

A COMMENT on the PROBATE and FORECLOSURE PROCESS/OPPORTUNITY COSTS to LENDERS 2020

The great recession of 2008 2009 impacted real estate markets and many related housing services sectors of the economy. Those most heavily impacted were mortgage lenders who dealt with non-performing loans and quickly came to realize that foreclosure costs and related loan losses were a matter of everyday business operations. Since the great recession mortgage lenders have adjusted their policies and practices and now 10 years later still expect to collect on mortgages; probably to a greater degree.

Following comment is essentially a case study on such mortgage and real estate foreclosure approach of a major lender, in this case Wells Fargo. Their initial hesitancy and eventual settlement willingness resulted in a loss on a single family property in probate.

The case involved probate courts, another lender and many other non-secured lien holders who essentially laid claim to the residue of the property owners estate. A simple analysis of her position at death shown in the court pleading showed that secured and unsecured lien holders to be \$70,000 short at property sale. This required all the lien holders to come to some sort of accommodation for settlement with the entire estate of the decedent. What follows is a discussion of the opportunity cost to the bank and other lien holders concluding in their eventual choice of payment now vs, payment later.

TRANSACTION DETAILS AND SETTING

The property involved was a four-bedroom 2100 square-foot house in Lincoln California located in a gated community which boasted a very large clubhouse and recreation center, parks and other amenities making the housing alternative a community purchase as opposed to just a house purchase in a subdivision. Sellers listing agent of the property suggested the buyers were buying into our community and not just our house and certainly review of the community review of the house is involved demonstrated that the 400 homes within the community position themselves as a separate **Destination** community.

The property owner unexpectedly passed away at the home in May 2019. Since she died intestate, her ex-husband was appointed executor trustee, becoming responsible for making payments to lienholders, managing affairs, and the ultimate dissolution of the

estate. Unfortunately, payments did not occur. Since mortgage payments were in default (more than three months) the bank-initiated foreclosure proceedings in December 2019. By that date the holders of first lien had lost approximately \$3235 per month of payments times six. \$19,140. The December foreclosure documents, including the published bid, showed the bank was anticipating a \$344,000 debt by the time of the trustee's sale on May 5, 2020.

An additional lien of \$29,000 was held by a second holder for trustee for solar electricity generation equipment permanently attached to the roof. The credit union/lender indicated reluctance to relinquish any claims on the estate's assets.

Since the property owner died in May and since property taxes were delinquent, additional funds were required to pay off property taxes, homeowners association liens and other miscellaneous claims, A more serious legal claim on the property was brought by the Internal Revenue Service (IRS) for six years of non-filed income taxes.

The liens as divulged in legal pleadings appear in Table 1, basically sketching dissolution claims/obstacles.

Table 1

LISTING OF DECEDENTS ASSETS AND LIABILITIES IN DECEMBER 2019

Asset Purchase Price New Buyer	\$ 375,000.
	Liabilities
Federal State Tax	\$ 32,646.63
Administration Costs	\$ 34,703.86
Selling Costs	\$ 31,629.95
Wells Fargo Loan	\$ 317,117.09
Matadors Community	\$ 29,158.12
Total Debt	\$ 445,255.65
NET ASSETS	\$ (70,255.65)

BEGINNINGS OF THE MARKET SOLUTION

The property initially listed for \$375,000 in June 2019. Buyer interest in the house was mixed and a firm offer appeared and received acceptance on November 1, at full price. Buyer expectations included assurances that court proceedings to remove solar liens would occur in November and the escrow would close in a month 30 to 60 days after acceptance.

Attorneys hired for the buyer, the seller, and the lien holders could not come to any kind of agreement in November or December and the transaction moved to a January 17 court hearing. All lenders were reluctant to settle offering no alternatives and demanded

that the issue be moved to trial. The trial setting hearing occurred on January 31 and all the parties were remanded by the judge to participate in a mandatory settlement conference on March 20. If the settlement conference did not achieve a solution then a formal trial was scheduled for January 31, 2020

THE ANALYSIS MODEL FOR THE OPPORTUNITY COSTS TO THE LENDERS

The model prepared for the bank relied on assumptions taken from the notice of default and foreclosure statements and the successful expectation of a published sale. Banks legally can force a foreclosure while a property remains in contract, as long as foreclosure documents comply with foreclosure law of publication.

As shown in the Table 2 we assumed that the bank would receive 344,000 at foreclosure sale and also a sound given expected retail price for housing in the neighborhood that the bank was not likely to get a bid at sale greater than \$344,000 part of the assumption was that given a retail price of 375,000 no investor would be willing to take the risk of holding and rehabbing the property to make \$15,000 at the time of flipping the property .

Table 2

THE OPPORTUNITY COSTS OF FORECLOSURE

ANALYSIS OF TRUSTEE'S SALE

682 Courtyard Loop, Lincoln, CA

Sale Date			5/5/2020	
Published Bid			\$ 344,999	
Monthly Loan Payment			\$ 3,235	
Lender Demand			\$ 318,000	
Opportunity Cost Payment Until Trustee Sale *1	11		\$ 35,585	
Received at Sale *2		100%	\$ 344,999	
REO Sale Price *3		109%	\$ 375,014	
REO Selling Costs *4		9%	\$ 33,751	
Days List to Close (Holding Cost) *5		61	\$ 107.83	\$ 6,578
Lost Payments...Foreclosure, Trustee Sale, REO sale			\$ 42,163	
Net Proceeds (August 2020)			\$ 299,100	

*1 Estimated foregone payments on Mortgage

*2 Assumption Proceeds Trustee Sale Equals Published Bid

*3 Estimate of listing/close Price REO Sale equal to Pending \$375,000 Offer

*4 Real Estate Selling Costs,,,no legal fees

*5 Estimate Days Listing to Close Range 130-23, Average 61

Cells in yellow represent driver assumptions for sensitivity analysis

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Source: Placer County Court Pleadings, REAB

The foregoing table shows that the first lien holder could expect payment of \$299,100 in the case of trustee sale, and the taking back of the asset as Real Estate Owned. Assumptions as to selling cost at 9 percent, and two figures for lost mortgage payments , before and after the sale, weigh significantly in the analysis. These demonstrate the application of the notion of opportunity cost as suggested in basic economics classes.

Fortunately, all lien holders came to a settlement agreement on the 3rd of February. The second lien holder agreed to satisfaction at \$25,000, and surprisingly the first lien holder agreed to \$290,000 settlement amount.

CONCLUSIONS, OBSERVATIONS and COMMENT

An initial take away from the analysis/outcome suggests the bank's foreclosure and REO strategy, considering the costs of at least 30 days on rehab/preparation for sale, relisting, sale and escrow preferred money now compared to maybe money later. While banks often face negative media, banks are more sensitive to the costs of resolution and seek minimization of loss as an operational goal.

Secondly, their acceptance of a \$290,000 settlement amount helps analyst suggest the bank's annual effective discount rate of 5.5 percent which can be compared to a to overall loss of 15.7 percent. Had the bank chosen to take back the property security their projected loss equaled 13 percent.

Another observation suggests banks hold understanding and their own estimates of process costs that foreclosure delay also generates outside legal costs (bank retained outside counsel), and resource opportunity costs within corporate asset management. The analysis only represents a case study or singular analysis of a messy probate foreclosure.

Fourth, lender approaches to foreclosure did change since the heyday of mortgage divestment of ten years ago. Add to that a solid price performing housing markets in Placer County and this lender approach appears rational. The unknowns of process legal costs can be suggested as yet another reason the lender moved so aggressively, albeit at the last minute for the transaction.

Lastly, the bank enabled a new home buyer to secure at wonderful property at a very fair price. One could also suggest a longer-term marketing benefit to the bank.