The feds are gearing up to pursue homeowners who lost their houses but still owe money to their lenders

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For Jose Santos Benavides, the ordeal of losing his home was over.

The Salvadoran immigrant had worked for years as a self-employed landscaper to make a $15,000 down payment on a four-bedroom house in Rockville. He had achieved a portion of the American dream, earning nearly six figures.

Then the economy soured, and lean paychecks turned into late mortgage payments. On Aug. 20, 2008, one year after he bought his dream home for $469,000, the bank's threat to take his house became real via a letter in the mail. Just four days before the bank seized the property, he moved out, along with his wife and their two young children.

That wasn't the worst of it.

In November, more than three years after the foreclosure, he was stunned to learn he still owed $115,000 — with the interest alone growing at a rate high enough to lease a luxury car.

"I'm scared, you know," Benavides said. "I can't pay."

The 42-year-old is among the many homeowners being taken to court by their lenders long after their houses were taken in foreclosure. Lenders are filing new motions in old foreclosure lawsuits and hiring debt collectors to pursue leftover debt, plus court fees, attorneys' fees and tens of thousands in interest that had been accruing for years.

It's an aftershock of the foreclosure crisis, and most homeowners don't know it's coming.

"When people take out a loan, they generally think the home is the security for the loan," said Alys Cohen, an attorney in the Washington office of the National Consumer Law Center. When they no longer have that home, "people don't expect that debt to follow them," she said.

It's all part of a legal process known as a "deficiency judgment," which is allowed in the District and 40 of 50 states, including Maryland and Virginia. Since the start of the mortgage meltdown of 2008, at least 400 Maryland homeowners have been pursued in court, according to a
Washington Post analysis of state court data. In the first four months of this year, 57 new court actions have been filed against homeowners — on pace to exceed last year's total of 120.

It works like this: A property with a $500,000 mortgage might be worth only $300,000 following the housing crisis. The $200,000 difference, or what's commonly referred to as the "underwater amount," is known to lenders as a deficiency balance.

It's unclear how many people walk away from homes when they can still afford to pay the mortgage. Likewise, there is little publicly available data on how many people pay off their deficiency judgments. A recent government audit found the recovery rate at one-fifth of 1 percent. But for those hit with the judgments, it can seem like double-dipping on their pain.

"Deficiency judgments are absolutely devastating to the foreclosed home buyer both as a matter of immediate financial impact and income tax consequence," said John Mixon, a recently retired professor at the University of Houston Law Center who has studied deficiency judgments for the past 30 years.

Among the lenders pursuing the judgments are Fannie Mae and Freddie Mac, the two quasi-governmental lending agencies that have long strived to open up home ownership to a wider segment of the population. Officials at those agencies said the judgments are necessary to recoup money lost in the crisis.

"Pursuing deficiency judgments has always been a remedy that we have looked at to mitigate our losses prior to the recent housing crash," said Freddie Mac spokesman Brad German. "It is not a new thing."

German said Freddie Mac is targeting "strategic defaulters," which the agency defines as "someone who had the means but chose to go into default, that there were no extenuating circumstances that affected their ability to pay. If you're choosing not to pay off your mortgage, but you're paying other bills, we would consider that strategic default."

In 2011, Fannie and Freddie flagged 12 percent of 298,327 properties they had foreclosed on — more than 35,000 — for deficiency judgments in an attempt to collect $2.1 billion in unpaid mortgage debt, according to an inspector general's report released in October from the Federal Housing Finance Agency.

"Pursuing these collections against borrowers we believe have the ability to pay but who have decided not to helps us minimize our losses, which in turn helps minimize taxpayer losses," said Malloy Evans, an attorney and Fannie Mae's vice president for default management. "And we think it's our responsibility to try to minimize those taxpayers' losses as much as we can."
Robert Van Order, who was a chief economist for Freddie Mac from 1987 to 2002, said he did not believe that targeting deficiencies would produce much revenue.

"That may be a good business decision, but I don't think that's a huge part of the market," Van Order said. "Is it worthwhile to hire some lawyers and some people to try to do it? It might be, but it's not going to make or break the companies."

"Deficiencies are less lucrative than some other types of debt recovery work. They tend to be larger and more complicated and more paperwork-intensive than, say, a medical or credit card bill," said Michael J. Cramer, president of Dyck-O'Neal, a Texas-based firm that has been collecting deficiencies for 25 years. "However, deficiency recovery represents an important facet of the debt recovery industry."

Fannie is also pursuing defaulting homeowners as a "deterrent" for people who might be thinking about defaulting in the future, Van Order said. Fannie Mae has hired debt collectors to pursue people in 38 states and the District, while Freddie Mac has taken homeowners to court in 17 states and the District.

Banks and lenders have rarely resorted to pursuing people for remaining debt once the home was taken. Before 2008, since property values were consistently increasing, the value of the home usually covered the mortgage amount, and lenders could make their money back by reselling the properties.

Van Order said the agency did not pursue homeowners very often for deficiencies during his tenure.

But the mortgage meltdown changed the equation.

Suing people immediately after foreclosure was problematic. For one thing, lenders usually could not get more money out of already broke homeowners. But, if lenders waited a few years, some forecast that people would have money again once the economy recovered.

The irony is not lost on Evan Goitein, a Bethesda-based foreclosure attorney.

"There is very little to be gained from the bank's perspective to be suing people for the money at this point," Goitein said. "While deficiency judgments are not really a problem right now, I can see it being a big problem in the future. So seven years from now when my client has recovered from his foreclosure, he's got a job again, he's saved up enough money . . . [from the bank's perspective], that would be a great time for the bank to try to sue them."

People are usually shocked when that happens, even though mortgage documents state that lenders are entitled to immediately recover the full loan amount upon default. Mixon said ordinary people often do not realize what is contained in the arcane legal language. "The thing that looks like it's protecting them is biting them," he said.
Benavides and his family had been living in a cramped, two-bedroom Besley Court apartment for four years when the process server handed him a document stating that collectors were coming after him over the debt on his old house. He had 30 days to respond.

"He tells me, 'You have to go to court,' " Benavides said. "I was just scared."

The notice spelled out that he owed $95,500 from the $375,200 mortgage, plus at least $21,000 in unpaid interest. The letter said the interest on the debt was $19 a day, roughly $577 a month. And the clock had been running for more than three years.

Benavides tried to call his original lender, Lehman Brothers, but it had filed for bankruptcy before being acquired by Barclays. He called one of the attorneys in the suit. He called the process server listed on the summons. Finally, he called a bank, and it said there was nothing that could be done, he said. Freddie Mac, which declined to comment on his case, had backed Benavides's loan, but for $1 assigned the note to Dyck-O'Neal.

Five days before Christmas, he filed for bankruptcy.

A long window for lenders

Lenders have an opportunity to forgive the deficiency. Most do so, either through a short sale before foreclosure, in which the lenders agree to accept an amount of money from a home sale that falls short of the mortgage, or through a "deed in lieu," in which the homeowner merely gives up the deed to the house in order to get out quickly.

But even then, homeowners can be stuck with paying state and federal tax on what the bank has forgiven. The Mortgage Forgiveness Debt Relief Act waived taxes on that debt until 2012. That relief was extended until December, but the act doesn't exempt homeowners from state tax, and it's uncertain whether the federal relief will be extended again. Most states forgive the taxes, said Annapolis bankruptcy lawyer Tate Russack.

States have different statutes of limitation on how long they allow lenders to pursue deficiency judgments, ranging from 30 days to 20 years. In Kansas, a deficiency judgment must be sought at the time of foreclosure. If a judge feels the bid at foreclosure sale isn't "fair value," the judge can deny or reduce the judgment.

In Maryland, it's three years. However, there's a little-known exemption for most mortgage documents that gives debt collectors 12 years to sue homeowners, plus another 12 years to collect the debt and on top of that a one-time renewal of 12 years for a total of 36 years.
"That's 36 years that lenders have to go after people," said Russack, whose firm has taken on 80 bankruptcy cases in the past four months, all of which involve deficiency judgments.

The rate of deficiency judgments has increased sharply in Maryland in recent years, The Post's analysis shows.

In 2006, the owners of 19 properties in Maryland were ordered to pay their deficiencies totaling at least $432,115. Six years later, the owners of 120 properties were pursued for $13.6 million.

Since 2008, a majority of the cases pursued were in Prince George's County, with Baltimore City and Montgomery County coming in at a close second and third. Those three jurisdictions had more homeowners taken to court than the state's other 21 counties combined. Those three jurisdictions also represented nearly $3 of every $4 sought by lenders and debt collectors, which totaled $45 million among all counties.

In Prince George's, one homeowner was hit with a judgment of $577,000, another with $563,000. All told, the median judgment for Prince George's homeowners was $98,000 — $10,000 more than the statewide median of $88,000.

"It is a problem of monumental proportions," Russack said.

Rep. Elijah E. Cummings (D-Md.), who in the past has been a defendant in foreclosure filings on his personal home, said he supports deficiency judgment reform.

"I strongly support policies and aid initiatives that will minimize or even waive deficiency judgments against borrowers to help ensure that such judgments do not compound the harms borrowers have already suffered," he said.

Already-foreclosed homeowners won't know that they're being targeted until they receive the court notice. In many cases, it is hard to even know who owns the debt until the notice arrives. Often times, the entity pursuing the debt is not the original lender, because that debt can be sold by the homeowner's lender to someone on the secondary debt market for pennies on the dollar. Most of the deficiency cases that Goitein said he sees involve smaller banks.

Because the debt is old, accruing interest becomes a major cost to homeowners.

According to The Post's analysis, the median interest rate in Maryland was $10 a day, $310 a month. One Germantown woman was charged $40 a day, or $46,000 in total, for what was originally a $136,000 deficiency on a four-year-old foreclosure case.

A Montgomery County Circuit Court spokeswoman said courts do not decide the amount of interest to be charged. The post-judgment interest is governed by state statute, she said, which mandates a minimum of 10 percent interest per year, according to the statute.
Once a judgment is entered, it sticks with the homeowner until it is paid off. In Maryland, it is filed with the land record in the county where the homeowner lives and follows him each time he moves. A lien is then attached to whatever future real estate the homeowner purchases and prevents the homeowner from selling that new property until the deficiency is paid off, Russack said.

In most cases, the only way out of a deficiency judgment is by filing for Chapter 7 bankruptcy. But because of the Bankruptcy Reform Act of 2005, that's only available to people earning no more than the state's median family income by family size, which is $108,915 for a family of four in Maryland. All others must file under chapters 11 and 13, where the debt is restructured, not eliminated.

The Post found 144 cases of bankruptcy filed after homeowners received a court order for deficiency — nearly 20 percent of all cases. Among them, 38 — more than a quarter — had some sort of garnishment of wages or other assets. Another 113 cases also involved garnishment, but there had not yet been a filing of bankruptcy.

'Foreclosure fatigue'

In 2011, an attempt was made to pass a one-year nationwide cap on deficiency judgments, but it died in a House committee.

Last year, the Maryland Consumer Rights Coalition was asked to make legislative recommendations to help ease the state's foreclosure crisis. Among other things, the commission recommended ending deficiency judgments and mandating a statewide forgiveness of the debt. But that recommendation was ignored, according to Marceline White, the commission's executive director.

The coalition considered making a renewed push for the recommendation during the spring session, which ended April 8, but ultimately held off.

"Frankly, I think there's a little bit of foreclosure fatigue among lawmakers," White said.

White said Bank of America recently announced it would forgive deficiencies in exchange for credit as part of a federal and state settlement of a $25 billion national mortgage lawsuit. The settlement requires the nation's top five lenders to help people who are having difficulty paying their mortgage.

As of March 31, Bank of America provided 599 deficiency waivers in Maryland totaling $40 million, an average of $67,235 per deficiency. The settlement terms end in 2014, and the bank says it will continue to forgive the debts.
"I can confirm that we will continue to waive deficiencies even after the monitor certifies us as having met our obligations under the settlement," said Bank of America spokeswoman Jumana Bauwens.

The wave of deficiency judgments had a prologue in Texas.

During the 1980s in Houston, the bottom went out of the oil market, with the price dropping to about $15 a barrel. Homes that had been assessed at $200,000 couldn't be sold for $100,000. More than 200,000 people lost their jobs and could not pay their mortgages.

The lenders foreclosed on the homes and then pursued the homeowners for the outstanding balance.

Once a judgment was granted, debt collectors had 10 years to collect, according to the Texas statute at the time, and another 10 years if the debt collector petitioned the court to renew the judgment.

"It was an absolute disaster," Mixon said.

In response to the situation, the state passed laws increasing consumer protections in deficiency cases.

"It's less an event in Texas today than it was back then," Mixon said. "But Texas still provides the object lesson of what could happen."

But for the moment, efforts to pursue deficiency judgments are ramping up rather than winding down.

Following the mortgage crisis in 2008, the Federal Housing Finance Agency took over management of Fannie Mae and Freddie Mac. The FHFA is now in private talks with the quasi-private lending giants to ramp up their efforts to go after even more homeowners for their deficiencies starting this September, according to the inspector general's report.

The FHFA inspector general's report showed that the return on the 35,000 deficiency judgments pursued in 2011 was less than 1 percent, or $4.7 million.

"Given a recovery rate of .22 percent, the Enterprises appear to have room for improvement," according to the audit. "Further, with 1.1 million seriously delinquent mortgages looming on the foreclosure horizon — triple the Enterprises' foreclosures in 2011 — FHFA's timely guidance on deficiency management processes may help the Enterprises recoup future losses and protect taxpayers' investment in their financial health."
By Sept. 20, the FHFA is expected to have drafted new guidelines for making the process more effective.

"Through our supervisory process, FHFA is working to implement the Inspector General's recommendations," said Jon Greenlee, the FHFA's deputy director of the division of enterprise regulation.

Evans said Fannie Mae applies a specific methodology to determine whom it will pursue, though he declined to elaborate, saying people could use such information to thwart the process. He did say that Fannie Mae does not pursue homeowners who have experienced certain financial hardships, such as a job loss, medical issue, death of a spouse or divorce.

But they do target people based on credit history and the characteristics of their loans and properties. For example, a person who pays their other bills but not their mortgage could be considered a strategic defaulter, he said.

"We do the analysis first to really focus on the population that we think has the ability to pay but hasn't chosen to do so," Evans said.

Coming to collect

Arturo Ventura, a 45-year-old food server at a restaurant in Northwest Washington, had struggled long and hard to find his place in America. The native of El Salvador had fled his homeland in 1983 during the civil war there. He went to school to find out that his favorite teacher had been slain. "They were killing all of the teachers at that time," he said.

After coming north, he moved in with his brother and started to work delivering newspapers from Connecticut Avenue to 34th Street in Cleveland Park, earning $150 each month.

Ventura eventually wanted to move into his own place, one preferably in a school district that could cater to the special needs of his 8-year-old son, who has Down syndrome. He began looking in Silver Spring and was surprised when real-estate agents showed him properties that he thought he could not afford.

But he learned from the agents that he was not required to provide a down payment.

In 2006, he found a three-bedroom condo and qualified for the $215,920 mortgage. It would be roughly $2,000 each month plus $260 for monthly condo association fees. He could pay for it, he said, by combining the $2,000 a month he earned as a food runner for local restaurants with the Supplemental Security Income payments for his son and money from his longtime girlfriend's part-time job.

Then the couple separated, and he could no longer make the payments.
He moved back in with his brother, let the condo lapse into foreclosure and eventually filed for
bankruptcy.

Last year, on Sept. 13, a copy of a court action against Ventura was mailed to his D.C. apartment
explaining that he still owed nearly $100,000 on the money he had borrowed on Aug. 15, 2006,
with interest growing at $16.21 a day since Sept. 14, 2009.

He cannot understand why they want him to pay for a house that someone else lives in.

"They still want me to buy the house they already sell?" Ventura said.

Database reporter Steven Rich contributed to this report.