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Deficiency Judgments In Florida

One of the most common questions I receive from sellers who are upside down on their mortgage(s) is what a deficiency judgment is and whether or not it may apply to them if they sell at a short sale, offer a deed in lieu of foreclosure or are foreclosed upon. The answer is it can occur in any of these situations.

Unfortunately, borrowers have no control when it comes to deficiency judgments. The ball is solely in the lender's court since lenders have the legal right to pursue the full amount of any deficiency. When the promissory note was originally signed at the time of purchase or refinance, the borrowers legally obligated themselves to pay the full amount. Whether or not the lender elects to pursue is at the lender's discretion and usually not determined until the last minute.

If lenders decide not to collect the deficiency, they may cancel the debt. Provided this is not the borrower's primary residence the lender may elect to report the cancelled amount to the IRS as taxable 1099 income. Contrary to popular belief, a deficiency judgment can often be pursued even when handing the property back through a deed in lieu of foreclosure unless the bank agrees, in advance to cancel the debt.

The lender has the option to collect part of the deficiency and to cancel part of the deficiency, but they cannot do both and collect the entire debt as well as report the debt as cancelled. For example, if the fair market value of the property on the date of the foreclosure, as determined by the bank's appraiser is \$350,000.00 or alternatively if the value of the property at the time it is deeded back to the bank has an outstanding loan balance of \$500,000.00, then the deficiency amount would be \$150,000.00 representing the difference.

Under this scenario a lender could elect to collect the \$150,000.00 shortfall or report the \$150,000.00 as cancelled debt. The lender could also collect \$75,000.00 and report \$75,000.00 as cancelled debt. In some cases, the lender may elect to cancel 100% of the debt if they can receive a greater benefit by showing this loss on their books. Unfortunately, one would have to be telepathic to know how they will proceed.

To the extent that lenders will pursue a deficiency judgment is based upon many variables. The greater the assets the borrower has, the greater the likelihood the lender will pursue a deficiency judgment. Contrary to popular belief, not all lenders are mentally challenged. The first thing a lender will do prior to making this election is to review your original loan application as well as any financial updates the borrower may have provided.

Another factor of pursuing a deficiency judgment is whether or not PMI (private mortgage insurance) is involved. Borrowers with less than 20% down are typically required to pay PMI. If PMI is involved, a lender will look to collect from the insurance company to be made whole. In turn, insurance companies hate to pay claims and typically have their own set of attorneys that, as a general rule, are more aggressive than bank attorney's who prefer to work bankers hours.

Net Result: If PMI is involved, the greater the likelihood a deficiency judgment will be sought.

The good news, however, in a potential deficiency judgment situation, in the state of Florida is that the lender has only one year from the date of the foreclosure sale to file a motion with the court to seek a deficiency claim. However, there is nothing to prevent a lender from assigning this right to a third party.

As a direct result of the potential of a deficiency judgment I encourage borrower (sellers) that the safer course of action is through the short sale process. Unlike a foreclosure action where the borrower has no control over a deficiency judgment, in contrast, if the property can sold through a short sale, the borrower avoids the stigma of a foreclosure on their credit report and avoids a deficiency judgment.

Additionally, by working with the bank in negotiating a short sale, a resolution is brought to conclusion regarding the deficiency amount. Many times a bank will release the borrower completely, depending upon the assets and financial position of the borrower as a reward for bringing a buyer. In other instances the bank will negotiate an agreed amount which most often is a deeply discounted sum settling for cents on the dollar in the form of a newly executed promissory note.

My experience has taught me whenever possible a short sale is the better solution for the borrower. Walking away from the problem by allowing the property to be foreclosed can open the door to a deficiency judgment for the entire amount of the difference. To me, this behavior becomes a game of Russian roulette which borrowers should be aware of and avoid whenever possible.