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Letters to the Editor

By Gulf Coast Business Review - Wednesday, March 24, 2010

'Deed in Reduction' would create win-win
Editor's note: The following letter was sent to Sen. Garrett Richter, R-Naples, and the Review:

Dear Sen. Richter:
If you recall I previously provided you with some ideas a few years back on possible solutions to the residential mortgage foreclosure crisis and also appeared before you, and the other members of Gov. Crist's H.O.P.E. Task Force in Tallahassee to present my ideas and concerns.

I recently read the "Personal guarantors seeking relief" in the Gulf Coast Business Review, as well as the Congressional Oversight Report of Feb. 10 detailing the pending commercial lending crisis. I have some ideas on this as well as on the proposed mortgage foreclosure bill, sponsored by Dave Aronberg and Tom Grady. In my law practice, I have represented commercial and private lenders, numerous borrowers and handled more than 400 commercial and residential mortgage foreclosure cases in the past four years on behalf of borrowers and lenders.

If legislation to eliminate guarantor obligations of mortgages is adopted in Florida, it will have a severe negative effect on lenders, especially local community banks that have invested heavily in the commercial real estate market.

If personal guarantors are eliminated, underwriting will be tight, requiring huge equity buffers if commercial loans are to go non-recourse, which effectively will put commercial loans out of reach for all but those who can afford a 30% to 40% down payment (or more).

Lenders will fear drop-offs in values, and with a non-recourse loan would have to project out recovery of their loans against commercial properties whose values are diminishing and projected to do so in the future. The only feasible answer is to require a higher equity buffer at the loan commencement, which is created by a larger down payment. This reduces available purchasers or investors for commercial real estate.

With fewer prospective purchasers, prices will drop more. As prices drop, an even higher equity buffer will be required — a scary scenario of downward spiraling real estate prices. That would be the result if such legislation were adopted.

My solution is to create legislation requiring the lender to recapture its collateral quickly and require the lender to exhaust its remedies against real property before pursuing the guarantors directly. This does not eliminate the guaranty obligation or the bank's rights for its recourse debt. It maintains the bank's loan/underwriting protection of a solvent guarantor, but it does require

that the lender look first to the real property as a source of repayment and only then to the guarantor for recovery.

Implementing my proposed “Deed in Reduction” program into law for commercial transactions would require the lender to address the deficiency issue promptly. The lender first would give credit to the borrower/guarantor for the current existing value of the property (most likely the highest value of the commercial property in the next 18-24 months) against the then-existing mortgage balance (mathematically the lowest amount at the commencement of the proceeding), which would reduce the claimed loss of the lender and the borrower and the ultimate exposure to a deficiency as against the guarantor.

Result: Win/win.

I suggest that the “Deed in Reduction” program be considered also to require lenders to exhaust first their remedies quickly and efficiently as against the real property prior to initiating suit against the guarantors. (For some reason every proponent of a new bill forgets the expedited procedure already in place in FS 702.10, which I have utilized successfully and quickly to eliminate foreclosure delays).

I can amplify scenarios that demonstrate that the procedure of suing the guarantors directly rather than first foreclosing on the real property creates massive damage issues for the guarantor while at the same time having a significantly detrimental negative effect on the commercial real estate marketplace. That practice actually harms the lenders in the long run because it destroys the underlying commercial marketplace and has a chilling effect on borrowers asked to guaranty loans when they are faced with paying 100% of the loan default without looking to the collateral for mitigation of damages.

The Florida Banker Association bill (as critiqued above) is definitely not the answer. Eliminating recourse debt is definitely not the answer. There are better solutions.

Kevin F. Jursinski
Fort Myers, Florida 33907