

The Impact of Declining Home Values On Your Relocation Program

— GRAEBEL UNIVERSITY

The plunge in home values over the past several years has had a significant impact on a corporation's ability to relocate employees in a timely and cost effective manner. Declining home values and increasing numbers of foreclosures have led to a substantial number of transferring employees being faced with significant financial decisions related to the disposition value of their home, either at a third party sale price under a buyer value option program or at an appraised offer price under a guaranteed buyout option program.

Terms such as "Negative Equity", "Loss on Sale", "Deed in Lieu of Foreclosure", "Foreclosure", and "Short Sale" have become common in relocation transactions and present everyday dilemmas for those involved in these transactions. Significant tax implications also may result from the cancellation of debt which is often associated with the use of these types of transactions.

Graebel University looks at each of these situations individually, reviews their impact on relocation transactions, and presents options which may be available under certain scenarios to address these situations.



Negative Equity

Definition

"Negative Equity" occurs when a third party sale price under a Buyer Value Option (BVO) program or an appraised offer price under a Guaranteed Buyout Option (GBO) program is less than the total of the amounts owed by the employee on all mortgages and other closing costs. This is sometimes referred to as the employee being "underwater" or "upside down."

Impact on Relocation

A Negative Equity transaction is different from a Short Sale transaction in that in a Negative Equity transaction the employee has the resources to pay the shortfall and the home is acquired.

According to the Graebel-sponsored and recently distributed Worldwide ERC Transferred Employees survey in which 162 companies responded, 7 of 10 companies will accept homes into the home sale program with negative equity and the vast majority require the balance to be paid at closing with no assistance from the company.

Options

If Negative Equity exists, the employee will need to pay the shortfall to close and have his or her home acquired (unless the policy provides loss on sale protection and the negative equity is eligible for this provision).

Loss on Sale

Definition

"Loss on Sale" occurs when the difference between the original purchase price of a home is greater than sales price – either the third party sale price under the BVO program, or the appraised offer price under a GBO program. There are many options to calculating Loss on Sale. Some companies consider capital improvements in the calculation (either depreciated value or actual cost).

Impact on Relocation

Companies that have a Loss on Sale benefit in their relocation policy have seen increased usage and a higher expense (by 33%¹) of this benefit and subsequently increased relocation program costs. Companies which do not offer this benefit have seen the challenge of relocating employees increase and, in some cases, become impossible. In most instances, Loss on Sale has been a hot topic of discussion when relocation policies are analyzed against a company's workforce mobility goals.

According to the ERC survey, 46 percent of employers offer a formal loss on sale program and another 18 percent offer this benefit on a case by case basis². There are many options to calculating a Loss on Sale.

Options

Creative options in dealing with Loss on Sale benefits include:

- > Capping the benefit at a specific dollar amount or at a maximum percentage of the home's disposition value. The number of companies that cover 100% of the loss on sale has dropped from 40% in 1987 to 13% in 2008. The dollar amount of the cap ranges from \$15,000 - \$200,000 with the most frequent dollar limit at \$25,000 - \$50,000³.
- > Creating a minimum dollar threshold to be met before the Loss on Sale benefit is available.
- > Adopting a formula-based approach that shares the Loss on Sale with the employee. For example the transferee is responsible for the first \$5,000 of loss and the remaining amount of the loss is shared at a set % until the cap is reached.
- > Requiring the employee to follow list price guidelines and to use an approved real estate broker in order to be eligible for the Loss on Sale benefit.
- > Calculating the Loss on Sale as the difference between the initial purchase price and disposition price and not considering any capital improvements in the calculation. Ideally the buyers and appraisers will consider the value of these improvements their valuation of the property.

Deed in Lieu of Foreclosure

Definition

“Deed in Lieu of Foreclosure” describes a situation where an employee has defaulted under the terms of a mortgage loan (including instances where an employee has Negative Equity in a home) and does not wish to contest the right of the lender to foreclose upon the mortgage. The employee executes a deed conveying the home to the lender and “walks away” from the equity, if any, which the employee may have in the home. Under this procedure, both the lender and the employee avoid the costs of a foreclosure proceeding. The default under the mortgage loan that preceded the employee transferring the home to the lender will have a negative impact on the employee’s credit rating.

Impact on Relocation

When an employee has defaulted under the

Foreclosure

Definition

“Foreclosure” is the process where an employee has defaulted under the terms of a mortgage loan (including instances where an employee has Negative Equity in a home) and the employee wishes to contest the right of the lender to foreclose upon the mortgage. The lender commences a foreclosure proceeding and the employee could remain in the home while the foreclosure proceeding progresses.

In many states, the employee will have a “redemption period” during which the employee has the right to pay off the mortgage and retain ownership of the home. Under this procedure, both the lender and the employee incur the costs of a foreclosure proceeding. Again, the default under the mortgage loan will have a negative impact on the employee’s credit rating.

Short Sales

Definition

A “Short Sale” describes the situation where an employee has Negative Equity in a home and the lender agrees to take less than the amount owed on the mortgage loan through a sale of the home to a buyer. In the past, lenders would not normally participate in Short Sale transactions and would rather commence foreclosure proceedings since they believed that they would increase their recovery by participating in a rising housing market and by being able to preserve their right to pursue the employee for any deficiency.

Due to the very high number of homes that are currently owned by lenders after the completion of foreclosure proceedings, and the sizeable amount of Negative Equity which exists in many homes, many lenders have been willing to consider participating in Short Sale



terms of a mortgage loan (including instances where an employee has Negative Equity in a home) and has given the lender a Deed in Lieu of Foreclosure, the employee will no longer own the home and the home would be excluded from a company’s relocation program since it will be impossible for the relocation company to convey clear title to the home to a buyer.

Options

Since the home will no longer be owned by the transferee the home sale portion of the relocation benefits will not be available.

Impact on Relocation

When an employee has defaulted under the terms of a mortgage loan (including instances where an employee has Negative Equity in a home) and a foreclosure proceeding is pending, the home would typically be excluded from a company’s relocation program since it will be very difficult for the relocation company to cure the default and convey clear title to the home to a buyer without the consent of the lender.

Options

The foreclosure status makes the home ineligible for the home sale portion of the relocation benefits since it cannot be acquired with clear title.

transactions. By doing so, lenders avoid the costs of a foreclosure proceeding and avoid taking ownership of the home. A prompt resale of the home, even at a loss, to a buyer is often viewed by lenders as a preferable alternative to taking ownership of the home and watching the condition and the remaining value of the home continue to decline, further increasing the lender’s loss.

In most cases, in order to be considered for a Short Sale, the employee needs to be behind in mortgage payments and demonstrate that other assets are not available to pay the shortfall. The amount of time which is required for lender approval of a Short Sale varies and can take up to two months or longer.



When a second mortgage or a home equity line of credit is involved in a Short Sale, the transaction is even more complicated since the employee will have to obtain the approval of two lenders. Participation in a Short Sale Transaction will usually have a significant negative impact on the employee's credit rating. In addition lenders will often request a reduced real estate commission on a short sale transaction to help reduce the selling costs.

Impact on Relocation

In a Short Sale transaction, the lender is in control of the transaction and can dictate the terms and timing. Many lenders will ask for documentation from the company of any payments which are made under a Loss on Sale program or other home sale benefits paid to the employee and consider including those payments in their calculations. Unlike a typical sale with a third party buyer where the relocation service provider manages the transaction once the buyer's offer is accepted, the employee and the employee's lender will need to be actively involved with the Short Sale transaction until closing.

Options

Options and recommendations which should be considered in dealing with Short Sale transactions include:

- > While a Short Sale transaction may be a good option for both the employee and the employee's lender, it is usually not appropriate for an employer to become directly involved in such a transaction. Each lender can treat a short sale differently and may have different processes themselves based on the investor who ultimately owns the mortgage note.
- > In a GBO transaction where no outside buyer is involved and the appraised price offer is the only offer which the employee has for a home, we do not recommend allowing a Short Sale transaction to be part of the relocation program as the employer will have to pay off the mortgage debt on the home as a condition of the employee's lender agreeing to such a transaction.
- > In either a GBO transaction or a BVO transaction where a third party buyer is involved, we recommend the use of a direct reimbursement program to reduce the risk to the employer which could arise if either the sale to the third party buyer falls through (with the employer having to pay off the mortgage debt on the home) or if the employee's lender does not approve the proposed Short Sale.
- > We recommend that employees contact their lenders as soon as they are aware that they may be in a Negative Equity situation to determine the process which the lender will utilize in order to consider a Short Sale.

Tax Implications

In situations where any portion of a debt is canceled by a lender as part of a Deed in Lieu of Foreclosure, a Foreclosure, or a Short Sale, the amount of debt which has been forgiven is considered to be taxable income to the employee by the IRS as well as by many states.

The Debt Relief Act of 2007 placed a temporary moratorium on the taxability of these debt forgiveness amounts for transactions which occur between January 1, 2007 and December 31, 2012 for amounts up to \$2,000,000 (\$1,000,000 if married filing separately) provided that the mortgage was on a primary residence⁴. Please note that this exemption from tax does not apply to equity lines of credit which if canceled will result in taxable income to the employee.



Conclusion

Negative Equity, Loss on Sale, Deed in Lieu of Foreclosure, Foreclosure, and Short Sales have added to the challenges for employers and employees in the current declining residential real estate market. All have significant impact on relocation policies as well as tax and legal implications. For additional information about any of these matters, please contact your Graebel account representative today.

⁴IRS Publication 4702 Mortgage Forgiveness Debt Relief Act of 2007 and IRS Publication 4681 Canceled Debts, Foreclosures, Repossessions and Abandonments

The information contained in this document represents the current view of Graebel Companies, Inc., on the issues discussed as of the date of publication. Because of changing market conditions, Graebel cannot guarantee the accuracy of information presented after the date of publication.

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