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Real Estate

House Lawyer: New federal loan guidelines ease the sting of ‘zombie foreclosures’



By **Harvey S. Jacobs** September 26

Homeowners who have been discharged in bankruptcy and who have “lost” their home to a foreclosure can now get back in the home-buying game in as little as two years, thanks to new Fannie Mae waiting period guidelines.

Before suffering through major derogatory credit events like bankruptcy, foreclosure, short sale or deed in lieu of foreclosure, you should know how long those events will adversely impact your ability to get back into the mortgage market. Fannie Mae and Freddie Mac have established waiting periods. For example, previous Fannie Mae and Freddie Mac guidelines required a borrower to wait four years after a Chapter 7 or 11 bankruptcy and seven years after a foreclosure to become eligible to borrow money on Fannie Mae/Freddie Mac conforming loan terms.

But problems arose with those guidelines, said William Rozek, a loan officer with Embrace Home Loans in Rockville, “when a borrower had his loan debt discharged in bankruptcy

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but, nevertheless, also had his property foreclosed upon in a ‘zombie foreclosure.’”

Zombie foreclosures occur when a lender goes through all the motions of foreclosing on a property, but fails to take the final step of recording the foreclosure trustee’s deed that transfers legal title from the borrower to the foreclosing lender. These zombie foreclosures severely disadvantage a borrower because his seven-year waiting period never starts.

The new guidelines allow a lender to apply the bankruptcy waiting period even when a zombie foreclosure exists. Borrowers can now get back in the home-buying game in as little as two years, Rozek said, “so long as I can document their extenuating circumstances that their loan debt was discharged in the bankruptcy, that the bankruptcy and foreclosure are disclosed on their new loan application and appear on their credit report.”

Current waiting periods without extenuating circumstances are as follows:

- Bankruptcy Chapter 7 or 11: four years.
- Bankruptcy Chapter 13: two years from discharge date or four years from last dismissal date.
- Multiple bankruptcy filings: five years if more than one filing in past seven years.
- Foreclosure: seven years.
- Deed in lieu, short sale, charge-off: four years.

The waiting periods also vary depending upon whether there are extenuating circumstances. Fannie Mae defines “extenuating circumstances” as nonrecurring events that are beyond the borrower’s control that result in a sudden, significant and prolonged reduction in income or a catastrophic increase in financial obligations.

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Borrowers should be prepared to provide their loan officer with an “extenuating circumstances letter” explaining why they had no reasonable alternatives other than to default on their financial obligations. The letter should reference and attach supporting documentation. Examples of acceptable documentation include: divorce decrees, medical reports or bills, notice of job layoff, job severance papers, and documents that explain why the borrowers were unable to resolve their financial problems.

Current waiting periods with extenuating circumstances are as follows:

- Bankruptcy Chapter 7 or 11: two years.
- Bankruptcy Chapter 13: two years from discharge date or two years from last dismissal date.
- Multiple bankruptcy filings: three years from most recent dismissal.
- Foreclosure: three years.
- Deed in lieu, short sale, charge-off: two years.

But why would a lender not want to get title to the property as soon as possible? There are several reasons. Once a lender is in title, it becomes liable for taxes, insurance, utilities, condo and HOA fees, and assessments. It also can become legally responsible for any damages that arise from the vacant property.

The lender must also assume the obligations of an owner, such as snow removal, lawn cutting and keeping the property from becoming blighted or a neighborhood nuisance. Often lenders record their trustee’s deed only after they have procured a new buyer for the property and then they record their trustee’s deed immediately before deeding the property

to the new buyer.

But that can take months or even years. This tawdry practice not only leaves the original owner in limbo (and personally responsible for mounting condo or HOA fees) but also causes the official land and court records to be less than accurate.

There is no legal requirement that the lender record its deeds after it has foreclosed. Local jurisdictions surcharge deeds that are not recorded within 30 days of the date they are notarized, but these minor charges are apparently not enough of a disincentive.

It would appear that legislative action requiring the prompt recordation of a trustee's deed, after auction, within a reasonable period, would alleviate the uncertainty that these zombie foreclosures inject into an already shaky system.

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