housing information

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Saving your home from foreclosure

A project of Consumer Action

Saving your home

Foreclosure—the repossession of your home by your lender—means you will lose the property and any equity you had in it. Your credit record will be damaged and you may incur a tax liability if the lender foregoes (forgives) any part of your debt.

Foreclosure becomes a possibility when you get significantly behind on your monthly mortgage payments. You could find yourself in a position where you cannot make one or more full mortgage payments for a variety of reasons, including:

- **Unplanned expenses or a loss of income:** An emergency car or home repair or unexpected medical bills can leave you short of funds to pay your other bills. Likewise, a long-term or permanent loss of income due to a layoff, a reduction in overtime hours, a divorce, or an injury or illness that keeps you away from work could affect your ability to make your full mortgage payment not just this month, but for many months.

- **A home loan that requires a large increase in monthly payments:** More than ever, homeowners have mortgages that are structured so that at some point the required monthly mortgage payment goes up significantly. (Increases occur one to five years after you make the first payment.) Depending on the loan terms and the interest rates at the time the rate adjusts or "resets," your monthly payment can increase by many hundreds of dollars. (See "Know your mortgage loans" on page 7 to learn about the types of loans that can put you at greater risk of default.)

- **Predatory loan terms:** A predatory loan includes unfair or deceptive terms, high rates and costly fees, payment requirements that the lender knows will be difficult for you to meet, or features that get you deeper into debt and strip your home equity. Since these loans are often unaffordable from the outset, the risk of foreclosure is very great. One in five homeowners may be at risk of foreclosure due to these types of loans. (See "Avoiding foreclosure scams" on page 6 for more about predatory lending and how to avoid a bad loan or a scam.)

Despite your best efforts to plan for emergencies, prepare for higher payments and avoid abusive lenders, you may still find yourself missing one or more payments. If that happens, you may still save your home from foreclosure by understanding your options and taking the appropriate steps.

Keeping your home

Many homeowners mistakenly believe that all lenders are eager to foreclose and take possession of their property. It is true that predatory or abusive lenders may intentionally lend money with the goal of pursuing foreclosure and repossessing the home. (To learn how to spot and steer clear of predatory lenders, see "Avoiding foreclosure scams" on page 6.)

However, legitimate mortgage lenders prefer to receive your loan payments, and will foreclose only as a last resort because it is a costly and time-consuming process. Lenders are required to explore options to keep borrowers in their homes. This means your lender may offer special "loss mitigation" programs to help committed borrowers avoid foreclosure.

Lender solutions to foreclosure

Lenders have ways to get borrowers back on track. Although lender solutions vary, foreclosure prevention options may include:

- **Reinstatement.** Occurs when you pay the lender the entire past-due amount you owe, plus any late fees or penalties, by an agreed upon date.
- **Repayment plan.** Your lender may add an additional amount of money to your regular monthly payment to make up the past-due amount, or missed payments may be added to the loan balance.
- **Forbearance.** A formal agreement with the lender under which your mortgage payments are reduced or suspended for an agreed upon period. At the end of that period, you resume regular payments, and bring the loan current through a lump sum payment or additional partial payments over a number of months (unless the loan has been modified to make this unnecessary).
- **Loan modification.** Involves permanently changing the mortgage to make your payments more manageable. Modifications include lowering the interest rate, extending the term of the loan, adding missed payments to the loan balance, or as last resort, reducing the principal amount of the loan.

Mortgages through the Federal Housing Administration (FHA) and Veterans Administration (VA) may offer different or additional foreclosure alternatives. For example, an FHA borrower may be eligible for a one-time payment from the FHA insurance fund to the lender to bring the mortgage current. The borrower is responsible for repaying the "partial claim" when you pay off the mortgage or sell the property.

The best solution ("workout" or "cure") will depend on your situation. A repayment plan may be a good remedy for someone who has to make up only one missed payment. A loan modification may be necessary for someone facing a long-term reduction in income. You and the lender work together to determine if any of the available tools will get you back on track.

If you and the lender cannot agree on a feasible repayment plan or other remedy, look into filing Chapter 13 bankruptcy. This temporarily suspends the foreclosure process and may force the lender to accept a repayment plan that is more affordable for you. Bankruptcy isn't always a solution—it will damage your credit and new bankruptcy laws enacted in 2005 make it tougher to file bankruptcy for some people. But depending on the state you live in, bankruptcy might help save your home. Talk to a HUD-approved housing counselor to learn more about this option. (See "Housing counseling can help" on page 5.)

Communicate with your lender

Many people lose their homes because they are too ashamed to act, or they go into denial about the seriousness of the problem. To prevent foreclosure, be decisive and explore all solutions. Contact your lender at the number on your statement at the first sign of trouble—even if you have not missed a payment but you think you might have to in future. Your lender will make notes about your phone call in your account file. Reputable lenders and loan servicers should view your contact as an indication that you are committed to fixing the problem rather than avoiding it. The lender may begin discussing possible solutions to your payment problem.

If you have already missed a payment and have not contacted the lender yet, do so immediately. Do not ignore letters or calls from the lender! The longer you wait to act, the fewer options you will have.

If your loan is with a predatory or abusive lender, your phone call might not help. However, it will not speed up a foreclosure since your state's law dictates the foreclosure timeline. If you suspect you have a predatory loan—and especially if you believe you will miss a payment—contact a HUD-approved housing counseling agency or one of the other organizations listed in under "Avoiding foreclosure scams" on page 6.

To prepare for your discussion with your lender or a counselor, have your mortgage bill and account number available plus proof of your income and expenses. Collect the last two month's bank statements, homeowner's insurance and copies of your most recent tax return. Then think about and jot down answers to the following questions:

• **Problem.** What has happened to cause you to miss your mortgage payment(s)? Do you have any documents to back up your explanation for falling behind (for example, a doctor's letter or a notice of unemployment benefits)? What, if any, efforts have you made to resolve the problem?

• **Outlook.** Is this problem temporary, or is it long-term or permanent? What changes in your situation do you see in the short term? In the long term? Are there other financial issues that might stand in the way of getting back on track with your mortgage?

• **Solution.** What would you like to see happen? Do you want to keep the home? What type of payment arrangement would work for you?

• **Commitment.** How committed are you to making a solution work? Will you return calls and submit required documentation and forms to the lender on time?

Throughout the foreclosure prevention process:

• Keep a folder in which you note all communications with the lender, including type and time of contact, name of representative, and outcome.

• Follow up any oral requests you make with a letter to the lender. Send it to the lender using certified mail so that you can make sure it got there. If you ask for a "Return Receipt" you will receive proof of delivery. Keep a copy of your letter.

• Make only promises you are absolutely sure you can keep.

• Meet all deadlines given by the lender.

• Stay in your home during the process, since you may not qualify for certain types of assistance if you move out. (You can choose to rent out your home, but this will change it from a primary residence to an investment property. This will most likely disqualify you for any additional "workout" assistance from the lender, so be sure that the rental income is enough to help you get and keep your loan current.)

Housing counseling can help

You don't have to go through the foreclosure prevention process alone. A counselor with a HUD-approved housing counseling agency can assess your situation, answer your questions, go over your options, prioritize your debts and negotiate on your behalf with the lender and/or servicer for a modified mortgage payment.

These counseling organizations are approved by the U.S. Department of Housing and Urban Development (HUD) to provide information and counseling on home buying and homeownership. Counselors may also be aware of regional or local foreclosure "rescue" funds and aid for temporary hardship.

To find a local HUD-approved housing counseling agency, check the HUD web site (www.hud.gov/offices/hsg/sfh/hcc/hccprof14.cfm) or call 800-569-4287 (TTY: 800-877-8339).

Many HUD-certified housing counselors are also non-profit credit counseling services. In addition to foreclosure prevention assistance, they can help analyze your finances, including bills and debt payments, and may be able to enroll you in an agency-administered debt management plan that could reduce your monthly payments to other creditors. Legitimate housing and credit counseling services are usually free or low cost.

Selling your home

Not every situation can be resolved through your lender's loss mitigation programs. If you learn you will not be able to keep your home, or if you don't want to keep it, and you don't have sufficient equity to sell it and pay off your mortgage(s) in full, consider:

• **Assumption of the loan.** If you have an assumable loan (look for a "subject to transfer" clause in your loan agreement), it is conceivable that you could transfer your property to a new buyer who agrees to take over (assume) the existing mortgage. Assumable loans are very rare, so this will be an option for only a small fraction of homeowners.

• **Lender-approved sale.** Your lender might hold off on foreclosure proceedings for an agreed upon time to give you a chance to put your home on the market. Or it might postpone the foreclosure sale if you have a pending sale contract.

• **A short sale.** This is also called a pre-foreclosure sale on FHA loans. The lender may allow you sell the home yourself before it forecloses on the property, agreeing to write off any shortfall between the sale price and the mortgage balance. This enables you to avoid a damaging foreclosure on your credit report. You may face a tax liability on the amount of debt forgiven.

• **Deed in lieu of foreclosure.** You voluntarily transfer your property title to the lender (with the lender's permission) in exchange for cancellation of the remainder of your debt. Though you lose the home, a deed in lieu of foreclosure is less damaging to your credit than a foreclosure. However, you will lose any equity you may have had in the property and you may face an income tax liability on the amount of debt forgiven. A deed in lieu may not be an option for you if there are other loans or liens against the property.

Some states allow lenders to pursue a deficiency judgment, which means that the borrower is personally responsible to repay any remaining balance on the mortgage after a foreclosure sale. California law does not allow deficiency judgments on "purchase money mortgages" (a mortgage used instead of cash to buy your primary residence). A certified HUD housing counselor can tell you if deficiency judgments are allowed in your state.

If you can predict that you'll have serious payment problems that could lead to foreclosure, consider selling your home before you go into default.

This works if you have enough equity in the home to pay off the entire loan balance and all expenses associated with selling the home (such as real estate agent fees) from the proceeds of the sale. Such a sale would allow you to satisfy your mortgage obligation, avoid lender-imposed late and legal fees, avoid any damage to your credit rating and protect what equity you have in the property.

Avoiding foreclosure scams

Once the lender files a "notice of default," your mortgage troubles become public record. Scammers, predatory lenders and other con artists keep their eyes open so they can prey on homeowners in trouble.

Here are just a few of the scams and schemes to look out for:

• **Predatory refinance loans.** Unscrupulous lenders often come to the "rescue" with an offer of a loan that will supposedly get you out of financial difficulty and help you keep your home. In reality, many of these loans include terms and fees that are almost guaranteed to get you deeper in debt. When that happens, the lender is often ready to quickly foreclose on your home.

• **Flipping.** These same lenders rake in hefty fees by convincing homeowners to refinance over and over again, even when refinancing is not in a homeowner's best interest.

• **Foreclosure prevention scams.** These "specialists" and phony counselors, who say they'll keep you out of foreclosure for a fee, are scammers trying to get your money with no intention of providing the promised services. At the very least, they typically charge high fees for something you could do yourself or with the help of a free or low-cost HUD-approved housing counseling agency.

• **Equity skimming.** Be wary of buyers who contact you out of the blue and offer to pay off your mortgage or sell the home if you deed the property to them. They may even offer to have you rent the home from them. Remember, a mortgage loan always remains in your name until you pay it off or the lender allows another individual to assume the loan. Deeding your property to another person doesn't change this. Equity skimming scams are designed to take advantage of uninformed homeowners. Often, the victims don't realize they are giving away their property and equity.

Remember, you do not need to pay for foreclosure prevention counseling as many free services are available. If you think that you are being targeted by a predatory lender or other scam artist, contact your state consumer affairs office or state insurance regulator. (See "For more information" section on page 10.)

Legal representation

One way to avoid becoming a victim is to talk to a reputable attorney, a trusted real estate professional, or a counselor at a HUD-approved housing counseling agency before you pay a fee or sign anything.

To find attorneys who represent consumers, visit the the National Association of Consumer Advocates at www.naca.net.

Know your mortgage loans

You can greatly reduce your risk of defaulting on your mortgage payments and facing foreclosure by choosing the right loan.

The 30-year fixed rate home loan that used to account for most home financing has given way to an array of "exotic" interest-only loans and other non-traditional adjustable rate mortgages. These loans can be risky and come with complex terms and payment calculations that many borrowers don't fully understand.

Dos and don’ts for borrowers

Don’t:

• Sign anything that you do not fully understand. If you are unsure, have all documents reviewed by an attorney, a trusted real estate professional, or a counselor at a HUD-approved housing counseling agency.

• Deed your property over to anyone. Signing your home over to someone else does not relieve you of your mortgage obligation.

• Let someone assume the loan without the lender’s permission and without their formally releasing you from liability for the mortgage.

• Move out of your house because someone promises to make the mortgage payments for you.

Do:

• Be suspicious of anyone, other than your lender, who contacts you with a loan or service they promise will solve your money troubles and save your home.

• Avoid high-pressure lenders, or those who encourage you to pay an upfront fee for any service or loan, borrow more than the value of the home, or take on a loan without considering your ability to make the payments.

• Get all terms and promises in writing.

• Be on the lookout for terms that change or are not disclosed at the beginning of the loan process.

• Avoid any refinancing loan with exorbitant fees, a stiff prepayment penalty, an excessively high interest rate, or a balloon payment due. (If you’re not sure whether the loan you’re being offered includes any of these abusive terms, have someone you trust review them for you.)

• Check for complaints about any company that offers to buy your home. Contact your state’s consumer protection office or real estate regulator. (See “For more information” on page 10.)

Protect yourself. Learn about different mortgages, their terms, and their risks by participating in a homebuyer education course offered by a HUD-approved housing counseling agency before you commit to a loan. (See “For more information” on page 10.)

If you are already in a mortgage with non-traditional or complicated terms, be sure you understand exactly how your interest rate, monthly payment, and loan principal balance could change over time. If you don't plan for these adjustments or refinance the loan, you could find yourself facing foreclosure.

Here are a few popular mortgage types and what you should know about each one:

Adjustable rate mortgage (ARM). Any time you have a loan where the interest rate can rise and fall with changing interest rates, your future monthly payments are uncertain. Typically with an ARM, your payment will be based on a relatively low introductory rate. Depending on the terms of the loan, after several months or a few years, your payment will be adjusted (often upward) on a regular basis.

Negative amortization mortgage. Negative amortization ("neg am") is what happens when your mortgage payment is smaller than the interest due on the loan for that month. To make up the shortfall, the lender adds the difference to your loan balance.

Negative amortization loans start out with a reduced monthly payment. At some point, the lender must "recast" the loan (re-calculate the monthly payments so that the original loan balance plus all unpaid interest is spread over the remaining years in the loan term). In other words, you must now pay off a bigger loan in a significantly shorter period (perhaps 20 or 25 years instead of the original 30)—and that requires a significantly larger payment. If your neg-am loan is also an ARM, and rates have risen since you took out the loan, you might experience even greater negative amortization than you expected.

Another risk with this type of loan is that if you try to sell your home after only a few years and it hasn't appreciated substantially, you could find yourself "upside down," owing the lender more than you could get for the property.

Interest-only mortgage. These ARMs allow homeowners to make smaller payments for a number of years at the beginning of the loan (typically 5 or 10 years) because the part of the payment which would ordinarily pay off the amount you borrowed (principal) is deferred.

Monthly payments increase when the lender recasts the loan to require monthly payments large enough to cover the interest and pay off the entire principal balance in the years remaining on the original loan term. If interest rates have also risen, the monthly payment will be even higher.

With an interest-only loan, you do not build up any equity unless the value of your home has risen, or you have made additional payments toward the principal during those years when you were not required to. Equity is the homeowner's financial share of the house.

Option ARM. These can be called payment option ARMs or flex-ARMs. As with any ARM, your payments would increase if interest rates go up.

Whether or not your payments eventually go even higher will depend on which payment option you choose for your loan: the minimum payment (typically resulting in negative amortization), an interest-only payment, a fully amortizing 30-year payment or a fully amortizing 15-year payment. (Choices may vary among lenders, and you can switch at certain times.)

Option ARMs have a built in recalculation period, usually every five years. At that point, the lender will recalculate (recast) your payment. No payment cap applies to this adjustment—which means your monthly payment could go up dramatically.

For more information

ACORN
888-409-3557; www.acornhousinghelp.org

A HUD approved housing counselor
www.hud.gov/offices/hsg/sfh/hcc/hccprof14.cfm; 800-569-4287

Homeowner's HOPE Hotline
www.hopenow.com; 888-995-HOPE (4673)

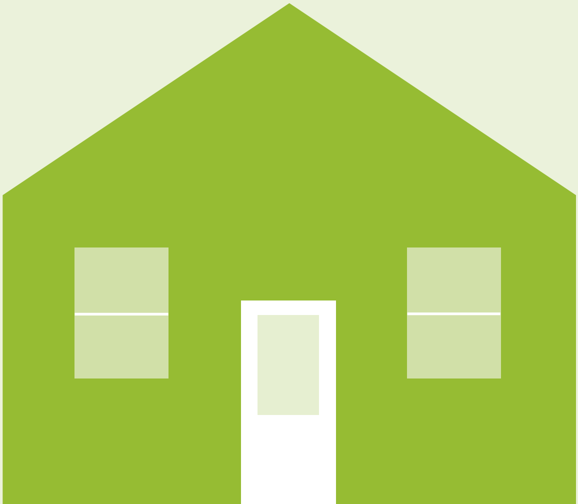
National Anti-Predatory Lending Consumer Rescue Fund
www.fairlending.com; 800-475-6272

Neighborhood Assistance Corporation of America (NACA)
www.naca.com; Click on "Home Save"

The Federal Trade Commission
www.ftc.gov; 877-FTC-HELP

State consumer protection offices
To find your office, go to http://consumeraction.gov/state.shtml, or check the government section of your phone book.

State real estate regulators
To find your office, go to www.arello.com/regulator/default.cfm, or check the government section of your phone book.



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Housing Information (www.housing-information.org), a Consumer Action project, is a resource designed to give consumers and community-based agencies serving consumers access to multilingual educational resources promoting intelligent and cost-effective home-buying decisions.