Community Housing
CHRC
Resource Center

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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.