PREVENTIVE LAW SERIES

FORECLOSURE ALTERNATIVES

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This handout discusses the alternatives to foreclosure available to borrowers who get behind on or miss their mortgage payments or who can no longer afford their mortgage.

FORECLOSURE

In California, the foreclosure process begins when a lender files a Notice of Default with the county recorder identifying the default amount and the date the borrower must pay off the default. The notice is mailed to the borrower and other affected parties. Ninety days after the notice of default is filed, the lender can schedule a trustee's sale of the property. Up to five business days before the trustee's sale, the borrower may pay off the default plus any applicable costs of foreclosure and stop the foreclosure process. There are two types of foreclosure processes available in California that are not always available in all states. Lenders will normally use the (1) <u>non-judicial process</u>, if available, which is controlled by the contract between the lender and the homeowner or the loan documents. If the mortgage loan documents give the lender a (2) <u>power of sale</u>, the lender will use this non-judicial process to foreclose on the home and sell the house.

ALTERNATIVES TO FORECLOSURE

- **Repayment plans:** If a borrower is suffering only a temporary setback, the borrower should notify the lender and negotiate a repayment plan that lets the borrower pay off a missed or reduced mortgage payment in installments over a period of months. To qualify for a Repayment Plan, sometimes known as a “loan forbearance,” lenders might require a down payment of 20-40% of the total amount past due and proof of the homeowner's ability to repay. Note that your account will remain in a delinquent status until fully repaid.

- **Loan Modification/Restructuring:** If a borrower can make the regular payment, but can't catch up with the past-due amount, loan modification or restructuring is another option to avoid foreclosure. This option includes changing the original terms of the mortgage by increasing the loan balance to cover any past-due amounts, including interest and escrow. The new balance will be re-amortized, extending the loan period and increasing the number of payments to pay off the loan. Please note, your lender might charge a modification fee as well as require you to pay a cash contribution toward compliance. There are many federal programs available to restructure your loan. See the link at the end of this handout or visit a legal assistance attorney to see if you qualify.

- **Partial Claim (VA and FHA loans only):** If the borrower has an FHA or VA Loan and can document temporary financial hardship, the borrower may be eligible to get a one-time, interest-free loan to bring the account current, and the borrower may be allowed to wait several years before repaying this loan. Borrowers may qualify for a VA or FHA partial claim if: the loan is between 4 and 12 months delinquent, the borrower can begin making full mortgage payments again, and the property is the borrower’s primary residence. When the lender files a partial claim, the Department of Housing and Urban Development will pay the lender the amount necessary to bring a VA or FHA mortgage current. The borrower must sign a promissory note, and a lien is placed on the borrower's property until the promissory note is paid in full. The promissory note is interest-free and is due when the borrower either pays off the first mortgage or sells the property.

- **Loan Refinance:** Another option may be to refinance to a fixed-rate mortgage, which sets a fixed interest rate for the full term of the loan. However, refinancing might be difficult if home prices fall and the home’s value drops below the original loan amount. Additionally, there could be prepayment penalties that the borrower would have to pay in order to refinance. A borrower should compare the cost of refinancing with their current lender as well as other lenders.

- **Short refinance:** The lender may be willing to forgive some of the debt and refinance the rest into a new loan. Where the market value of the home has significantly depreciated, such that a refinance at a loss will assuredly cost the lender much less than the depreciated market value, and the borrower can demonstrate the ability to repay the refinanced payments, the lender may consider this a viable option.

- **Selling:** Selling the home may not seem like a realistic option in a slow market, but the borrower facing foreclosure should at least try. Despite the significant costs associated with a real estate sale, the borrower should consult a trusted real estate professional to determine whether selling the home is a viable option given the expenses and the market value of the home. Real estate agent commissions are negotiable.

- **Short sale or Pre-Foreclosure Sale:** The lender may allow the borrower to sell the house for less than the outstanding loan amount, take the proceeds, and forgive any remaining debt. A lender will usually only consider this option when the borrower has had the property already on the market for sale for a reasonable period of time and has been unable to get offers that exceed the loan amount owed. The lender will usually only agree to a short sale when there has been a downturn in the real estate market and property values in the area have dropped. One downside of a short sale is that the borrower may have to declare the difference between the amount of the short sale and the mortgage balance as income for tax purposes. It is also possible that the borrower may still owe the bank or mortgage company the deficiency when the house is sold for less than the amount of the mortgage loan. Depending on the laws of the state where a short sale occurs, the lender might be able to pursue a deficiency judgment against the homeowner for the shortage between what the homeowner owes and the sale price of the property. So, if a homeowner chooses to go the route of a short sale, he or she should negotiate with the lender to accept the sale as "payment in full" and get this agreement in writing. A short sale negotiated properly with the lender may avoid a possible deficiency judgment against the homeowner. The advantage of a short sale over a foreclosure is that homeowners avoid having a foreclosure on their credit record.

- **Deed in Lieu of Foreclosure:** A last resort to foreclosure is for the homeowner to "give back" the property to the lender or mortgage holder by executing a "deed in lieu of foreclosure." In such a transaction, the borrower voluntarily conveys all rights and interest in a real property to the lender to satisfy a loan that is in default. While the home is lost, the borrower is released from most or all of the personal indebtedness associated with the defaulted loan. The lender will then sell the property. If the homeowner has any equity in the property, a deed in lieu of foreclosure is definitely not a good idea. If the homeowner executes a deed in lieu of foreclosure, the borrower will probably not receive any money left over from the lender's sale of the home, even when the selling price is more than what the borrower owed on the mortgage. On the other hand, the borrower could possibly avoid a deficiency judgment by using a deed in lieu of foreclosure if the lender's sale of the property fails to cover what the borrower owes. In most states, the lender can only get a deficiency judgment if a lawsuit is filed to foreclose.

  A deed in lieu of foreclosure will negatively affect a borrower's credit but is less damaging than foreclosure. This option may sound like an easy way out, but usually the homeowner must have tried to sell the house for at least 90 days before the lender will consider this option, and the homeowner must provide some documentation of a reduction in income or increase in living expense or other significant hardship. Also, lenders will typically only consider this option for owner-occupied property, not investment property.

LEGAL ASSISTANCE SERVICES

A legal assistance attorney is available by appointment Monday from 0800 - 1100 and 1300 - 1500, Tuesday through Thursday from 0900 - 1100 and 1300 - 1500, and Friday from 0900 - 1045. Powers of attorney and notaries are available Monday through Friday at the same times. For more information, please contact the Legal Assistance Office, located in Building 56, 32nd Street Naval Station, San Diego, CA, by telephone at (619) 556-2211, or our office at Naval Air Station North Island – Coronado, Building 318 – Second Deck, above the Fleet and Family Support Center, Saufley Road, by telephone at (619) 545-6437.

RESOURCES

Department of Defense **Homeowners Assistance Program**: http://hap.usace.army.mil/
Departments of the Treasury & Housing and Urban Development **Making Home Affordable Program**:
http://www.makinghomeaffordable.gov/pages/default.aspx
Department of **Housing and Urban Development**: www.hud.gov
Fleet and Family Support Centers: http://navylifesw.com/sandiego/families/ffsc/

Cal. Civ. Proc. §§ 1161b and 1161c