

ARIZONA - MARS-COMPLIANCE VERSION 13d

**ADVISORY: YOUR RIGHTS AND LIABILITIES UNDER ARIZONA  
FINANCING INSTRUMENTS AND THE EFFECTS TO YOU IN DEBT  
WORKOUTS:**

(LICENSEE INSTRUCTIONS: COMPLETE LINES; ONE COPY TO CLIENT OR CUSTOMER AND ONE TO FILE)  
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DATE: \_\_\_\_\_

TO: \_\_\_\_\_

(CLIENT/CUSTOMER/OTHER)

RE: THE PROPERTY AT:

\_\_\_\_\_  
\_\_\_\_\_

Greetings:

This Advisory is given to you because you are about to engage in a debt modification or workout or to engage in financing that uses debt instruments or assumes legal obligations which your real estate licensee wants to assure that you understand. The following Advisory was prepared by an Arizona attorney about common debt instruments used in Arizona for home purchases and the remedies for their foreclosure and also discusses the effects of a debt modification or workout. It was prepared as a consumer courtesy by ECKLEY & ASSOCIATES, P.C., a licensed law firm, to whom any legal questions coming from this Advisory may be directed at 1(800) 999-4LAW. By this preface, the real estate licensee assisting you in the foregoing transactions is not recommending any particular lawyer to you or giving legal advice. The licensee is assisting you to better understand the ramifications of your transaction in comportment with fiduciary duties and Commissioner's Rule R4-28-1101. Legal advice is only given by a lawyer, not your real estate licensee. This form is general and meant for educational purposes and not the rendering of direct legal advice on your specific transaction either by your real estate licensees or by ECKLEY & ASSOCIATES, P.C.. This Advisory is void if altered in any way. Effective to January 1, 2011; always check for updates in the law!

*On the behalf of your real estate licensees, title and escrow services and ourselves, we sincerely hope this Advisory helps a very difficult and sometimes confusing and even painful decision-making process.*

**THE WORKOUT PROGRAMS:**

The U.S. is swamped with defaults on real estate mortgages. It is a tragedy that has often been in the front pages of the news. As a result, the government and many lenders have designed programs to attempt to ease the defaults and foreclosures that have come to dominate the marketplace. The largest workout private program, not government-sponsored, directly, is the Hope for Homeowners program. The members of this program are all of the larger lenders and they formed the program and established Guidelines for it that are very much like but not identical to the governments or GSE Programs. The government-sponsored programs or GSE programs are commonly known as HAMP, HAFA and 2MP. These programs come into play when the loan was originally or currently insured by Fannie

Mae, Freddy Mac, Ginny Mae and other government-underwritten or guaranteed loans. These programs have their own established Guidelines for work-outs, too. The Guidelines determine eligibility for work-outs such as modifications, short-sales and deeds-back, but, unfortunately, adopting these programs or, even once adopted, strictly following the Guidelines remains optional with the lender. This makes it very difficult for your professionals to maneuver your case through the system, regardless of how eligible you are or how capable they might be. THIS ADVISORY COVERS THE DIFFICULTIES IN WORKOUTS AND YOUR RIGHTS AND LIABILITIES IN THE SYSTEM.

#### **CURRENT WORK-OUT OPTIONS:**

Most of these programs do not apply to loans in excess of \$729,000, but this does not mean the lender or investor will not "deal" on amounts beyond that—only that the federal programs do not for the most part apply after that amount. If you are seeking to do a debt work out or modification, there are several kinds: (1) a "modification" in which the loan is changed in terms (principal, interest, payments) to try to be more affordable to you. Rarely will permanent principal reductions be granted, but some new programs will permit it under certain conditions. Under "modification" you keep the property and remain liable on the debt; then (2) the "short sale" which is a process in which the property is offered for sale to another (you will not remain in the property) for less than what is owed on the debts against it and any resulting offer must be approved by the lender. These can be long and somewhat frustrating (and the lender has no duty to approve any offer), but this process is getting better; then (3) the "deed in lieu of foreclosure" in which you simply deed the property to the lender and move out. In many cases, the lender will ask that the borrower try each of these attempts to mitigate the debt in the order just given.

Most lenders will still use Guidelines similar to the above even when the loan goes beyond \$729,000 and some will even use the work-out options, above, on commercial loans.

The Guidelines tend to be rigid with strict requirements to even be eligible, with specific income-to-debt formulas and specific hardship requirements to be considered. All call for prompt, complete and thorough documentations of financial condition. All also call for a lot of work from the real estate licensee—much more than would be the case for a conventional listing or purchase. Due to backlogs and continuing confusion on the lenders-end with these new programs, MEETING THE GUIDELINES IS NO GUARANTEE THAT THE DEAL WILL GO THROUGH. Many of these programs are currently being sued by states Attorney Generals and being investigated by the federal authorities for that very reason. Nonetheless, for those genuinely in hardship, these programs are many times better by far from than alternatives and many are successfully completed.

**IMPORTANT NOTE:** *In any of these options, there will be tax and credit ramifications as set forth in this Advisory.*

#### **THE DEBT INSTRUMENTS:**

The most common instruments in Arizona for home purchases is a purchase money deed of trust or a purchase money mortgage. You likely have one or the other on your above property or will have through your transaction, though no opinion is expressed on whether or not you do.

#### **THE REMEDIES GENERALLY, FOR DEFAULT:**

In general law, except for certain residential non-deficiency loans set forth, below, the loan secured by real estate may be enforced by the lender or holder of the instrument either suing the debtor directly on the debt (usually the promissory note the debtor signed), or by a foreclosure against the property, conducting either a judicial foreclosure (in a court) or a non-judicial trustee sale (the latter on trust deeds loans, only). Under the foreclosure law the creditor sells the house either for enough to get the entire loan paid off (and the creditor keeps the payoff up to the amount of the remaining loan and expenses to foreclose it) or it sells short of that debt amount (very common, recently, due to adverse market conditions) and if there is a shortfall, the creditor can on certain obligations collect the shortfall from the debtor even after the property has been sold on the foreclosure sale, *unless barred from doing so by the Arizona law prohibiting the collection of any*

*foreclosure sale shortfalls (the "deficiency" of the foreclosure sale) from the debtor.* In most Arizona cases, there are no deficiencies on first-position residential trust deeds and mortgages (see below for clarification).

#### **THE GOOD NEWS FOR MOST HOME-MORTGAGE BORROWERS IN ARIZONA:**

Most Arizona residential debt BARS deficiencies, so the debtor in most cases loses the home and the debtor's prior investment in it, but does not also suffer being pursued by the creditor for the deficiency. (For California, Nevada and New Mexico debts, see the "California" under the "FAQs" heading at the website: [eckleylaw.com](http://eckleylaw.com) ).

**MOST ARIZONA HOME-SECURED TRUST DEEDS AND MORTGAGES DO FALL UNDER THE PROTECTION OF THE ANTI-DEFICIENCY STATUTES AND THAT MEANS THERE CAN BE "NO DEFICIENCY" AGAINST THE DEBTOR IN A FORECLOSURE.** See below for what qualifies. But even when there is no deficiency, there can be IRS, credit, employment and other ramifications, as explained below.

#### **ANTI-DEFICIENCY STATUTES:**

Arizona law has two "anti-deficiency" statutes that will often apply to loans secured by single residential real estate and whether or not the home is occupied by the borrower. Where these statutes apply, a lender's remedy will be ONLY a foreclosure, with NO RIGHT TO SUE (OR EVEN ASK THE DEBTOR) FOR MONEY beyond the amount received from the foreclosure sale. These two "safe harbors" are as follows:

One applies to mortgages, which must be foreclosed judicially, or deeds of trust if foreclosed judicially (that means by the creditor suing the debtor in a court). It is A.R.S. ' 33-729(A). It limits the claim to the proceeds of a sale of the property; that is to say, the lender is limited in remedy to only what it gets from auctioning the property at a trustee's public sale and if the lender gets more than what is due the lender, the debtor gets the balance. If the lender gets less than what is due, the lender still has no other claim or recourse against the debtor.

The other "anti-deficiency" statute applies only to deeds of trust when foreclosed via a trustee sale (sold at a private auction and not through a suit in the court). It is A.R.S. ' 33-814(G). Same rule: The creditor only gets the amount from the sale of the property and no more.

#### **THE TEST FOR WHETHER THESE EXCEPTIONS APPLY TO YOU:**

For either of the anti-deficiency statutes to apply, the mortgage or deed of trust must be secured by real property that: (1) consists of 2 1/2 acres or less; (2) and is restricted to and utilized for a single-family or dual-family dwelling.<sup>1</sup> (3) the proceeds of the loan had to be used to pay all or part of the purchase price of the property (better that all of it was). If all three of the foregoing apply, a deficiency on a normal foreclosure is unlikely. Private finance like Contracts for Deed, Land Trusts (rarely used the last 20 years) and Lease/Options operate under different rules and are not covered here.

#### **STRAIGHT REFINANCES:**

If the current loan is not the original one that purchased the house, but a refinance of one that purchased the house, the refinanced loan usually has the same character as the loan is replaced. A "refi" will also often be covered by the same non-deficiency rule. See Bank One v. Beauvais, 188 Ariz. 245, 937 P.2d 809 (App. 1997), in which the court held that an extension, renewal, and/or refinancing of a purchase-money loan retained the character as a purchase-money loan, and therefore was subject to the same general non-deficiency treatment as a purchase money loan. This also

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<sup>1</sup> In other words, the property must contain a single-family house or duplex that is used as a dwelling. Vacant land, multi-unit properties in excess of two units, and commercial properties, to name a few examples, do not qualify. In addition, the consumer does not actually have to live in the unit. The consumer could be leasing it to another and this rule still applies.

applies to second trust deeds or mortgages if they were "purchase money" and were for residential property as noted above. See Mid-Kansas Federal Savings and Loan Ass'n v. Dynamic Development Corp., 167 Ariz. 122, 804 P.2d 1310 (1991). Loan funds not part of the original closing later borrowed and used to reinvest in the home such as to upgrade it or put in landscaping, a pool, improve or upgrade the home are generally not purchase money debts and would likewise give the creditor in most cases the right to sue directly on the debt or foreclose and take a deficiency, but also see "blends," below.

#### **REFINANCED "BLENDS"**

A "blended" loan is one in which a new single loan is made to refinance two prior loans: One loan being a prior purchase money loan the other being a second mortgage or trust deed entitled a "home equity line of credit", or "HELOC" or not labeled at all. Whether the new refinanced loan has a deficiency potential or not is based upon how the second mortgage or trust deed—regardless of whether it is called a "line of credit" or something else, was actually used at the time it was taken out. If the HELOC being refinanced was actually used at the time the HELOC was originally taken out to purchase the property—part of the closing on buying the property--then it is likely still a purchase money loan as that is how it was used. Thus, it was not subject to a deficiency originally and even if it was later refinanced by yet another "HELOC," it is still not subject to a deficiency because the original "HELOC" was used to purchase the home. Alternatively, if the HELOC was actually used to draw more money out of the property (such as to pay credit cards off, improve the home, or purchase a car or a boat), it was not used to actually make the original purchase the property and so it actually was one on which a direct action on the promissory note and a deficiency claim after a foreclosure could be granted. So the question is this: Does that deficiency type of second loan still retain its character if part of a refinance of it is blended with an original purchase money loan that has no deficiency? The Beauvais case, above, had one of these type of blends but it ruled against a deficiency on the refinanced loan on other grounds and so the issue of "blends" was never directly answered. If it ever came back to the Arizona Supreme Court squarely on this question, however, it is generally thought in the legal community that the refinanced instrument would likely be treated as a purchase money instrument without deficiency. This is not only for the strong public policy against deficiencies on residential purchase loans. But also based on the practical challenges of obtaining a partial deficiency out of a note that is blended with a non-deficiency—where the note itself states one consolidated balance and does not address the issue of split the amounts or payments against the two refinanced amounts or provide to which balance any payment or foreclosure proceeds would be first applied and has no language in it that would help separate the merger. Dividing it somehow after the fact would be an ambiguous and difficult legal step under various legal doctrines. And, in recent practice, few if any creditors have been asserting any deficiency liability on residential "blends" after a foreclosure.

Most of the 80/20 and 70/30 residential loans of the 2000's in which all proceeds went to the purchase of the property are actually, in total, purchase money loans and have no deficiency or right to sue separately on the promissory note under Arizona law. In fact, most of these loans violate the lender's own underwriting standards, were designed in two parts instead of one to qualify the unqualified buyers with no down payment as though they had "equity" for the first loan to close the 80% or 70% loan and were thereafter, a fictional second later, then borrowing on the equity of the 20% or 30% for the second loan as though the 80% or 70% loan was "pre-existing". In this way lenders also defeated the rules requiring the transaction to pay mortgage insurance to Fannie Mae, Freddy Mac, FHA and others and could book and sell the 80% and 70% loans as high equity-based loans into the secondary markets. **ACURATELY CLASSIFYING THE LOAN AS DEFICIENCY OR NON-DEFICIENCY IS CRITICAL A QUESTION FOR YOUR LAWYER TO ANSWER.** Having a non-deficiency loan can give a good deal more bargaining power to the borrower with the lender than a deficiency loan.

#### **EXCEPTIONS THAT COULD STILL MAKE THE CONSUMER OR SOMEONE ELSE LIABLE:**

The non-deficiency rule will not apply if the debtor has allowed the property to be wasted by such things as his own bad maintenance, by vandalism of him or others or uninsured losses before the foreclosure sale ("voluntary waste<sup>2</sup>"). This is

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<sup>2</sup>"Voluntary waste" is damage to the property by the borrower that reduces the value of the Property; giving the lender the right to collect damages in the amount of the diminished value. See A.R.S. 33-729(B).

A.R.S. ' 33-729(A). Also: If money was taken out of the loan for other purposes than purchase of the property (lines of credit, home equity loans and even purchase money loans where there was cash-back that was itemized as such), these anti-deficiency rules do not apply and the lender could see that cash directly from the borrower as a result of or in addition to the foreclosure, but see "blends," above. The anti-deficiency rules also do not apply to a loan guarantee executed separately, even where guaranteeing a loan that is itself a non-deficiency loan. As to the guarantor, they are often liable even if the primary debtor is not. See below.

#### **WARNING: WORKOUT TRAPS TO AVOID:**

Some lenders, either through disorganization or planning, have twisted some of the workout rules and laws to give themselves an advantage at the cost of the consumer. Here are two among many that your real estate licensees want you to know about as a potential risk to you. These are not always the case, but your licensee wants you to know that the outcome of working with your lender is never a certainty and that some of these can, indeed, come about. If they do, they might be the times when you and your licensee will want to engage a lawyer to try to surmount them.

- **LOAN MODIFICATIONS:** Under the HAMP, Hope for Homeowners and some other programs, the lender often grants a "trial period" loan modification in which monthly payments are significantly reduced with the inference by the lender that a permanent reduction will likely come about after the "trial period." In fact, many times, no long-term reduction is ultimately granted. On a national basis as of January 1, 2011, fewer than 20% of all trial loan modifications end up with a permanent reduction. Thus, at the end of the trial period, the loan goes back to its original amount automatically and along with that the lender sends a bill for all of the payment shortfalls during the trial period, along with interest and penalties, and demands payment within 30 days. If a consumer goes on one of these trial modification programs, the consumer is advised to put into savings the money that would otherwise be payable plus interest and penalties, for the 80% statistical likelihood that no affordable permanent program will finally be offered. *In less than 2% of all loan modification applications is a permanent principal reduction (reducing it to at least not exceed fair market value) granted.* The usual reason given by the lenders as to why the borrower "failed" the trial program is a "failure to timely submit the complete documentation requested" when, in fact, it is the lender that for the most part loses all of it. **ALWAYS KEEP COPIES OF ALL DOCUMENTS SUBMITTED AND ANY AND ALL COMMUNICATION BACK AND FORTH WITH THE LENDER. MAILED MATERIALS SHOULD BE SENT BY CERTIFIED MAIL WITH A RETURN SIGNATURE-OF-RECEIPT CARD AND SHOULD HAVE A COVER LETTER ADDRESSED TO THE CORRECT PERSON. COMMENTS MADE BY THE LENDER OR ITS SPOKEPERSON SHOULD BE DOCUMENTED BY A CONFIRMING LETTER SAYING "ACCORDING TO YOUR TELEPHONE STATEMENT TO ME OF (GIVE DATE) THAT YOU WANTED AN UPDATED FINANCIAL AND THAT MY PROSPECTS FOR MODIFICATION ARE EXCELLENT, I AM ENCLOSING THAT FINANCIAL (ETC)."**
  
- **SHORT SALES:** Under any of the short sale programs, and more often when a first and a second loan are present, the lenders will direct that the consumer pay more money in cash into closing or "sign a note" for any balance remaining after application of the short sale proceeds (usually on the second loan, as the first loan lender usually accepts all of the proceeds as a settlement, but it can also be on the first loan). In cases where the second loan is a **deficiency** instrument (which most are not because they were one of those 90/10s or 80/20s used to purchase the property, as discussed above,), this is a lawful practice at this time. **BUT IT IS NOT A LAWFUL LENDER PRACTICE WHEN THE LOANS BEING WORKED OUT HAVE NO DEFICIENCIES!** That is to say a lender cannot ask for more money from the borrower on a non-deficiency debt, since the borrower has no money liability on the debt (see above). This is a forbidden lender practice and it is made more egregious when the lender accepts a short sale and then, on the eve of closing, advises the borrower for the first time that it will want more money from the borrower, either in cash at closing or on a new promissory note that lasts after closing.

See the definitions of what is and what is not a deficiency loan under those headings, above. There is no consumer duty to pay all or part of a non-deficiency loan as a precondition to doing a modification or short sale for which he or she is otherwise eligible, nor is there a duty to sign another loan promising to pay some or all of it.

The Arizona case of Baker v. Gardner, 160 Ariz. 98, 770 P.2d 766 (1988) established that a lender cannot bypass the anti-deficiency statutes by waiving a foreclosure (where the anti-deficiency statutes appear as a seeming foreclosure remedy only) and instead sue the debtor directly on the promissory note or demand payment personally from the debtor. The only recourse the lender has is to take back the property—not ask for more money. The Arizona Supreme Court stated clearly that the anti-deficiency protection is a substantive consumer right—meaning that if the loan meets the anti-deficiency rules there is no possible way to contort the debt into any kind of a personal one—not merely a procedural right that only arises after an actual foreclosure. **The Court held that it was rather the legislature's all-encompassing intent to limit any and all remedies for qualifying residential purchase money loans to a return of the property, only.** If the loan itself is a non-deficiency type, then lender remedies from the day it was signed to the day it is retired are limited strictly to a return of the property. No demands for personal payments of money are lawfully available except as a preface to taking the property back by foreclosure. What this means is that a lender attempt to exceed its remedies or its representation to the borrower that it can ask for more than the law allows is a violation of consumer protection law. Aside from such a practice being a fairly obvious violation of the federal Unlawful Debt Collection Practices Act, 15 USC 1692 (the lender is threatening a collection right or remedy it does not legally have), it could very well be a felony for a lender to demand money for a non-deficiency loan or to insist or imply that it has the right to do so as a precondition to approving a short sale under ARS 13-2320 (making misrepresentations by the Bank in connection with the processing or collection of a residential debt a Class 4 felony). Section 215 (a) (2) of 18 USC, Part 1, Chapt. 11 (requesting or accepting a benefit as an influence or reward in connection with approving the short sale) may also apply under Federal law, calling for fines against the lender or institution for up to 3 times the amount of the “incentive” it wanted paid or \$1M, whichever is greater, and 30 years of federal imprisonment against those with the lender or its collection arms who attempted it. If the consumer finds himself in this position, he needs legal counsel, immediately, and **SHOULD NOT SIGN THESE UNLAWFUL AGREEMENTS.**

There are a number of other ill-practices some lenders and servicers engage in. These are but a few. The general rule is always to never sign legal documents without counsel.

#### **NON-RESIDENTIAL PROPERTIES:**

Bare land, office buildings, tri-plexes and larger, commercial offices and the like are DEFICIENCY instruments unless they contain express language inside them stating that they are “without recourse” to the debtor. On those, the lender can sue for money, go to a sale and collect against the debtor for a deficiency. Alternatively, the lender can sue the borrower directly on the entire balance of the promissory note without a foreclosure, though instances like that are rare and usually only seen where the lender is in a second position behind a large first lien, so that remaining equity against which the second trust deed or mortgage is secured is slight to none. The defenses there are more narrow. There are defenses in foreclosure law, itself, such as that the property was not sold at a reasonable value or that a claim for deficiency was not instituted in a timely fashion and other defenses. In some cases there can also be the defense of a wrongful appraisal and underwriting failures that could arise to a regulatory violation in addition to being actionable by the borrower or guarantors as misleading lending practices. These need careful analyses by a competent attorney.

#### **GUARANTEES AND LINES OF CREDIT:**

Guarantees are enforceable even if for a debt which was purchase money, as the actual is on the separate written Guarantee and not the debt and even where there is no deficiency for the primary borrower. Pure lines of credit (for any use such as a credit card or for cash or for home improvement but not used as part of the purchase price of the property) all pull out money and so they are not purchase money debt and can be claimed upon independently and are not limited by the anti-deficiency statutes. A so-called pure “HELOC” is a line of credit-type loan when not used to purchase the home, though some HELOCs have been used for part or all of the purchase price. If it is action on the original HELOC that is taking place, there is a deficiency potential. If the original HELOC was later refinanced and blended into a non-deficiency debt, it is arguable (though there is no current direct case precisely on point—see “blended” loans, above) that the resulting single refinanced instrument has become a non-deficiency loan. **SEE A LAWYER FOR A CALL ON THIS ONE UNDER YOUR PARTICULAR FACTS.**

#### STATE AND FEDERAL VA LOANS:

Mortgages or trust deeds issued or guaranteed by these organizations have different collection rules and can result in action against the person, as for example when a loan guaranteed by the Federal Veteran's Administration as a Vet benefit for the borrower-Vet is not paid. The VA has an action against the borrower for the shortfall it paid against the debt by terms of the Vet's VA guaranty which has nothing to do then with the state non-deficiency statute.

#### WASTE:

If a borrower lets the property waste, such as get vandalized, damage it him or herself, let maintenance lag, or if the property burns down, the borrower can still be liable. One such waste could be insurance failures. In a deed-in-lieu or if the borrower has simply left the home, the borrower needs to continue to keep it insured until taken over by the lender as any losses that are uninsured could become the borrower's personal liability (this is a liability that is direct and not a matter of whether or not the debt has a deficiency factor to it). If the borrower only has homeowner's insurance on the property, all homeowner's insurance is void 30 days after the homeowner no longer occupies the property or it is not occupied. If this applies, the borrower should contact his or her insurer and arrange to have the property insured under a different type of policy that will still insure the property against all losses without borrower occupancy and while vacant. In addition, if a vacant home has a pool and it is allowed to "go green," that is an environmental law infraction and can be cited by the authorities against the homeowner—even an absent one as long as he is still on title—as a crime.

#### NEW ARIZONA PRE-FORECLOSURE NOTICE REQUIRED:

H.B. 2626 became effective on July 28, 2010, and is now codified at A.R.S. § 33-807.01. The statute sets forth a new notice requirement in Arizona foreclosures. The requirement must be met prior to the non-judicial foreclosure of a principal residence, if a first deed of trust was recorded against the property on, or after, January 1, 2003 through December 31, 2008.

Specifically, the statute *requires a lender to attempt to contact a borrower in writing to explore options to avoid foreclosure*, at least thirty days before a notice of trustee's sale is recorded. In Arizona, the notice of trustee's sale initiates the non-judicial foreclosure process. The statute also requires that the lender maintain documentation of the notice in the credit file.

Although the statute clarifies that its requirements are not applicable to lenders "compliant with the United States Department of Treasury Home Affordable Modification Program," and other specific types of loans, the vagueness of the statute's notification requirements has encouraged the attorneys for the lenders to advise routine notification to try to avoid that as a borrower defense. If a lender sends a notice, the borrower might contest whether the notice was "sufficient," or whether the lender "maintained the notice in the credit file". If a lender fails to maintain "proper" documentation of the required notice in the credit file, the borrower may raise as an issue the lender's failure to identify a property as a borrower's principal residence, or a lender's failure to comply with HAMP.

The attorneys for the lenders are recommending that to comply with this notice the lender should adopt as minimum protocol the sending, via certified mail (return receipt requested), of a letter outlining the borrower's options to avoid the foreclosure of his home, including the name and phone number of the lender's or servicer's loss mitigation department. The letter should also request that the borrower contact that department for the express purpose of "exploring options to avoid foreclosure."

The attorneys for the lenders are also recommending that the above letter should be maintained in the credit file along with a certificate of compliance, similar to the one proposed in the House Engrossed Version of H.B. 2626 (the Senate Engrossed Version was adopted). A.R.S. § 33-807.01, et. seq.

You are entitled to this notice and to proof that it was sent. Moreover, you are entitled under the required notice to participate in the HAMP, HAFA and 2MP workout Programs according to the Program Guidelines and the lender does not have any discretion as to whether you will be given access to the Program if you are eligible. A just access to the Program is a pre-requisite for a foreclosure. Lender failures in these regards is a violation of state law and to the extent that state law is violated, the lender may be in additional violation of its own state and federal regulation, which prohibits the lender in general from violating state procedural and consumer protection laws.

#### **RENTS:**

If the property produces rents and a deposit and you as a landlord keep those without paying the mortgage on the property, you can be liable for that amount as "rent skimming," which can also be a crime. In addition, you could be liable to the tenant for multiple damages for taking their money and leaving them "high and dry" in a foreclosure. Recent state and federal legislation requires landlords (and the creditor) to notify a tenant of the pendency of a default or foreclosure in the underlying finance (the foreclosure notice is not itself the landlord's notice). Federal law requires the creditor to honor the term balance of an innocent tenant's lease or grant tenant an additional 90 days' occupancy after the foreclosure sale, whichever is longer. Lenders or buyers at foreclosure sales who are in violation can be claimed against for injunctive relief and damages. Landlord violations are treated as violations of the state residential Landlord-Tenant Act, exposing the landlord to damages claims.

#### **DUE ON SALE:**

Due on sale clauses are provisions in the debt instrument that attempt to prohibit any sale, assignment or in some cases even a change of occupancy of the property taking place without the lenders consent. These, when held by conventional lenders such as state chartered or federally chartered savings and loans and banks have been generally enforceable over the years as a result of legislation and court decision since 1982. The remedies for failing to get consent or even seeking it are generally a foreclosure action against the property. The creditor can get no greater remedy under that foreclosure than they would have had for a simple non-payment. Seller and buyers who plan upon going forth without obtaining such a consent should get counsel and at the very least should build into their agreements a "what happens then" allocation of duties between them to handle the lender, some of which might be that they defend or that one or the other gets new financing or the like. In the currently adverse economic environment, lenders do not appear to be attempting to enforce these clauses and appear generally glad that payments are even being made. In any such transaction, an escrow should be used to assure that payments remain current, taxes and insurance are collected and paid and that the buyer also becomes insured on the property. A clause that simply prohibits "assignment without permission" is NOT a due on sale clause and is harder to enforce. Often, the same clause also attempts to limit leasing or purchase options, though those clauses may be unenforceable in some instruments under the Garn Act. Read your debt instrument to see which applies.

#### **DEPOSITS:**

Deposit agreements or account agreements such as savings or checking or even brokerage accounts usually have a clause buried somewhere in the deposit agreement that states something to the effect that a "failure to pay any other debt due (the depository instruction) will allow the lender to sweep any depository account on file with the institution. Applied as an example, if one defaults on a trust deed with XYZ Bank and also has a savings and checking or brokerage account with XYZ Bank, the depositor can lose the entire account through such a "sweep"—often without further notice by XYZ Bank other than that it did the sweep. It is often advisable to remove such accounts prior to any delinquencies or defaults.

#### **HOAS AND OTHER LIENS:**

A deed back or modification does not usually relieve a borrower from accrued Homeowner Association liabilities and other dues associated with the property (though a deed-back can relieve the debtor of HOA liabilities AFTER the deed-back). In most cases, until the title actually passes to the creditor in a deed back or a foreclosure or to a buyer in a short sale, the HOA liability continues in the name of the original borrower, indefinitely. Until another party enters title, the HOA dues accrue against the one in title. Knowing this, in some cases, lenders are not foreclosing simply to continue

to make the homeowner liable under the HOA rules and not the lender. If the property is deeply underwater and likely unsalvageable by any of the Programs, sometimes it makes better sense to get the title back into the lender's hands as soon as possible to avoid liability for the accruing HOA dues. In a recent case, a debtor remained in his home and instead took a bankruptcy which attempted to discharge the HOA dues. The accrued amounts to the bankruptcy would under bankruptcy law be discharged as a personal debt, but remained a lien on the property, itself. But (the HOA sued for those accruing *after* the bankruptcy) since title was still in the borrower's name) and won in the trial court on the theory that after the bankruptcy, with the debtor still present, they start to accrue again and are new debts not affected by the past discharge. These dues and assessments can often be pursued by most HOAs and creditors as a separate debt not just against the property but personally against the borrower. The creditors may typically assign these debts to an attorney or agency for collection, sometimes long after the deed back or modification. In a short sale, these need to be taken care of in the deal and at closing to assure that they do not follow the debtor.

#### **PAYMENT OR COSTS INSURANCE:**

Some consumer debtors, either through their credit cards, their insurance obtained when they took out their loans or through unions or employers or other private ventures or insurance products, have a form of "payment insurance" or "disability" policy that will make mortgage or other debt payments for loss of job or income, disability, death, other causes. This is not the same as "mortgage insurance" which the lender obtains to cover any shortfalls in a foreclosure on your mortgage, but an entirely different product. If a borrower has such a policy, the borrower may wish or need to make a claim on it, as it may make some or all of the payments or have a fund that could assist them in living costs as part of its claims coverage. If the debtor unsure whether he has them, the debtor should make inquiries with the various vendors to determine whether they exist and if they do, make claims on them.

#### **IRS AND TAX RAMIFICATIONS:**

The Feds have determined some new IRS rules covering the taxability of losses from being forgiven a debt. Section 108 of the Code usually taxes debt that is forgiven, but it has some exceptions and has been changed by Congress for the current crises. Debt which has been forgiven by a modification, short sale, foreclosure or deed-in-lieu was at one time taxable under a formula set forth under IRC 108. Congress has suspended that for discharged debt under \$2 million from 2008 until 2012--this is the first time this has even happened and was not even suspended during the downturns of 1985-1991. If any losses are going to be realized, they ought to be before that date. Note: You do not get the moratorium protection unless you file a special form claiming it with the returns for the year you realized the loss. See IRS Publications for details on that calculation. In addition, it is not yet assured that the states will also allow that in its laws. Section 108 forgiveness does not include forgiveness for debts that were not used to purchase the home, such as a true HELOC. Non-deficiency debts are probably excused entirely under IRC 108, no matter what their classification. In addition, one is excused from "phantom gain" treatment under IRC 108 if they went bankrupt or were "insolvent" (as defined by the Code) at the time of the debt forgiveness. Check with the Federal Publications and the Revenue Department for the state you file taxes in. In addition, check with your CPA or Accountant about the limited ability to deduct losses associated with the property, such as long term capital losses. Section 108 "phantom income" will be reported to IRS through a 1099-A or 1099-C. However the creditor couches it can be contested on the debtor's final returns as being "mis-cast." IRS Form 982 must be filed to claim any relief from phantom income for which the taxpayer might be eligible, in addition to other normal tax offsets where that relief is not available. These rules, form numbers and other applications are subject to change and all payers should exclusively consult their CPA or Accountant for any applications or updates. If there is a deficiency judgment, there is no "phantom gain" if the lender pursues it so potentially section 108 does not even come into play and no "phantom gain" is realized.

#### **CASUALTY INSURANCE:**

If you do not occupy the premises or deed it back, this may void any casualty insurance you have on the property, since it may be a "homeowner's" type that requires continuous personal occupancy of the home. Arizona policies and supporting law provides that homeowner's insurance (personal occupancy) is void 30 days after the homeowners are continuously not in occupancy. Another type of insurance--more akin to the policy used when there are tenants--is more the type and if the

home is entirely vacant, there are only a few policies around that will continue to cover. This is important because of there was an uninsured loss before the lender took the property back (if it does) then the borrower could still be on the liability hook for "waste." The loan agreement specifies that the borrower will "keep the property insured" and that selection lands on the back of the borrower in most cases since only he actually knows the status (occupied, a tenant, unoccupied) of the site--not the lender. A policy of separate (and assure that it is correct type) insurance can be independently purchased with almost any casualty insurer when the premiums for the existing (and perhaps wrong type) policy are prepaid as part of the mortgage payment and the policy type is thus difficult to change. If insurance premiums are tied up in the mortgage payments and they are not being made, one must assure that the insurance policy has not lapsed as one works through a modification or a short sale. Again, without making the whole payment, the borrower can arrange a separate short-term coverage with almost any typical casualty insurer.

#### **DEED BACKS AND OTHER DEBT-MITIGATION PROGRAMS:**

Some debtors are sending the lenders their keys and deeds-in-lieu of foreclosure and inviting the lenders to immediately take over the property without the need for foreclosure or without working through any of the programs. In some cases, lenders accept these and take the property; in other cases, they do nothing. Lenders ARE NOT REQUIRED to take a deed and resolve measures cooperatively. They may very well ignore the borrower, send the deed back or keep it and continue with a foreclosure. If that occurs, then the borrower may need legal services to try to defend against any adverse parts of this process. The deed-back step--if the lender acts or fails to act in some way that operates to actually or constructively accept the deed-- can build additional defenses against later adverse lender or collection actions and this is especially an important alternative on those instruments in which a deficiency is possible. In addition, artfully drawn deed-backs can alleviate or completely offset any potential IRC Section 108 tax exposure and can even, by wording, settle potential waste and other claims and can sometimes give good grounds to contest any later adverse credit reporting over the non-payment. In deeds like that, it is strongly advised that the borrower have their own well-qualified real estate attorney draft them carefully and with special provisions and recitals that can accomplish some or all of these objectives and, above all, to assure that no deed is headed or titled "deed-in-lieu-of-foreclosure" as this heading stays in the county recorders records forever and gets picked up by credit reporters and is, in fact, not even a recital required to deed property to the lender. The lenders' own form deeds are not designed to do any of the above and in fact in most cases unnecessarily castigate the borrower as part of their format. **DO NOT SIGN THE LENDER'S DEED OR ATTEMPT TO DRAFT ONE YOURSELF WITHOUT LEGAL COUNSEL.**

#### **LICENSE FOR MORTGAGE MODIFICATIONS:**

Effectively in 2010, only licensed attorneys or licensed loan modification brokers or government-sponsored consultants will be able to do certain types of loan modifications without a separate, special license to do so in Arizona. Your real estate licensee can, however, engage these professionals or work with them to help you.

#### **NEW FTC RULES:**

The Federal Trade Commission ("FTC") has jurisdiction over most real estate lending through the interstate commerce clause of the U.S. Constitution and the federal regulation and insuring of lenders. These rules affect real estate brokers and sales licensees and they affect "work out" companies that are not necessarily real estate brokerages, but purport to assist in debt work-outs for real estate and other debts. The relevant FTC rules that may affect your transaction follow.

#### **FTC RULES REGARDING REAL ESTATE LICENSEES:**

The FTC has taken the position that a real estate broker or salesperson negotiating a short sale with a lender on behalf of the seller should comply with FTC's new Mortgage Assistance Relief Services Rule ("MARS"). MARS applies to any person that provides, offers to provide, or arranges for others to provide, any "mortgage assistance relief service." A "mortgage assistance relief service" includes any service, plan, or program, offered or provided in exchange for consideration to assist or attempt to assist the consumer with negotiating, obtaining or arranging a short sale (or other loan form of workout). The FTC has taken the position that a listing broker or salesperson cannot charge a seller a

non-refundable retainer fee in a short sale (and other modification) transaction. In addition, MARS requires that the real estate licensee make a number of disclosures for your protection, including both the substantive matters in this Advisory and the giving of the following Notices: Your real estate agent(s) or workout Company in this transaction advises you as follows:

- they are not associated with the government, and their services have not been "reviewed" or "approved" by the government or your lender;
- the lender may not agree to change your loan; and
- if you elect to stop paying your trust deed or mortgage other loan debt for any reason, whether because you are advised to do so by the agent or workout Company, elect on your own to do so, or simply because you cannot pay, you could lose your home and damage your credit rating.

#### **FTC RULES REGARDING MORTGAGE RELIEF COMPANIES:**

If this is a modification or a short sale for a fee with a brokerage or other entity that holds itself out as a Mortgage Relief Company (an "MRC"), which may or may not also be a real estate brokerage, you cannot be requested to pay an advance fee for the work; you only need to pay when the MRC has provided you with an offer from the lender or servicer that you find acceptable and the lender or servicer offer is contained in a written document from the lender or servicer describing the key changes to the mortgage that would result if the consumer accepts the offer. In addition, if this is a MRC, can stop doing business with the MRC at any time and can accept or reject any offer the MRC obtains from the lender or servicer, and, if you reject the offer, you do not have to pay the brokerage's or licensee's fee. The MRC also must disclose in advance the exact amount of the fee. The MARS Rule prohibits mortgage relief companies from making any false or misleading claims about their services, including claims about matters such as:

- the likelihood of consumers getting the results they seek;
- the company's affiliation with government or private entities;
- the consumer's payment and other mortgage obligations;
- the company's refund and cancellation policies;
- whether the company has performed the services it promised;
- whether the company will provide legal representation to consumers;
- the availability or cost of any alternative to for-profit mortgage assistance relief services;
- the amount of money a consumer will save by using their services; or
- the cost of the services.

In addition, the rule bars mortgage relief companies from telling consumers to stop communicating with their lenders or servicers. Companies also must have reliable evidence to back up any claims they make about the benefits, performance, or effectiveness of the services they provide.

#### **ACCORDINGLY, YOUR AGENT(S), MRC (IF APPLICABLE) AND LICENSEE(S) IN THIS TRANSACTION MAKE NO SUCH PROHIBITED REPRESENTATIONS REGARDING ANY OF THE FOREGOING MATTERS.**

If you are represented by a licensed attorney approaching these debt matters as part of your legal representation in legal issue on an hourly basis, these kind of relationships are exempt from the FTC rule. Even if the attorney is acting as or working with a MRC, most attorneys are excluded from this rule. All provisions became fully effective January 31, 2011. To review the MARS rule in full, go to <http://www.ftc.gov/opa/2010/11/mars.shtm>.

#### **CREDIT:**

In most deed backs, short sales or mortgage reductions, the lender will report an "adverse" on the debtor's credit reports and this could affect a debtor's ability to obtain additional credit, could have an effect on existing credit with his other vendors and could have affects on insurance, employment, licensure, security clearances and the like, most of which require or prefer a "clean financial record." In addition, there is no certainty about how delinquencies in payments,

work-outs, modifications, short-sales, deed backs or foreclosures or even bankruptcy will impact future credit capabilities or eligibilities except to say that it is highly likely they will impair them and that the impairment might be related to even the type of action or inaction (modification through bankruptcy, above) that the debtor elects to pursue. Most lenders indicate that they will "reward" the debtor that cooperates with the lender's programs (such as by not reporting the cooperating debtor with "as poor" of credit rating as it could—the key word here being "as poor," but it will still be reported as poorer than it began as). These programs have not been in operation long enough to know whether they have made any difference to the borrower's ability to obtain new credit at all. For most, it cooperation has made no immediate new credit difference over non-cooperation and a "D" on the credit report card for an approved short sale has shown no proven greater "advantage" over the "F" that is given by a foreclosure. Some lenders or underwriters have stated that they will not "black ball" the cooperating borrower "as long as they would otherwise" if that borrower cooperates and ever comes back to that lender. But the initial default even for the cooperative debtor still generates a "back ball" for what is often a considerable period of time. Moreover, it has recently come into question whether the primary underwriters who are offering these "limited black ball" programs (Fannie Mae and Freddie Mac) will even be in existence to honor them once the black ball is over. The best policy when there is to be an unavoidable black mark on one's credit is to get it behind one as soon as possible so that the "healing time" for credit to improve afterwards can start.

#### **IMMIGRATION STATUS:**

Some borrowers may be in the US on a given immigration status or condition which could be adversely affected by an alleged failure to maintain financial integrity. If this does or might apply, the borrower needs to contact INS, directly, to determine how the financial status change is viewed in the event you have adverse financial issues occur in the US.

**Even current status may be difficult to rely on in a time such as the present when immigration appears to be in flux and in the process of legal discouragement.**

#### **A SHORT GENERAL DISCUSSION OF CREDIT CONSEQUENCES:**

A good credit rating is an important commodity in this society. It takes a long time to build a good one and only a short time to create a bad one. With computerized credit reporting systems, as well, no act creating bad credit is ever entirely "in the dark," i.e. a credit reporting system will probably pick it up in some way. A give-back of property when it has lost financial sense or when financially unable to pay because of business reversals is not the kind of act that is typically earmarked as the worst form of credit abuse—such as bankruptcy or lawsuits resulting in adverse judgments—but it is an act that, if ever reported to a general reporting system, could result in a serious mark against credit. If one's credit rating is already poor, it could make it poorer; if one's credit history is unblemished, it would be a blemish.

A property give-back is not a matter of more conspicuous public record however; it is therefore hard for credit reporters to pick up, unless the person to whom the property is given up is already a member of a reporting group. Typically, governmental or conventional or larger-scale lenders are members of such a group and so are even smaller ones in some cases. A reporting group regularly transmits into a credit-reporting circuit information it has concerning any debtor dealing with it. In this way all adverse credit information (including property givebacks or repossessions) is automatically "dumped" into the mainstream of credit information available to the creditor group. The more usual way such a give-back is determined by creditors who are not members of a reporting group or when the creditor to whom the property was returned is not a contributor to the reporting circuit is that the debtor, himself, is caused to report it, i.e. the debtor may someday encounter a credit application that asks "...have you ever defaulted on a debt, paid off a debt for less than what was due or given up property in lieu of foreclosure.(?)..." or something like this. In the event the write-down or write-off of the debt was a "dispute settlement" in which the debtor released his claims against the creditor in par return for the creditor's release of claims against the debtor, this would not be forfeiture in lieu of foreclosure or a tax-subject modification or even a credit adverse. The debtor will wish to consult an attorney if they think you have issues like this. Under the Fair Credit Reporting Acts it is possible—should a debtor disagree with the credit report being issued about him—to demand that all reports carry a statement of explanation or protest from the debtor or his lawyer of up to 100 words in length. It is provided by law in most cases that this statement is to accompany not only the original report but all those taken from the circuit by others.

If a conventional deed-back of the property (one typically headed "deed-in-lieu-of-foreclosure") is filed with the county recorder or is reported to the credit reporting system by the creditor, it will normally result in an extremely poor credit rating—one usually only slightly better than a judgment or a foreclosure. Usually, the delinquency on the original debt will also show on these reports. See however the remarks made under other headings, above.

Credit is not typically reported (for consumers) on the tri-merge and credit rating as a "FICO" score. FICO is now under considerable critique as a result of allegedly "mis-calling" the last crash of borrowers. The authors of FICO are now working on another formula, the market is being told. That remains to be seen. Experian, formerly only a credit-entry reporter is now developing an entirely new credit-rating module that may tend to understate a past short sale or foreclosure (making a financial assumption that the off-loading of pre-existing underwater assets and debt by the borrower improves present actual paying power) more than FICO currently does. In addition, Experian, a traditional credit reporter, is now developing its own credit rating system in an attempt to replace FICO, which has fallen into question as a reliable predictor of credit conduct. Under the Experian credit analyses, a different and possibly "better" rating entirely might be had in the future by the same borrower.

More about cooperating with lenders in a default situation: As noted, above, there is some information out in the marketplace that lenders may still re-lend in the future on a more "easy scale" if one does a cooperative work-out such as a short sale than if one allows a foreclosure. This is a factor with some of the government-owned programs like Fannie Mae, Freddie Mac and FHA, but generally there is no law that REQUIRES a lender to loan to anyone who is not found an acceptable credit risk under that lender's proprietary standards and resale proforma. The lifting of a new "credit black ball" does not mean that one is guaranteed a new loan at that time. At a time when down payments are also increasing and other credit standards such as ratios between income and allowable debt are also tightening, aside from the fact that these distinctions may mean little to anyone, it is very likely that none of these distinctions will make that much difference in the long run if the debtor is not substantially more generally creditworthy in the future than they are today. There are current rules (always subject to change) that will disqualify a borrower from applying for certain types of loans depending upon what type of loan they defaulted on, such as Fannie Mae which has a rule now in place (October, 2009) that states that a person who allows their primary home to be foreclosed (as opposed to short sale) will not be eligible for more Fannie Mae credit (note that it does not say "will get if you follow the rule," but rather be "eligible") for 5 years thereafter as opposed to 2 years for a short sale. It is 7 years for an investor who allows a foreclosure as opposed to a short sale. FHA's recent rule is that a debtor can be liable for a new FHA loan as early as 1 year after a short-sale or other disposition if the HAMP and HAFA steps were followed and all other debts were kept current. Again, this may not mean much as these rules are constantly changing and "eligibility" is not the same as otherwise qualifying for the loan. Moreover, if these government-owned entities are dissolved or sold back into unguaranteed private hands, it is likely that even these rules would become either moot or again be changed. The best analyses of the credit issue it to say "any adverse credit remark will hurt." Sometimes, though, to "dig out to a better place," the adverse credit marks are a transitional cost of "getting well". And only after suffering them and putting them behind one does the "cure" of credit rehabilitation start.

#### **WORKOUT OR A BANKRUPTCY?:**

Some consumers are so "under water" not just with their home loans, but also with auto loans, other consumer liens of credit and credit cards that a residential short sale may not be the answer. The "real answer" in that case may be a more radical approach to the financial issues such as staying in the home and engaging in an a formal and all-encompassing consumer credit counseling or even considering a Chapter 7 bankruptcy or Chapters 13 or 11 reorganization. In most cases, if the consumer is willing to reaffirm the home loan in the bankruptcy, with an experienced lawyer he will keep the home and discharge most or all of the other creditors. Many times, even full-deficiency second loans can also be negotiated out for no or a small payoff in bankruptcy. This is not a matter of HAMP, HAFA or 2MP which will usually retreat in a bankruptcy—it is rather the realities and use of a "constructive" bankruptcy. For the salvageable, it can often get more for the debtor than these federal programs can. It also leaves the consumer more able to make the home payments after the bankruptcy of the other debts and the consumer is also free, on the other side of bankruptcy, to start negotiation with the home loan lender to reduce that loan, too. In some cases, where investment property is involved (which includes residences that are held out as rentals and not occupied by the debtor), the debtor may be eligible in a bankruptcy for a "cram down" remedy that would reduce secured debt to manageable levels that a modification or a short

sale would never accomplish. These are not available, though, for a personal family home in which the debtor resides. All of this needs to be considered BEFORE the decision to close a modification, short sale or other workout that has the consumer leaving the home, as otherwise it could very well be the last home the consumer will have for many years and if the other debts are not discharged first, no workout on the home will be affordable as long as there are other massive consumer loans that take away all of the money to pay even a reduced amount and which continue to haunt the debtor even after the debtor loses his home.

#### **ARBITRATION OF DISPUTES:**

Many loan agreement and notes generated during the last 7-10 years contain arbitration clauses that can sometimes extend to prohibiting foreclosure or adverse actions against a borrower except through arbitration (not a lawsuit). This means that the lender who threatens to file a lawsuit on an instrument containing these clauses and, in some cases, one who tries to foreclose without first going to arbitration—a much more cumbersome process—is violating it's own agreement. It also means that loan modification or short-sale disputes could be filed in a relatively more peaceful arbitration than in litigation and, perhaps, get solved more readily than the "stalemate" when a Bank refuses to budge on a modification or a short sale. Rather than argue back and forth with the lender, one can initiate mandatory arbitration and request that all further adverse lender action be stayed during it. You may wish to check your documents to see if you have these kind as they can streamline dispute resolution on all levels.

#### **CONTACTS WITH REGULATORS FOR WRONGFUL LENDER PRACTICES:**

If you feel that you have a bonafide dispute with a lender, you can report that lender to the state Attorney General, Consumer Protection Division, (for federal savings and loans) to the Office of Thrift Management, (for federal banks) to the Office of the Comptroller of the Currency and, as to state thrifts, to the Department of Financial Institutions. As to consumer complaints, you can lodge them not only there but with the FDIC and with the Federal Trade Commission. All of these resources are on-line. Google for them.

#### **STRATEGIC DEFAULT AND "WALK-AWAYS":**

A "strategic default" or a "buy and bail" is a process where a debtor keeps up payments on an existing (underwater with more debt than value) home long enough to buy another home at the current low loan rates and low purchase prices, then, after move-in to the new home, the debtor lets the house payments on the former home lapse and go into default, making now just the payments on the new home, keeping it and bettering his overall asset and payment position and, after several years of on-time payment, also acting to restore his credit. This method works best where, as in Arizona, most home purchase money loans (where all of the loan proceeds went into buying the property) have no deficiency so that the foreclosure of the old home generates no further financial risk to the debtor—such as a deficiency judgment against the debtor for any foreclosure sale proceeds shortfalls to meet the unpaid debt. These are not as effective in those states which permit deficiency judgments, but can still be partially effective with a few more steps not relevant for this article.

Here is the current status of this process in Arizona and in many states, but after Arizona you need to check state-by-state: As to the old debt, it is no crime to be unable or unwilling to pay it. It is just a debt default and will have the above adverse credit and other consequences. But if a mis-statement is made on the loan applications to qualify for the new home, it could be a form of fraud on the new creditor (except for the fact, of course, that the borrower INTENDS TO PAY the new one—just not the old one). Some argue that unless it prejudices payment to the new creditor, it is a "no harm, no foul" step against that lender.

The issue, if any, would have to be some mis-statement made in the application for the new loan, so let's examine that question. Obviously, one's credit underwriting for the new loan will have its own standards, will have designed the loan application and all of the questions on it that it deems material, will have its own access to the tri-merge to verify the borrower's history, to the borrower's FICO scores for creditworthiness and a financial statement from the borrower and will verify everything the borrower says and if the underwriting approves the loan it will be because the borrower has met or exceeded all these criterion. Assuming every question in the application was answered truthfully, then the only alleged

"misrepresentation" about considering a default on the old home—even though it is then current—is "secretly considering it", even when it has not happened yet, is not even sure of happening yet and no question about that was asked by the lender. Is the consideration of a future option that has not happened yet and which will not affect the new lender—the one that is intended from the beginning to be paid in full—in the least a "fraud?" The reality is that as long as the new lender is paid promptly and reliably, the issue rarely comes up as there is no reason to examine a loan in good stead and it is to the new lender and loan application process that any duties are owed. And the notion that one might default it is not a violation of the former loan applications—the one for the old home left behind—since those applications were completed and signed long ago when that home was obtained and are not now relevant. The reality is that if you are paying the new lender—the one the application was made for—they are happy as a clam and would be the last one to give you any troubles.

There is a federal statute and a state statute in Arizona that bars "untruthful statements" on residential loan applications and processes (whether by lender or borrower) and makes the practice a felony but those are for affirmative misrepresentations, such as falsely answering a direct question. They do not seem to apply when no question asked is falsely answered, as noted above. At this time there is no credit application that states "do you ever intend to default or believe you might default on now existing debts at some point in the future(?" to which, aside from being a fairly bizarre hypothetical credit applications question, a false answer could even be given, so the clear application of these laws to a directly false answer to a direct question has factually never come about. Thus, these laws have not been applied at this time to a strategic default in any known Arizona case. Most lenders have their own underwriting standard and own documents for qualifying the borrower to be buying two homes at once. If that is met by the borrower and the documents are completed without any mis-statement in them, it is difficult to see any clear violations of statute.

As to the borrowers, most of these statutes were to curb "liar loans" where debtors vastly overstated their income and assets to the next lender to get the loan—not ones where all questions were answered truthfully at the time and a default came about years later. It is likely that some lending regulations or some new type of loan application addendum will be passed on this practice at some point, but as of January 1, 2011 there were none known. Always check with an attorney to determine the status of these rules, laws and regulations, as they constantly change.

For those citizens who are completely underwater on their current loans, know that no matter how much they pay, the gap between value and the debt is just too large to ever see daylight, who realize that the Banks are NOT going to modify the loan permanently and down to an amount low enough to close the gap, and who still have credit strong enough to qualify for a new home purchase, the strategic default could be a survival option. *But this step is serious business, still has other tax, employment and credit ramifications as noted in this Disclosure and for that reason never opt for one without extensive legal consultation.*

#### **OTHER RAMIFICATIONS:**

Some employers and employment has rigorous expectations for credit rating maintenance. Bad credit can affect the debtor in those places. For instance, if the debtor is a peace officer, military officer, security officer or clergy good credit maintenance is considered part of his or her duties and a "waiver" can only be obtained by advance application with a superior, if one is granted at all. Some have security clearances with employers, such as the high tech and computer industries, who consider credit rating a mark of risk level for industrial or national espionage and a bad credit rating could affect that. Credit card vendors are starting to "freelance scan" credit scores and may raise rates, close cards or curtain limits duties to adverse credit marks, even if you have paid the cards on time. Insurance companies rate your insurance risks based upon your credit reports. Persons with certain licenses such as real estate, securities, insurance, law or medicine might have employment or licensure adversely affected by a checkered credit score. Some religious groups consider it reprehensible not to pay debts or to incur more debt than one can pay and can sanction those who do so. A checkered financial past can disqualify a debtor from some public posts and is always a matter of disrepute. These are all "hidden" elements of failing to keep loans current or taking "hardship" workouts on them.

#### **LEGAL CHANGES:**

Remember that the laws are always changing and you will need to stay abreast. Everything noted above could be in change now or in the future. Unless you have an ongoing employment contract with an attorney on your obligations or rights, you may not learn of these. Thus, never take any steps (including election to be inactive, which is a step of itself) in reliance on the above rules still being effective until and unless you re-consult with properly licensed counsel. Congress, the states and the lenders have recently enacted many rules and laws that could change the rights your creditor is willing or required to give you. There are many new programs that are designed to assist you. These are not set forth here and should be sought from either or both the creditors and your real estate counselors.

#### **OTHER PROGRAMS:**

It will be assumed that you have elected to forego other rehabilitative programs if you elect a particular one such as a short sale, modification or a deed backs and your real estate licensees will try to abide by your election. It is always possible during these times, as well, that a better program may come about and you would be ineligible for it because of whatever steps you have taken now. This is your election and also your own risk. In addition, of course, it is you that has to feel comfortable with the election to take the steps you have directed, as the real estate licensee cannot render appraisal, investment or financial or financial planning advice except to assure that you get a competent explanation of the basic legal ramifications of documents and your elected steps. Other programs could come, a better economy could dawn, laws about the debt instruments above or otherwise can change and all of these could play out for or against the ultimate wisdom of your selection of legal and financial courses from here. The important point here is that what you do now and what you instruct your real estate licensee or lawyer to do to do for you is about your life and how you wish to conduct it and has to your call, alone.

#### **YOUR REAL ESTATE LICENSEE:**

Despite what you may have heard about workout programs, they are not fast, sure, nor easy. As you may have seen in the press recently, for the most part they have been failures for many applicants (possibly because they did not know the information contained in this advisory) and now the federal government and many states' Attorneys Generals are suing the lending industry for the excesses noted above and for many more. *This point is noted because you need to know that your real estate licensee can work very hard and competently to get your workout program in front of a lender and still through not fault of his own or your fault have a tough time getting it through or fail, entirely.* Not because the licensee is not skilled enough, but because the lenders are still very, very resistant to these workout programs and in many instances have actually and intentionally become obstacles to them. Your licensee has to work extremely hard to position your workout proposal and many times, despite all competent attempts and a lot of work, the lender will not accept the plan, offers an onerous and unacceptable counter-plan or simply ignores the application altogether. This is rarely the failure of the licensee. It is the failure of the flawed and uncooperative banking and resolution system. Have patience, but also have no false hopes. Whether a "workable" deal comes about despite the highest and best effort is often a "crap-shoot".

#### **SEE LAWYER AND ACCOUNTANT:**

For a better explanation of the above rules and to determine whether they apply to the given property, debt or debtor, the above person is advised to consult with an attorney and an accountant. **THOUGH GENERALLY KNOWLEDGEABLE ABOUT THESE MATTERS AS A MATTER OF EDUCATION, REAL ESTATE LICENSEES ARE NOT AUTHORIZED TO GIVE LEGAL, TAX OR ACCOUNTING ADVICE TO YOU.**

**THIS ADVISORY WAS WRITTEN BASED UPON THE LAW AS IT WAS ON JANUARY 1, 2011. IT IS SUBJECT TO CHANGE AND THOSE CHANGES MAY NOT BE REFLECTED IN THIS ADVISORY. THIS ADVISORY IN GENERAL IN NATURE, YET EVERY CASE IS UNIQUE AND SO IS THE ADVICE THAT MIGHT BE GIVEN ON YOUR SET OF OBLIGATIONS, FACTS AND FINANCIAL STATUS. YOU WILL NEED TO SEEK ADDITIONAL INFORMATION OR ADVICE FOR ANY CHANGES OR OTHERWISE FROM AN ATTORNEY OR ACCOUNTANT**