Mortgage Default Prevention

The following information will help you understand the mortgage default process. It will also guide you in serving as your own advocate in negotiating with your lender.

Please review *Alternatives to Foreclosure* and decide which option would work best for you. If you've missed a mortgage payment, your first step is to contact your lender:

- Be prepared to spend significant time on hold
- Document date, time, name of person you talk to and summarize what was discussed.
- Ask for a direct phone number and extension
- Do NOT agree to a repayment plan unless you are positive you can fulfill the agreement
- Ask for a workout package to be sent to you
  (Reduce or eliminate unnecessary expenses before submitting your financial information)

OVERVIEW OF ALTERNATIVES TO FORECLOSURE

Private Foreclosures:

Private lenders are in the business of lending, and have little or no interest in owning and managing properties. Foreclosure is a last resort, and lenders are interested in selling the property as soon as possible.

Ultimately, the only thing that will stop a foreclosure proceeding is repayment of the debt; everything else delays the proceedings.

Keeping the Property vs. Selling the Property

If your monthly house payment (including property taxes and insurance) does not exceed 40% of your gross monthly income, it should be possible to keep the property. If the payment is greater than 40% of gross monthly income, consider selling or transferring the property to avoid negative impacts to your credit.

The objectives in order of importance should be:

- Keep the property if possible.
- Don't give away equity if you can keep it or liquidate and put it in your pocket.
- Minimize damage to your credit. You will need it later.

Lender Workout:

Before exploring new options, try to come to terms with the existing lender. Lenders want the loan to be current; they do not want foreclosure. Perhaps you can make up the defaulted amount over a period of months: maybe the note can be re-written to include the defaulted amount; or maybe the lender will except a deed-in-lieu of foreclosure and preserve your credit. These are some questions you should ask yourself and possible your lender. The lender will want to know why the loan is in default and why you think you will be able to make the payments in the future. Temporary financial setbacks that have since been cured are the best candidates for this. Your lender will probably not be inclined to stop foreclosure proceedings if they have reason to believe they will just have to start again in 6 months.

Some options enable borrowers who can overcome the cause of the hardship to keep their homes. These options include:

- Short-term repayment plans
- Forbearance
- Refinance
- Modification
- Partial Claim or Advance Claim

Other workout options assist a borrower who will not be able to recover to transition to more affordable housing. These options include:

- Straight sale
- Assumption
- Pre Foreclosure Sale *(also called a pre-sale, short sale or VA compromise)*
- Deed-in-Lieu of Foreclosure

Workout Option Descriptions

Short-term Repayment Plan – All lenders first try to negotiate a short term repayment plan by asking the borrower to begin paying the full payment due plus a partial payment to get the loan caught up.

- Short-term repayment is successful for a large percentage of delinquent borrowers who fall temporarily behind but are not experiencing serious financial distress.
- This option is usually negotiated by the collection agent for the lender and is not in writing.
- Short-term plans are generally 90 to 120 days.

Forbearance Agreements – The lender agrees in writing to allow the borrower to "catch-up" on the mortgage payments over a period of several months.

- The homeowner must be careful to keep the commitment or face foreclosure.
- The cause of the default is specific and temporary but cannot be resolved in a short period of time.
- The borrower demonstrates a strong desire to retain ownership of the property.
- There is reasonable evidence that with adequate time the borrower will be able to resume making full monthly payments and have excess funds to pay off the past due balance.
- Lenders usually require a financial application before agreeing to forbearance. If the homeowner has a good past payment history, he/she has a better chance of working out a forbearance agreement.

Refinancing – Applying to the original lender or another bank or mortgage company to re-write the mortgage loan. This would be done to lower the interest rate, or establish a fixed rate, or lower the monthly payment or all of the above. The purpose of the refinancing is to make the mortgage payments more affordable and to prevent future default.

Modification – Changes one or more of the original terms of the loan, such as the interest rate, payment amount, maturity date or the amount of the unpaid principal balance. A modification can cure the default by capitalizing the arrearage and/or reducing the monthly payment to an amount, which is more affordable for the borrower. Loan modification may be appropriate when:

- The loan is at least 12 months old and has not been previously modified.
- The borrower has equity sufficient to cover the arrearage, or
- Changes in the loan terms such as a reduction in the interest rate, extension of the repayment term or reamortization of the debt would reduce the payment to a level the borrower could afford.
- The borrower demonstrates a strong desire to retain ownership of the property.
- The borrower has a stable income to support the new payment.

Partial or Advance Claim – Lender may be able to help borrower obtain an interest-free loan from HUD to bring mortgage current. Borrower will execute a Promissory Note and a Lien will be placed on the property until the Note is paid in full. Borrower may qualify if:

- Loan is at least 4 months delinquent
- Mortgage is not in foreclosure
- Borrower is able to begin making full mortgage payments

Straight Sale – If the borrower has sufficient equity, they may be able to sell the property prior to foreclosure and net enough from the sale to pay off the loan. This may be an option if:

- In the opinion of real estate professionals, the house is in marketable condition and if properly priced can sell within 90 to 120 days.
- The borrower is willing to offer the house at or below market value to generate a quick sale.
- At the anticipated sale price, there is enough equity in the property to repay the outstanding balance due and sales transactions costs.
- If the lender sees that the borrower, has equity and is making serious efforts to market the property the lender will generally delay foreclosure for a reasonable time to allow the property to sell.
- The lender will probably require the borrower to make full or partial payments during the marketing period to keep the overdue balance from growing.

Assumption – Some mortgages can be assumed (taken over) by a third party. When a mortgage is assumable, the property can be transferred, and the person to whom it is transferred can pick up the payments. If payments were behind when the mortgage was assumed, absent a workout agreement, the person assuming the mortgage will be in default and subject to foreclosure. The advantage may be that the assuming party is in a better position to deal with the default. A mortgage is always assumable if the contract documents say it is or, in most states, if the documents are silent on this issue. Other mortgages contain a "due on sale" provision which is a clause specifying that transfer of the property creates a default.

Pre-Foreclosure Sale ***(also called a pre-sale, short sale or VA compromise)***– is the sale of a property by the borrower for less than the amount necessary to payoff the loan. Wherein the lender agrees to accept the proceeds of the sale (or some other agreed upon amount) to be applied toward the debt. The Lender will consider a short payoff when the borrower:

- Is experiencing a financial hardship.
- Is actively trying to sell the property or already has a buyer willing to purchase at market value.
- Is not receiving any cash from the transaction.
- Most investors require that the sale price be at least 95% of the fair market value as determined by an appraisal or BPO completed by a disinterested third party within the past 90 days, that supports the price being paid.
- The borrower, based on his or her financial ability, may be asked to make a cash contribution to offset the amount of the debt being forgiven.
- The borrower may incur income tax liability for the amount of the debt, which was forgiven as a result of the sale.

Deed-in-Lieu of Foreclosure ***(DIL)*** – is the borrower's voluntary conveyance of title to the lender in exchange for discharge of the debt. In accepting the deed, the lender is also accepting responsibility for all liens against the property including judgments, junior liens, lease obligations, etc. Lenders research title very carefully before accepting a DIL. Consider this option when:

- The borrower has little or no equity in the property
- All other loss mitigation choices have been exhausted
- The borrower has a financial hardship and can demonstrate that he is incapable of paying the debt.
- The borrower wants to walk away and has made a written request to convey the property.
- The amount of the lender's deficiency must be reported to IRS as income.

ADDITIONAL INFORMATION

1. If you have a 401K you may be able to make an emergency withdrawal.
2. VA Loans may have certain protections against foreclosure. Call the Veterans Administration at 1-888-349-7541 to find out if you are eligible.

Hardship Letter Outline

A letter which explains your situation is known as a *Hardship Letter* and should be sent to your lender with a completed workout package.

I. Provide Homeowner identification information
- Name, address of the property and account number

II. Introduction
- The first paragraph of the letter should identify what loss mitigation option the homeowner is requesting.

III. A description of the hardship and the reason for the hardship
- It's important for the borrower to be specific, explaining what caused the problem.

IV. Overview of current income and expenses
- The borrower should provide full financial disclosure of all income and expenses. Most lenders will provide a financial statement to be completed by the borrower.

V. Propose a plan
- This gives the borrower to request what he/she may need.

VI. Provide a method contact
- Daytime and Evening number

VII. Attachments:
- Financial Statement
- Hardship verification (e.g. unexpected repairs, reduction in income, medical, etc.)
- Verification of increase income.

Homeowner Checklist to Avoiding Foreclosure

You may not be having financial trouble now, but many people do have money problems at some point in their lives. This checklist is not comprehensive and is not intended to provide legal advice. If you need legal advice, you should speak with a lawyer. The best way to avoid foreclosure is to make your mortgage the first bill that you pay each month. However, that is not always possible. The following information provides general suggestions and ideas as to how you can prepare for and work through tough times.

Before Trouble Starts

☐ Start a file, in a safe place, for records relating to your home

- Purchase and sale agreement
- Mortgage application
- Closing documents
- Property tax bills
- Property insurance information
- Letters you receive from and copies of letters you mail to the bank

☐ Use checks, money orders or automatic withdrawal to pay bills

- Do not send cash
- Do not use credit cards
- Keep a record of all payments (date paid and check number)
- Correct errors quickly

☐ Pay high priority bills first

- Food
- Mortgage
- Utilities (heat, hot water, electricity, gas)
- Do **not** pay credit cards or other unsecured debts **before** the mortgage

When Things Start to Feel Tight

☐ Where is the Money Going?

- Write down every cent you spend
- Create a budget that shows your current income and expenses
- Review every item on your budget
- Prepare a revised, realistic budget that you can live with until your circumstances improve

☐ Increase Your Income

- Collect federal and state benefits if you are eligible
- Claim the earned income tax credit if you are eligible
- Stop all voluntary deductions being taken out of your paycheck
- Consider selling unnecessary property to raise money

☐ Reduce Your Expenses

- Review every expense for potential savings – reduce or eliminate unnecessary expenses
- Pay only for the type of phone service you need (cancel cell phones)
- Cancel cable or satellite television service temporarily
- Identify ways to conserve on energy and other utilities
- Participate in a home weatherization program
- Review your homeowner's and auto insurance policies and shop around

☐ Other Considerations

- Contact your mortgage servicer at the first sign of trouble
- Ask your utility company for budget billing so you can pay the same amount each month
- If you are behind on your utility bills, start an affordable repayment plan

After Falling Behind

☐ Identify the Problem

- What caused your current situation (job loss, illness, divorce, decreased income)
- How long do you expect your difficulty to last
- What specific type of help do you need
- How much can you afford to pay toward your mortgage

☐ Communicate

- Speak with your bank's delinquent loan or loss mitigation specialist
- Explain your situation
- Ask for a mortgage workout package
- Keep a phone log that shows the date and time of your call, who you spoke to, the person's phone number and what was said
- Follow up your phone call with a letter and keep a copy for yourself
- Send all letters by certified mail and keep the receipt

☐ Pay What You Can and Save the Rest

- Send to the bank as much of the mortgage payment as possible
- If the bank returns your payment, save the money – **do not spend it** on other bills

☐ Know Your Options

- There are many ways the bank can help you if you fall behind on your mortgage. Which one you choose/need and what the bank allows will depend on your individual situation.

Choosing Which Debts to Pay First

Choosing which debts to pay when you can't pay everyone. The Consequences of not paying different types of debt. What if you cannot pay all your important debts?

Unsecured vs. Secured Debt

The most import principle in setting priorities is to understand the concept of *collateral.* Collateral is property which a creditor has the right to seize if you do not pay a particular debt. The most common forms of collateral are your home in the case of a mortgage (or deed of trust) and your car in the case of most car loans.

Determine which of your debts
are *"secured"* and which are *"unsecured"*.
You should almost always pay secured debts first.

1. **Always Pay Family Necessities First.** Usually this means food and unavoidable medical expenses.

2. **Next Pay Your Housing-Related Bills.** Keep up your mortgage or rent payments if at all possible. If you own your home, real estate taxes and insurance must also be paid unless they are included in the mortgage payment. Similarly, any condo fees or mobile home lot payments should be considered a high priority.

3. **Pay the Minimum Required to Keep Essential Utility Service.** While this may not always require full and immediate payment of the entire amount of the bill, the minimum payment necessary to avoid disconnection should be made if at all possible.

4. **Pay Car Loans or Leases Next If You Need to Keep Your Car.** If you need your car to get to work or for other essential transportation, you will usually make your car loan or lease payments your next priority after food, housing costs, unavoidable medical expenses and utilities. You may even want to pay for the car first if the car is necessary to keep your job. This would also mean keeping up on the car insurance payments as well.

5. **You Must Pay Child Support Debts.** These debts will not go away and can result in very serious problems, including prison, for nonpayment.

6. **Income Tax Debts Are Also High Priority.** You must pay any income taxes you owe that are not automatically deducted from your wages and you certainly must file your federal income tax return even if you cannot afford to pay any balance due. Remember though, if you have lost income due to a change of circumstances, your tax obligations will also be reduced. Pay only what is necessary.

7. **Loans Without Collateral Are Low Priority.** Most credit card debts, attorney, doctor and hospital bills, and other debts to professionals, open accounts with merchants, and similar debts are low priority.

8. **Loans With Only Household Goods As Collateral Are Also Low Priority.** Sometimes a creditor requires you to place some of your household goods as collateral on a loan. You should generally treat this loan the same as an unsecured debt – as low priority.

9. **Do Not Move a Debt Up in Priority Because the Creditor Threatens Suit.** Many threats to sue are not carried out. Even if the creditor does sue, it will take a while for the collector to be able to seize your property.

10. **Do Not Pay When You Have Good Legal Defenses to Repayment.** Some examples of legal defenses are that goods purchased were defective, or that the creditor is asking for more money than it is entitled to.

11. **Court Judgments Against You Move Up in Priority, But Often Less Than You Think.** After a collector obtains a court judgment, that debt often should move up in priority, because the creditor can enforce that judgment by asking the court to seize certain of your property, wages, and bank accounts. This is also a good time to obtain professional advice.

12. **Student Loans Are Medium Priority Debts.** They should generally be paid ahead of low priority debts.

13. **Debt Collection Efforts Should Never Move Up a Debt's Priority.** Be polite to the collector, but make your own choices about which debts to pay based on what is best for your family. Debt collectors are unlikely to give you good advice.

14. **Threats to Ruin Your Credit Record Should Never Move Up a Debt's Priority.** In many cases, when a collector threatens to report your delinquency to a credit bureau, the creditor has already provided the credit bureau with the exact status of the account.

15. **Cosigned Debts Should Be Treated Like Your Other Debts.** If you have put up your home or car as collateral on a loan, that is a high-priority debt for you if the other cosigners are not keeping the debt current.

16. **Refinancing Is Rarely the Answer.** You should always be careful about refinancing.