to **foreclosure**. Foreclosure is the legal process that the lender or mortgagor must take to claim their interest in the property. At this point, things can get pretty ugly. Rather than try to describe the process in prose, the foreclosure process will be better illuminated by the following:

Maryland Homeowner Foreclosure Timeline*

At First Signs of Financial Difficulty

Steps

#1

What You Can Do

Reduce unnecessary expenses, save money, and contact the HOPE hotline for free non-profit Housing Counseling

1-877-462-7555

#2

Missed Mortgage Payment
Lender begins calling, sends a delinquency notice

Day 1+

Homeowner sends lender "Loss Mitigation" workout request package or pre-filing mediation option: ***Note that choosing pre-filing mediation changes the timeline***

#3

"Notice of Intent to Foreclose" letter mailed certified and 1st class mail
Important: May include offer for pre-file mediation – see reverse

Homeowner to submit "Foreclosure Mediation Opt-in" Form to courts w/$50 filing fee

#4

"Order to Docket" (OTD) filed in court with certified or personally served copy to homeowner*

Day 90+
(45+ days after NOI)

#5

Opt-in deadline 25 days from date of OTD

Deadline for homeowner to request Mediation held with the Office of Administrative Hearings (OAH)

Without Mediation

#6

OAH to receive paperwork 20 days before mediation

Homeowner to submit all required documents to OAH

#7

Mediation held at OAH
60 days or less from homeowner's request

Homeowner & mortgage company meet to review financials to decide if mortgage company will offer options to foreclosure: ***If you choose pre-filing mediation, this post-filing mediation may not be available to you - see reverse***

Without Mediation

#8

15+ days after mediation
or 45+ days after OTD

Foreclosure Sale at courthouse

Homeowner to seek other housing options

#9

30+ Days after Sale

Court ratifies sale and title is transferred to new owner

#10

45+ Days after Sale

Vacate or Face Eviction

At any point up to the Foreclosure Sale, the homeowner can bring mortgage current by paying all arrears including late fees and foreclosure costs

www.MDHope.org

***NOTE:** This document represents a simplified version of the foreclosure process in Maryland without a Preliminary Loss Mitigation Affidavit and some steps may vary. Information is not presented as legal advice.

REO is an acronym for Real Estate Owned. This is how repossessed bank-owned property is often referred to. By the time residential property reaches this point, it is very often is a state of great disrepair and depreciation by environmental deterioration, damage by disgruntled former owners, theft of valuable hardware and components (especially heat pumps and copper wire and plumbing) and flooding.

Banks don't like having to maintain a portfolio of undesirable properties so they will usually make pretty significant concessions to try get them sold at just about any price to be finished with them. Hence, an opportunity for someone with the will and resources to flip them comes into being.

Flip? – that's another article.

DISCLAIMER

John P. Hale is a licensed real estate agent in Maryland and Pennsylvania. He is affiliated with Coldwell Banker Residential Brokerage in Westminster, Maryland. John has been licensed since 2000 and also practiced in Tucson, Arizona for many years. Mr. Hale holds the following designations and certifications awarded by the National Association of REALTORS® (NAR) and other authorized institutions: ABR-Accredited Buyers Representative, AHWD-At Home With Diversity, CNE-Certified Negotiation Expert, CRMS-Certified Risk Management Specialist, CRS-Certified Residential Specialist, CTA-Certified Tourism Ambassador, e-PRO-Online Real Estate Practice, GRI-Graduate of Realtor Institute, MRE-Master of Real Estate, MREP-Mortgage Real Estate Professional, MRP-Military Relocation Professional, and Workforce Housing Certification.

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