

Last, but not least, is the option of allowing the property to be sold through foreclosure and being prepared to negotiate and settle any deficiency claim following foreclosure. Most foreclosures in Arizona are completed through a non-judicial trustee's sale conducted by an attorney or title company. If the loan is a recourse loan, the lender may elect to sue the borrower and guarantors for the deficiency following the trustee's sale. The deficiency is equal to the difference between the amount of the debt and the fair market value of the property as of the date of the trustee's sale. The lender will claim that the fair market value of the property is equal to the winning bid at the trustee's sale but that is not necessarily the case, particularly if the lender opened the auction with a bid amount that is less than the value of the property in hopes of having a third party bidder take the property. Also, it should be noted that the lender must bring the deficiency action within 90 days following the date of the trustee's sale. Sometimes this deadline is missed. If a deficiency action is filed, the borrower and guarantors have the ability to challenge the amount of the deficiency based on the value of the property as of the date of sale. If a property is going through foreclosure and there is personal liability it is always a good idea to obtain an appraisal of the property as of the date of the trustee's sale in order to be in the best position to defend the deficiency action. In most cases, these lawsuits settle for much less than the amount sought by the lender and the settlement amount is often paid over time. Settlements we have negotiated include a \$63,000 settlement payable over time on a \$315,000 deficiency on an undeveloped lot, a \$100,000 lump sum settlement on a \$546,000 deficiency on a multifamily property, and a \$150,000 settlement payable over time on a \$1,800,000 deficiency on multiple undeveloped lots.

In addition to figuring out which option is best under the circumstances, the apartment owner should seek tax advice in order to be prepared to deal with the tax consequences of forgiveness of debt income. This should be done early in the process so that the consequences can be anticipated and the timing controlled if at all possible. The apartment owner also needs to be cognizant of any liabilities related to operation of the apartments that may result in personal liability to the principals. Sales and employment taxes are examples of such liabilities. To the extent a property is facing foreclosure, it is a good idea to carefully review the property obligations and make sure that payment of any obligations that might result in personal liability to the principals are given the top priority.

These are difficult times for a troubled apartment owner. Often the toughest decision is the realization that it is time to cut the loss if the loan cannot be modified or the lender is unwilling to agree to reasonable modification terms. Once that decision is made, the owner can evaluate the options and pursue the one best suited for the owner and the property.

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Tough Decisions for Owners of Troubled Apartments

Many apartment owners are faced with a property worth less than half what was paid for the property, a loan on the property that far exceeds the value of the property, a substantial decline in the property's occupancy rate and not enough money to pay the monthly loan payment. Many times, the owner has invested his or her life savings in the apartment complex planning on a regular income stream for the owner's retirement years. Now, this same investor has lost all equity in the property and is facing a foreclosure because the property rents cannot support the required loan payment. To make it even worse, the investor may have signed a personal guaranty for the loan, which puts all of the investor's personal assets at risk if the lender decides to pursue the loan guarantors after foreclosure.

Apartment owners are generally hard working individuals who pay their bills on time and find the idea of not paying the loan on their apartment complex as abhorrent. These owners often tap 401K and other retirement funds to make the loan payments where the property rents are not sufficient. Eventually though even that is not enough and the owners realize that they cannot continue to deplete their resources in order to cover the loan payments. It is time to make some tough decisions, including, if necessary, walking away from the investment. Except for bankruptcy protection, which is not addressed in this article, the options in such a situation are loan modification, short sale, deed in lieu of foreclosure, and foreclosure.

Of these alternatives, only a loan modification results in the apartment owner preserving the investment. Owners should be aware that in many situations due to the nature of the loan a modification may not be an option. For example, if the loan is a securitized loan (i.e. a CMBS loan) the loan servicer usually does not have the capability of offering a loan modification. Examples of loan modification terms include a reduction in the interest rate, interest only payments for some period of time, extension of the maturity date with a re-amortization of the loan, and converting a portion of the loan amount to a contingent amount payable only if the property sells for more than the reduced principal balance on the loan. Whether or not a loan modification is possible should always be explored early in the process.

In a short sale, the lender receives a discounted loan payoff. If the loan is a recourse loan where the property owner (and its principals if an entity) has personal liability, a short sale will usually require a cash contribution from those personally liable as a condition to the lender approving the short sale. The amount of cash required will depend on the extent of the personal liability for the loan and the financial resources of those personally liable for the loan. Where the individuals personally liable for the loan have liquid assets such as cash in bank accounts and stocks, the lender will usually require a larger contribution because the lender sees these types of assets as easy to recover if the lender is collecting on a judgment. On the other hand, if those personally liable are insolvent, except perhaps for some retirement funds (which are generally protected from creditors) the lender is more likely to approve the short sale with no contribution or settle for a much lower amount. The motivator in a short sale situation is that the lender really does not want to own the property and would prefer to settle the loan for a lesser amount.

In a deed in lieu of foreclosure the property is conveyed to the lender in satisfaction of the loan. The lender takes title to the property subject to all matters affecting title. As a result, a deed in lieu of foreclosure will not work if there are junior liens or other liens such as mechanics liens on the property. Lenders typically do not favor deeds in lieu of foreclosure. Also, as with a short sale, if a lender does take a deed in lieu of foreclosure, a cash contribution in order to settle the personal liability may be required.

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