Foreclosure freeze may hit buyers

Title insurance may protect those who already bought foreclosed homes

By Dave Carpenter
THE ASSOCIATED PRESS

It seemed too good to be true: You bought a house in foreclosure at a fraction of the former price. Maybe you even knocked out a wall or two and remodeled with all the money you saved.

But now thousands of foreclosures around the country may be invalid because of bank paperwork problems. Should you worry?

"Anyone who's purchased a foreclosed property in the last three years should really be concerned," says George Babcock, a Providence, R.I., attorney who represents homeowners who have been foreclosed on.

"They should call the attorney that did their closing and say, 'Hey, do I have a problem?' "

Bank of America, JPMorgan Chase and other major lenders have frozen tens of thousands of foreclosures in at least some states while they review the paperwork for errors or mishandling.

For homeowners, there are several questions to ask. But first, experts say, they should check to make sure they have title insurance, which protects the homebuyer from any claim on the property that surfaces after the deal has closed.

Those claims can arise from unpaid taxes or legal glitches in the ownership documents. Most people who take out mortgages are required by their lenders to buy a policy. For those paying cash, it's optional but highly advisable, especially now.

"If you're a bona fide purchaser with title insurance and no knowledge of any irregularities in the transaction, courts are going to be extremely loath to set aside the sale," says Diane Thompson, an attorney with the National Consumer Law Center.

This new twist to the foreclosure crisis is no trivial matter for the large and growing number of people buying homes out of foreclosure.

The foreclosure listing service RealtyTrac Inc. says that nearly 250,000 homes sold from April to June, or 24 percent, were in foreclosure.

In Nevada, it was 56 percent. Arizona was next with 47 percent and California third with 43 percent.

The cost of title insurance varies by state and circumstance but is often roughly 0.5 percent of the mortgage — in the neighborhood of $1,000 for a $200,000 loan. Premiums are expected to rise as title companies brace for new claims.

A homeowner with title insurance shouldn't have to worry if the previous owner stakes a claim to the home. Even a successful claim, experts say, would almost certainly end up with the title company settling with the evicted homeowner — not the new buyer out on the curb.

If they failed to make payments repeatedly, evicted homeowners might not be able to afford their old homes anyway, something a judge would consider.

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They're more likely to seek a large check than a return to a house with an outsized debt.

The situation is murkier for people who bought their homes with cash and didn't bother with title insurance. The issue of who has proper title in that situation could be uncertain.

"It is not clear, which is why the banks have imposed their own moratoriums on foreclosure," says CEO Tim Dwyer of Entitle Direct Group, the holding company for EnTitle Insurance Co., an Ohio title insurer. "Potentially, you face a legal battle in that situation."

Analysts expect the sudden questions to lead to a flurry of claims on homes now in the hands of other people, some spurred by lawyers trying to capitalize on the uncertainty.

"Lawyers who represent homeowners in foreclosure are going to see an explosion in demand," said Tom Lawler, an independent housing economist in Virginia. In most cases, he noted, "it's unlikely that the foreclosure will actually be reversed and the title will revert to the original borrower. But it's possible."

Babcock, for one, says his phones have been ringing off the hook with calls from people who were foreclosed on and want to know if he can get their houses back.

He has sent off dozens of letters to recent buyers of those homes, alleging that because of defects in the foreclosure process they don't actually own the property and suggesting impending legal action.

"I'm not saying that all of the titles are toxic," he says. "But many, many, many are."

Mark Stopa, a Tampa, Fla., lawyer who represents hundreds of homeowners facing foreclosure, contends that perhaps a quarter of cases have title problems that merit challenges.

Legal experts concede it's possible that there may be a judge somewhere who's disgusted enough with how the banks conducted themselves to throw out foreclosures. So if you're the new owner of a foreclosed property and worried, what should you do?

First, check to make sure you have a title policy and the title is clear, which means there are no liens against the property and the ownership is clearly established.

The fee to have a title search conducted should be $35 to $100, according to Jason Biro, a 14-year veteran of the mortgage industry who now runs the nonprofit consumer advocacy firm Saving Your American Dream.

If no problems surface, you may still want to run another title search every six months or so if you are interested in selling anytime soon, given the current confusion, Biro says. If you've had the property four years or so, it should be OK, Stopa says.

Those who paid cash and without title insurance will not necessarily be forced to pack up and leave.

That's because many states provide protections for those who bought in good faith, according to Biro — essentially anyone who wasn't trying to exploit a flaw in the foreclosure system. So the buyer of a foreclosed property should still be able to fend off a title-related claim. The downside: That fight could entail significant legal expenses.

In the future, there may be a bigger issue — what happens to foreclosure sales if buyers are concerned that they can't get title insurance. It's rare, but not unheard of, for a title insurance company to be liquidated.

Yet another risk in the flagging economy is that the title insurance company is liquidated, leaving you without protection. That's rare, but it does happen. Credit ratings agency A.M. Best Co. warned buyers as recently as last year of financial problems among some title insurers.

What about buying right now?

Rick Sharga, a RealtyTrac senior vice president, said buyers who are making a foreclosure purchase from a bank shouldn't be concerned. He says they should just double-check to make sure it's possible to get title insurance.

If the title insurance company won't sell a policy on a property, you probably shouldn't buy it, Stopa says.