Foreclosures: New Challenge for Appraisers

Oklahoma Tax Commission

Ad Valorem Division

Annual Conference 2009

History of Loans/Foreclosure

- Borrower versus Lender Rights
- Early Roman Law: Borrower defaulted lost his land and became the lender's slave.
- Norman Conquest 1066: Loan paid off in one payment. Due date called Law Day.

Debtors Prison

- English and United States- Debtor Prisons
- The Clink and the Sponging House
- The Marshalsea

Marshalsea Prison

- Family Lived in prison
- Daughter had to report to jail each evening
- Stayed there until debt paid

Debtors Prisons

- United States Early Debt Imprisonment
- Georgia—Settled by Debtors
- Oklahoma's Constitution Article II. Section 13
- **No imprisonment for debt**

Residential Mortgage

Mortgage Review

- Mortgage-Debt secured by property
- Fail to pay loan lose the property
- Opportunity for homeownership

Mortgage Review

- Oklahoma-Lien State
- Confers legal right to attach a claim and go to court.
- Property is collateral

- Borrower: legal and equitable title (can redeem property)

Important Part of Mortgage: LTV Ratio

- What is the loan-to-value ratio?
- Loan/Value = LTV Ratio
- _____
- **Lender wants it low. Why?**
- **Buyer wants it high. Why?**

$$\frac{\$80{,}000}{\$100{,}000} = 80\%\ \text{LTV}$$

What does the LTV mean?

Down payment?

Default what happens to lender?

$$\frac{\$80{,}000}{\$133{,}333} = 60\%\ \text{LTV}$$

What does the LTV mean?

Down payment?

Default what happens to lender?

What if house value drops?

$$\frac{\$80,000}{\$75,000} = 106\% \text{ LTV}$$

What does the LTV mean?

Default what happens to lender?

Great Depression (First One)

- Loan to Value: 60% (80%)
- Mortgage 5 years or less (30 year)
- Paid Interest, Interest, Interest, then Balloon at end of Five Years

- Refinanced every five year

25% Unemployment

“It’s a Wonderful Life”

Federal Government

- 1933 created Home Owners Loan Corporation (HOLC)
- 15 years term
- **No Balloon payment**
- **Self-Amortizing.**

Self-Amortizing

- HOLC (1933) demanded self-amortizing loans.
- Payment includes Interest + Principal
- Mortgage ends; you’re free and clear.

Foreclosure

Definition of Foreclosure

- Legal proceeding to terminate a mortgagor's interest in property instituted by the lender (mortgagee) either to gain title or to force a sale…to satisfy debt secured by property.

Black's Law Dictionary 2001

Foreclosure

- A Foreclosure is a legal process,
- ***Not a sale!!***

Current Foreclosure Storm

- “Nonprime” Mortgage
  - Subprime Mortgages
- Mortgage “Shock”
  - Adjustable Rate Mortgages
- “Underwater” Situation
  - Declining Home Price

Non-Prime Mortgage

- **Sub-Prime Mortgage**
- Borrower-credit rating or income problems
- Interest Only
- Balloon Payment

Mortgage “Shock

- Adjustable Rate Mortgages (ARM)
- Rate starts at 5.0% but goes to 7.0%
- $100,000 Loan: $349 to $535 payment

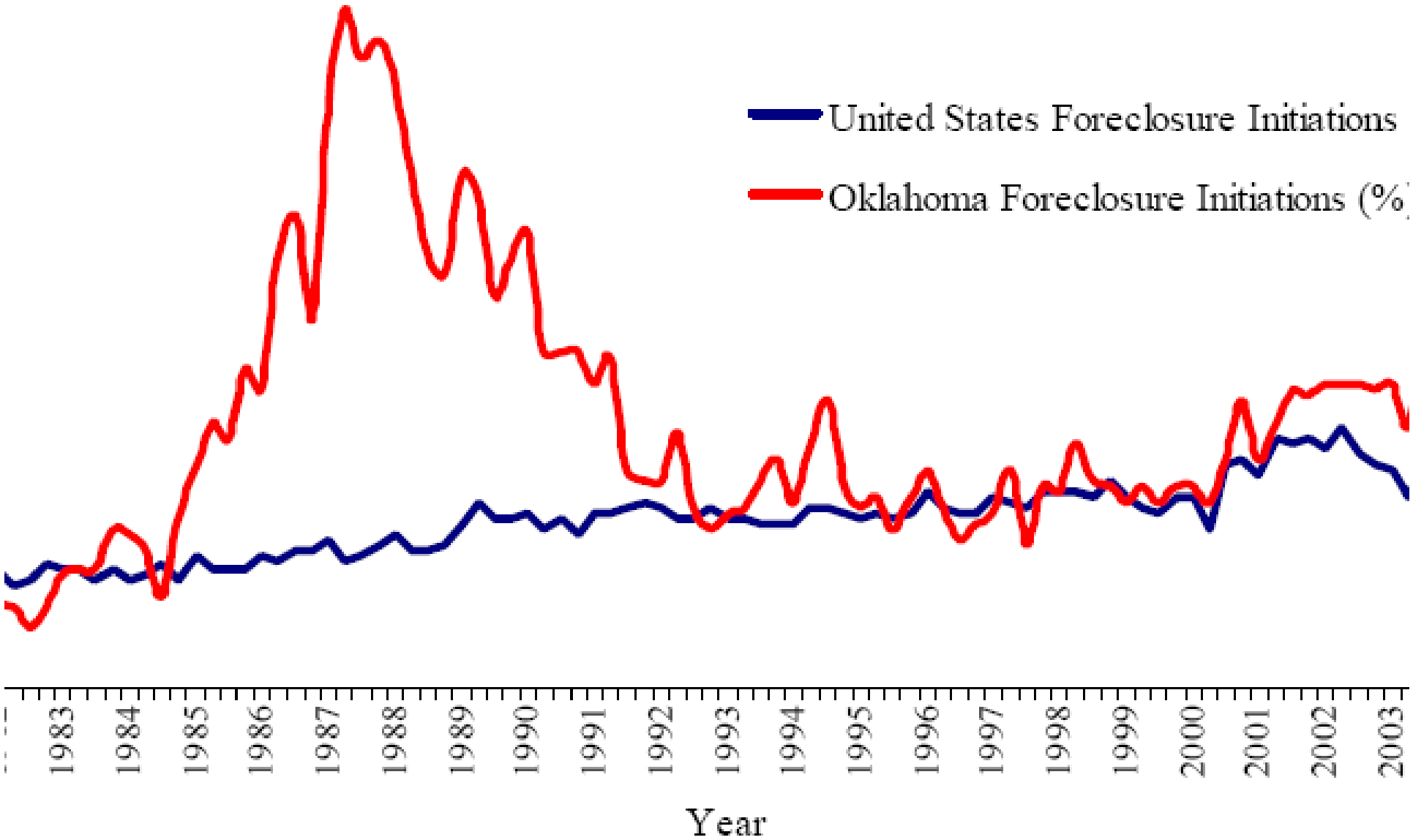
“Underwater” Situation

- **Declining Home Price**
- **House now worth $80,000**

What do I do now?

Oklahoma Foreclosure

- History of “boom and bust”
- Numerous Foreclosures in 1980s.
- Economic Stress on State


United States Foreclosure Initiations
Oklahoma Foreclosure Initiations (%)
1983
1984
1985
1986
1987
1988
1989
1990
1991
1992
1993
1994
1995
1996
1997
1998
1999
2000
2001
2002
2003
Year

Mortgage Foreclosures

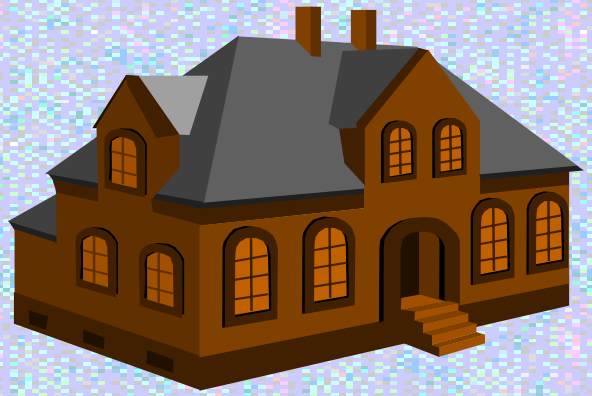
- **National:** 3.5% of all mortgages are 90 days or more delinquent
- **Oklahoma:** 2.45% of all mortgages are 90 days or more delinquent

NY Federal Reserve Bank

- Initiates Federal Policy
- More Gold Reserve than Ft. Knox
- Vault 65 feet below sea level
- Die Hard Vengeance Bruce Willis (1995 Movie)

Foreclosure Process

Borrower misses payment



Notice of Default

Short Sale

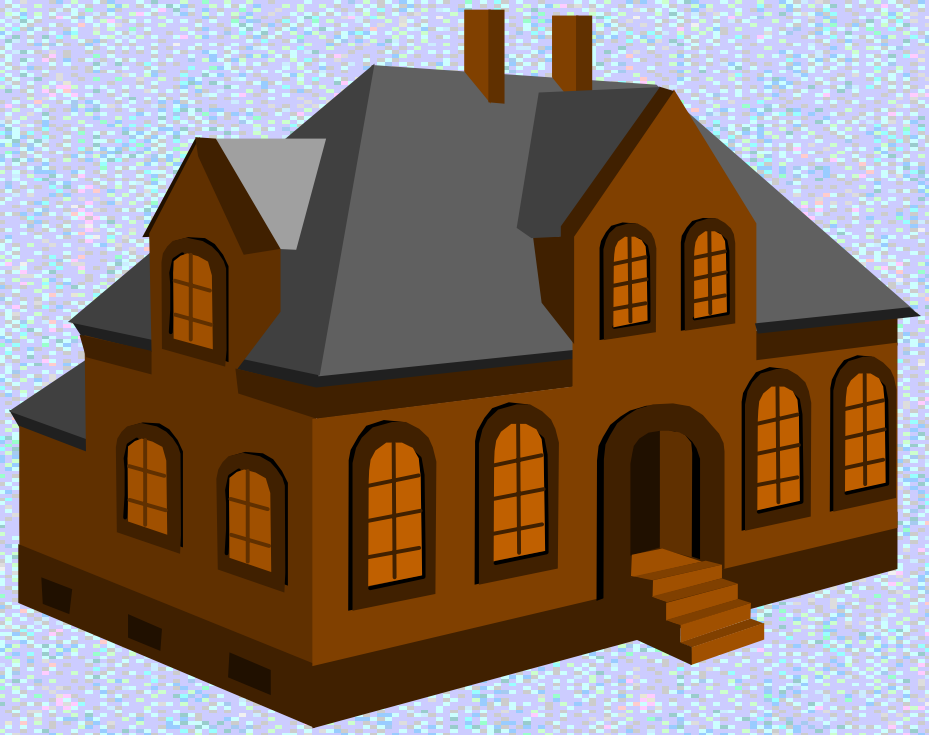
Redemption
Cure Default

Deed in lieu

Lender asks for relief from Default

Options to Prevent Default

- Work-out
- Prepay
  - Sell
  - Refinance
- Default



Court Orders
Seizure of Property for Debt

↓

Foreclosure Sale
(Sheriff's Sale)

↓

Lender or
Third Party Buys

Lender Buys and adds to Other Real Estate Owned (OREO)

↓

Property Sold by Lender (Arms-Length)

Pre-Foreclosure Sale (Limit loss)

- **Not arms-length**
  - **Short Sales**
  - **Deed in lieu of foreclosure**
- Various sales (pressured sale)
- Sheriff's Sale
- **Not Traditional arms-length Sale**

Post-Foreclosure Sales

- Real Estate Owned (REO)
  - Property owned by institution
  - (Building, lands, real property, etc)
  - **Want to hold this property**
- Other Real Estate Owned (OREO
  - Real Estate through foreclo
  - Employees property, etc.
  - **Don't necessarily want to h property.**

Bank Sale

Bank Auctions

- “Get it Off their Books!”
- Multiple Sales (Often NOT Market Value)
- Can reflect typical market price.

IAAO on Auctions

- "Auction in general…lower end of price spectrum …must be well advertised and well-attended.
- Seller must have set minimum bid and right of refusal.
- Absolute or Reserve Auction
- IAAO Standard on Ratio Studies (2007)

Remember: Foreclosure

- A Foreclosure is a legal process,
- ***Not a sale!!***

Foreclosure Sale Questions

- **“It’s a Foreclosure sale.”**
- **ASK**
- ***What kind of Foreclosure Sale?***
- ***Not all Foreclosure Sales Equal***