

## Burned by real estate, some just walk away

LAS VEGAS – Oct. 22, 2007 – During the height of Las Vegas's real-estate boom two years ago, property investor Rob Rozzen bought 16 homes, hoping that skyrocketing prices would pump up his retirement nest egg.

Now, Mr. Rozzen says he is considering filing for bankruptcy protection. As the housing market slowed, the 40-year-old was unable to sell the homes, and his full-time job as a real estate agent was no longer able to support mortgage payments totaling \$45,000 a month. So one by one, over the past 14 months, Mr. Rozzen has stopped making payments on his investment properties, for which he paid between \$226,000 and \$390,000, and lenders have foreclosed.

As a result, Mr. Rozzen's credit score plunged from 730 to the high 400s, he says. The Prada clothes, luxurious vacations, and full-time housekeeper and pool cleaner he once enjoyed are things of the past. Still, he says, walking away from his investment properties was his only option. "You get to a point where your hands are tied," he says.

A growing number of investors like Mr. Rozzen are making the drastic decision to walk away from their properties and ultimately send their homes into foreclosure, lenders and real estate agents say. Many investors who were hoping to quickly flip their investments are now left with homes that can no longer be sold for more than the mortgage debt. In many cases, these investors can't even find tenants willing to pay enough rent to cover hefty mortgages.

Certain data point to the trend. According to an August study by the Mortgage Bankers Association, defaults on mortgages where the owner doesn't live in the house are a major driver of the defaults in Florida, Nevada, California and Arizona – four of the states with the fastest rising rates of seriously delinquent loans. Defaulted mortgages are defined as those 90 days or more past due or in foreclosure, according to the study.

But walking away from a mortgage is almost always a bad idea. You can lose your ability to take out future loans, and you might find the lender coming after your personal assets, such as your principal residence, depending on your state's laws and the terms of your loan.

"A lot of these people can't think clearly because the level of financial distress is so great," says David Dweck, president of the Boca Real Estate Investment Club in Boca Raton, Fla., who is also a Realtor. "They're hoping (that by taking this step), it's going to work itself out."

Tom Crossett is one investor on the verge of walking away from his properties. At the height of Florida's condominium boom two years ago, the 53-year-old air-conditioner contractor from Delray Beach, Fla., bought four units with the plan to flip them quickly. He paid between \$143,000 and \$173,000 for the units.

Mr. Crossett now says the developer of the complex that sold him the converted-from-apartment units reneged on many of the promises, including extensive renovations, making them a tough sell. To help make monthly mortgage payments totaling \$4,000, he's been stuck renting the units to tenants who make sporadic payments. He says that next month, he plans to cut his losses and stop paying the mortgages. "The only way I can see for me is to just get out, stop the bleeding and let them go," Mr. Crossett sighs.

Before walking away from a mortgage, legal experts say, investors should approach a lender about a possible loan "workout," in which the mortgage payments are reduced but the investor gets to keep the property. Some investors say they have tried this, but without success. Still, banks don't typically want to act as property managers, nor do they want to have high foreclosure numbers on their books.

"There is a real incentive for both lenders and borrowers alike to do a workout and avoid foreclosure. Lenders are not good at being homeowners," says Fred Witt, national director, real-estate tax services, at Deloitte Tax LLP, in Phoenix.

One of the first effects of walking away from a mortgage is an assault on one's credit. The foreclosure could remain on your credit report for years and will sharply reduce your credit score, experts say. "This makes it more difficult or extremely costly, and in some cases impossible, to do more financing in the future," says Jack Guttentag, a professor of finance emeritus at the Wharton School of the University of Pennsylvania who operates a mortgage-advice Web site.

In some cases, lenders can go after an investor's other assets to satisfy a loan if the borrower defaults. But that often depends on the loan agreement, which sets out what recourse the lender has in the case of a default. In a nonrecourse loan, lenders can take only the property itself to satisfy the debt. Most loans, however, are recourse loans, which means that the borrower's other assets may be at risk.

Individual investors may even be on the hook if they borrowed through a limited liability company or a partnership. Principals of LLCs, or general partners of partnerships, can be personally liable if they act as guarantors; lenders often require personal guarantees as part of the loan agreement.

"Banks want the individuals on the hook," says New York lawyer Gideon Rothschild. Partnerships and LLCs are good to "protect you against slips and falls on your property," adds Jay Adkisson, a Newport Beach, Calif., lawyer, but they offer little protection if a lender requires you to sign a personal guarantee.

What's more, whether other assets, such as insurance policies and personal residences, are shielded from

creditors varies widely by state. In Florida and Texas, for instance, your home, life-insurance policy, annuity or retirement plan are generally shielded from creditors. California, by contrast, offers much less protection for debtors. (More details about your state's laws are available at [http://www.assetprotectionbook.com/state\\_resources.htm](http://www.assetprotectionbook.com/state_resources.htm).)

Of course, investors can take steps to shield their assets from creditors. But setting up fancy structures, such as offshore trusts designed to keep property off limits from creditors, typically only works if done before creditors appear on the horizon, says Beachwood, Ohio, lawyer John E. Sullivan III. Similarly, assets in a 401(k) are generally protected from creditors if the plan was already in existence. "If you plan when the coast is clear, you should be OK," says Mr. Sullivan. "If you choose to wait, it could be too late."

Mr. Adkisson, the Newport Beach, Calif., lawyer, says he has received about 30 calls a week in recent months from real estate investors seeking to shield their assets, just as lenders are beginning to chase after them. "There's just an absolute flood of people seeking asset protection, and it's all after the fact. It's like buying auto insurance after the car wreck."

There are a few things you can do to protect your money even as creditors are moving in. One idea: Move to Florida and buy a big house. As long as you can stay out of bankruptcy and qualify for Florida residency, a creditor can't force the sale of your home under Florida law, says Mr. Rothschild, the New York lawyer, who adds that the tactic won't work under new bankruptcy rules if you're forced to file for bankruptcy protection.

Investors who face foreclosure may be left with a big federal tax hit, says Mr. Witt, of Deloitte. That's because, in a recourse loan, the amount of the loan forgiven by the lender, in excess of the property's fair market value, is typically taxed as ordinary income to the taxpayer, he says.

The tax code does offer some relief, but only if the loan is forgiven during bankruptcy proceedings or if the borrower was insolvent immediately before the loan was discharged. However, it's tough to prove insolvency, since the Internal Revenue Service considers many assets, such as 401(k) retirement plans, in determining whether a borrower is insolvent. "These assets are typically exempt from creditors, but not for tax purposes," says Mr. Witt.

One option to avoid, if possible: filing for bankruptcy protection. Laws passed in 2005 make it much tougher in some cases to protect certain assets, such as your primary residence, from creditors during bankruptcy.



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