

‘I OWE WHAT?’ UNDERSTANDING NEGATIVE EQUITY / NEGATIVE PROCEEDS

By Laura J. Henneberry

Before you crack open the champagne to celebrate offloading that home that seemed bound for inventory, you better check whether the transferee is in a negative position - that is, bereft of equity and requiring cash to get out from under their obligations. Henneberry explains the mathematics behind this situation and why it is increasing in frequency.

You finally sold the home! You found that one buyer who was willing, in your mind, to take it off your hands. You have negotiated a quick closing, and then the call comes in: your closing partner is asking for \$1,000; \$10,000; or even (gasp!) \$100,000 to close this deal. What happened? And who is going to explain this one to the client?

There has been so much written about the real estate market that most of us cannot bear to hear any more about it. One of the remaining issues to discuss, however, is the “negative” proceeds of this market. A few years ago, the seller routinely walked away from closing with cash. Now, it seems as if every other property is somehow “negative,” meaning the seller actually has to bring cash to the closing table.

When a transferee’s equity is calculated, it is a straightforward plus and minus of what is owed on the property. The transferee is given credit for the sales price (either through a guaranteed buy-out offer, amended value program, or buyer value option program) minus any outstanding interest on the mortgages, home equity lines of credit (HELOC), a combination of outstanding interest on the mortgages and HELOC, other liens on the home (such as judgments), any real estate taxes owed on the property, and any homeowner association dues still owed.

In addition, the transferee may be charged for any repairs necessary to the residence plus any buyer incentives that he or she may have negotiated in an outside sales contract. On the plus side of the equation, the transferee may receive credit for an escrow or impound account, and credit for any prepaid real estate taxes, interest on mortgages or HELOC, or homeowner association dues. Add, subtract, and there you have it: the transferee's equity.

An Old 'New' Phenomenon

During the past two years, an increasing number of transferees are finding themselves in a negative position. This means that when all those debits and credits are added up, the transferee does not have any equity in his or her home; in fact, he or she owes money to get out from under. There is many a corporate client these days receiving a call from the third-party relocation company, an in-house consultant, or the transferee him- or herself, asking how the company is going to help out with this predicament.

“We deal with negative equity situations on an individual basis - generally, by comparing the sales price to the original purchase price of the home to determine if a loss on sale due to market conditions is creating the negative position for an employee,” said Nick Casiello, CRP, CEO of The Relocation Department, Inc., Glen Ellyn, IL. “We're careful not to confuse total mortgage balances compared to sales price with loss on sale.”

Any number of reasons can be responsible for the recent upturn in these negative scenarios: the transferee bought the property with a small down payment and the home did not appreciate; the transferee has taken out all of his or her equity through a HELOC or second mortgage and, in essence, mortgaged the property to the maximum in the belief that the home would continue to appreciate and he or she would regain a sizable amount of equity; or, the market simply took a downturn and the home just does not cover what is owed. Sometimes, a

bankruptcy or IRS tax lien shows up and eats away any equity. Whatever the reason, the transferee has no cash coming to him or her and either the transferee or his or her employer needs to make up for the deficit.

Negative Proceeds - Now What?

Fast forward: the home is sold and the closing date is approaching. You get an urgent call regarding the closing and the negative proceeds. Now what?

A closing with an outside buyer of the home is no different than a closing with the transferee, except in addition to all of the charges on a transferee's equity, you have to add in all of the charges in which you, as the seller of the home, are responsible. These costs could include a real estate commission, real estate transfer taxes, title, attorney fees, buyer incentives (such as a home warranty, buyer closing costs, and so forth that you agreed to pay on behalf of the buyer), homeowner association transfer fees, and the like. Add all of these costs to the charges that carry over from the transferee's equity such as a mortgage, a HELOC, real estate taxes, and homeowner association dues, and you could be in a large deficit position.

CHART 1

Let us look at a quick and easy scenario:

Transferee is paid:.....	\$250,000	Sold to buyer:.....	\$250,000
Mortgage 1:.....	\$225,000	Mortgage 1:.....	\$225,000
HELOC:.....	\$35,000	HELOC:.....	\$35,000
Real estate property taxes:	\$4,000	Real estate property taxes:.....	\$4,000
HOA dues:.....	\$200	HOA dues:.....	\$200
Home warranty:.....	\$300	Home warranty:.....	\$300
		All other closing costs including real estate commission, transfer taxes, title, and other seller charges:*....	\$20,000
		<i>* (Assumes that all of these costs were 8 percent of the sales price)</i>	
Equity:.....	-\$14,500	Due from seller at closing:.....	-\$34,500

In Chart 1, if the third-party company or employer had paid off the mortgages prior to closing (with enough time to procure the releases necessary to give clear title to the buyer), then it would have been a positive closing of \$225,500 (-\$34,500), plus mortgage \$225,000, plus HELOC \$35,000, since these would not be subtracted at the time of closing). So, there are variables: a negative equity does not necessarily equate with negative proceeds if mortgages, judgments, and so on have been paid off prior to the actual resale closing.

As you can see, with estimated closing costs between 8 and 10 percent of the sales price, there is also no guarantee that a positive equity (money to the transferee) is going to mean a positive proceeds situation. The opposite can occur and often does these days.

One of the things to remember is when a negative proceeds situation occurs, the seller is obligated by the terms of the resale contract to have his money at the “closing table” to meet the closing date. Negative proceeds have to be there on the day of closing.

“Negative proceeds are no different than a buyer showing up with less than the amount of money needed to close the purchase,” said Trent Lehman, attorney at Lehman Title & Escrow, LLC, Brentwood, TN. “In the negative proceeds scenario, the seller cannot give clear title, a standard contract requirement, until all debts and costs associated with the sale are satisfied. Until the funds are received from the seller, the sale is effectively stopped.”

By remembering some basic accounting premises, you will be able to understand the closing numbers between the buyer and you. You have finally sold the property. You sent the money to cover the negative proceeds. You have one less house in inventory. Congratulations!

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