

Junior Lienholders

The junior lien holder in a short sale and trustee sale receives little or nothing. If the first mortgage is underwater, which is the case with most clients, the second has to fight for a few crumbs. In a short sale, \$3000 seems to be the most common amount permitted by the first lien holder to be paid to the second. There is no magic about this amount. It just seems to be widely accepted. Sometimes the first will allow a percentage of the debt. For example, if the second lien is \$48,000, the first may allow 10% or \$4800. Each lender handles this slightly differently. And each investor, regardless of lender, has the final say.

The goal is always to get both lenders to agree to forgive any deficiency, regardless of how much the second lien holder receives as a result of the short sale. If the leverage of the Arizona anti deficiency statute is not available, this can be tricky. When a second lien is used to purchase the property, the lender cannot pursue the deficiency after a trustee sale. Even though our statute is silent as to short sales, the lender can be gently reminded that they will receive nothing if the property proceeds to trustee sale. They will also be reminded that they cannot pursue a debtor for any deficiency balance. Does this tactic succeed? Only sometimes.

In cases where the second was obtained after the purchase of the property, it is not in the lender's best interest to forgive the debt. In this instance, the debtor can negotiate a cash contribution or promissory note. The debtor can also wait to see if the lender pursues him after the close of escrow of the short sale. This assumes that the second lien holder is willing to release the lien so the debtor can transfer title. Without this, the transaction cannot close.

It is not uncommon for the second to charge off the debt, and pursue the debtor, before the short sale approval or before the trustee sale. In the case of the trustee sale, the second is usually, in reality, an unsecured debt. There will be no money left over to pay the second. As a result, the second is not limited by the 90 day requirement to pursue. They have up to six years. As a practical matter, many times the second lien holder is not pursuing the debt after trustee sale. There are two reasons for this. Some don't understand our anti deficiency statute and don't think they can legally pursue. Others are waiting until better economic times. They figure if they wait, the debtor may be in a better position to pay. After all, they have up to six years.

When the debt is charged off to a collection company, it is difficult to get them to stop collection efforts. This is the case even if the second is a purchase money second and the property has been sold at trustee sale. Since Arizona law prohibits the lender from suing on the debt, how can the lender use other means to collect? The lender leaves the amount owed on the credit report as a collectable debt and this effects the debtor's ability to borrow in

the future. It is difficult, if not impossible, to get in contact with the company's legal department to explain the situation. Sometimes the only recourse, it to sue. That is time consuming and expensive. Most clients cannot afford to do this.

As with other aspects of our current real estate market, we are constantly adapting to lender guidelines, government regulation, and uneven application of both. It is a lesson in the art of patience. I look forward to the day when I know what information is required and how it will be interpreted. In the meantime, I am learning to adapt and respond to the unpredictable environment that has become my reality.