MICHIGAN STATE UNIVERSITY | Extension

OPTIONS IN FORECLOSURE

Washtenaw County MSUE
Mortgage Foreclosure Intervention Program (734) 222-9595

Section IV: WHEN YOU CAN'T KEEP YOUR HOME

A mortgage crisis can be a stressful time during which many decisions must be made by the homeowner. When the homeowner avoids dealing with the crisis, it can mean a loss of control over their finances and a loss of control over the impact the mortgage crisis may have on their credit report. If it is determined that you can't keep your home after a review of your finances and conversations with your lender and housing counselor, there are still options available to you to AVOID a foreclosure on your credit report.

I. STRAIGHT SALE: Even in a bad housing market, put the house up for sale with a reputable realtor at a fair market price. Interview the realtor to be sure they have experience with foreclosures and short sales.

1. Ask the lender to delay the foreclosure and for permission to complete a pre-sale.
   GET THE AGREEMENT IN WRITING.
2. In a bad real estate market, do not assume that the house will sell quickly.
3. A pre-sale works <u>if</u> the sale price is high enough to pay off the mortgage, any home equity loans, back taxes, selling expenses, and foreclosure fees.

II. SHORT SALE: The lender may allow you to complete a sale even though the price is less than what you owe them. Most servicers will accept a request to short sell the home but will reserve the right to finalize the agreement until a signed purchase agreement has been submitted. Most often, servicers are requiring the home to be listed at fair market value for 60-90 days before they will consider a short sale offer. In order to be considered for a short sale, servicers will want the following information faxed to their loss mitigation department:

1. Hardship letter detailing the nature of the crisis and requesting permission to short sell the mortgage.
2. Two consecutive years of federal tax returns.
3. Thirty days proof of income.
4. Three months of checking and savings account statements.
5. 401(k) statements, list of assets.
6. Home budget summary including income, current housing expense, utilities, car payments, food/gas/insurance, and credit card debt and monthly payments. This budget should reflect the financial hardship to the household by continuing to make the mortgage payment.

Complications: Even if the servicer agrees to consider a short sale pending a signed purchase agreement from a qualified buyer, collection activity will NOT stop while you are trying to sell the home. In some cases, the servicer may agree to delay the foreclosure sale; however, this is uncommon. A short sale can take 90-120 days to be fully executed from the time a purchase agreement has been submitted to the servicer. It is not uncommon for the servicer to foreclose on a property in the middle of a short sale negotiation.

Second Mortgage Complications: It is very difficult to execute a short sale for property that has a second mortgage involved. It might be possible for the homeowner to negotiate with the second lien holder to release their lien for a small fee (sometimes as little as $1,000) but that does NOT absolve the homeowner from responsibility for the second mortgage debt. It simply transforms the secured debt to an unsecured debt (by releasing the lien). The homeowner may be asked to sign a promissory note or negotiate a payment arrangement to the second mortgage holder. If repayment arrangements are not worked out, it is possible for the second mortgage holder to sue the homeowner and garnish wages. It is worth noting that even in a foreclosure situation, the second lien holder will attempt to collect the debt after the Sheriff's sale. The foreclosure eliminates the second mortgage lien; however, it doesn't eliminate the obligation of the homeowner to the debt.

When negotiating a short sale, it may be possible for the first mortgage lender to "cancel any deficiency," (the difference between what you owed and what you sold the home for). In other words, ask the lender to waive their right to demand repayment on the rest of what you owe. The sale will be reported to the credit bureau; however, it might be reported as "paid less than what is owed without deficiency" which is technically a settlement statement and has less of an impact on your credit report than a foreclosure. **It is important to get all commitments in writing.**

There are income tax consequences of a short sale option. In situations like this, the IRS considers the amount of debt the lender cancels for you (the amount you don't pay back) to be passive income. If you have lost income and will be in a lower tax bracket, it could work out fine. If not, you could be left with a big tax bill. Talk to a tax professional, a tax lawyer, or a non-profit advocate familiar with tax law. If by doing a short sale you will be facing a big tax bill you cannot pay, sometimes the better choice is to let the foreclosure proceed. Even in a foreclosure, there are tax implications; however, the Mortgage Debt Relief Act allows for certain exemptions that can significantly reduce or completely eliminate tax implications of foreclosure for Sheriff's sales between December 31, 2007 and December 31, 2012.

III. MORTGAGE ASSUMPTION: A third party takes over your mortgage, brings it current, and continues paying it. Some servicers and investors are waiving the assumption clause in the original mortgage contract and allowing QUALIFIED arm's-length assumptions to avoid foreclosure.

1. Some mortgages are assumable while others are not. Look at your original mortgage documents or ask your lender. The person assuming the mortgage must qualify with a good credit score, good debt-to-income ratio, and strong credit history.

2. See a lawyer before you proceed with a mortgage assumption because when someone else assumes the mortgage, they become the new owners of the home. It may work, but you need to fully understand it and avoid some major pitfalls.

3. Sometimes, adult children assume their parents' mortgage or vice versa in order to keep the equity (the amount of the house that you own) from being lost to foreclosure and to keep the equity within the family. Consider this if you have an assumable mortgage; have a lot of equity in your home; and have a relative who has the money, credit, and willingness to assume the mortgage.

4. DO NOT WORK OUT AN ASSUMPTION with strangers or real estate companies who claim to want to "save your house." There are scammers in the community that will offer to

assume the mortgage and allow you to become a renter. While you are "renting" from them, they can "strip" or take the equity in the home and often times will leave town allowing the home to foreclose anyway.

IV. DEED IN LIEU OF FORECLOSURE: You voluntarily turn over your house to your lender. It offers several advantages to both the borrower and the lender. The principle advantage for the borrower is that it immediately releases him/her from most or all of the personal indebtedness associated with the defaulted loan. The borrower may receive more generous terms (keys for cash) to leave the property than if a formal foreclosure proceeded. Advantages to the lender include a reduction in the time and cost of repossession.

Ask the lender to:

- Cancel any deficiencies and fees.
- Eliminate negative credit references.
- Allow you to have extra time in the house.
- Pay your moving expenses.

Complications: To be considered for deed in lieu, most servicers/investors require the property to have been listed at a fair market price for 60-90 days prior to the request. Both sides must enter into the transaction voluntarily and in good faith. Generally, the investor will not proceed with a deed in lieu if the outstanding balance of the mortgage exceeds the current fair market value of the property. DO NOT DO THIS unless you get something in writing.

Complications: DO NOT LEAVE YOUR PROPERTY PENDING A DECISION BY THE SERVICER/INVESTOR OF A DEED IN LIEU. You must be living in the home to be considered for a deed in lieu. There are scammers in the community that prey on vulnerable homeowners and have convinced many to leave the home. Don't be one of them.

There is a law requiring the deed in lieu is voluntary, and lenders often will not act upon a deed in lieu unless they receive a written offer from the borrower specifically stating that the offer to enter into negotiations is being made voluntarily. Neither the borrower nor the lender is obliged to proceed with a deed in lieu until a final agreement is reached. In the state of Michigan, if a homeowner agrees to a deed in lieu, they forfeit their six months right of redemption.

V. GENERAL FORECLOSURE TIPS

1. Record information on calls. Keep a phone log with who you spoke to, when, and what you discussed.
2. Get all agreements in writing.
3. *Never* sign a release giving up all legal claims until the actual workout agreement with your lender is finalized.
4. If you are ever unsure, seek advice from an attorney or non-profit HUD housing counseling agency.
5. Stay organized. Stay focused.