LEGAL AID
SOCIETY OF HAWAIʻI

AVOIDING FORECLOSURE:

UNDERSTANDING THE BASICS AND POSSIBLE ALTERNATIVES TO FORECLOSURE

This brochure may be helpful to you if:

- You are paying a mortgage on your home, and;
- You are or will soon be falling behind on your payments.

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Aloha United Way

I. The Basics of Foreclosure

A mortgage is a specific type of loan, in which a bank or lender loans you money to purchase a property. Because mortgage loans are usually made for a very large amount of money, the banks needs some "collateral," or a guarantee that they will be able to get their money back if you stop making payments. In a mortgage transaction, the house that you purchase is the collateral. This means that if you "default" on your loan, or fail to make the payments as scheduled, the bank can take certain actions to "repossess," or take back the property in order to satisfy your debt.

Foreclosure is the legal means that your lender can use to repossess your home. When this happens, you lose ownership and possession of the property, meaning that you must move out. If your property is worth less than the total amount that you owe on your loan, your lender or the U.S. Department of Housing and Urban Development (HUD) could seek a deficiency judgment against you for the difference. If this happens, you lose your home and will still have an additional debt.

Foreclosure or a deficiency judgment will seriously affect your ability qualify for credit in the future, and will likely create a financial burden on you. So you should try to avoid it if at all possible.

II. Pre-Default and Default: Missing Payments

A. What happens if I miss a mortgage payment?

If you miss you a payment, the first thing that happens is that your lender will probably charge you a late fee. Missing one payment <u>does not</u> automatically mean that you are in foreclosure; it simply means that your account is delinquent. If you do not pay your mortgage within 30 days of your due date, your mortgage is considered to be in default, and the servicer may begin sending you notices of default.

If you continue to remain delinquent on your payments, you will begin to accrue arrears, or past-due payments. Sometimes the lender will not accept payments until you can re-instate the loan, or bring it current, or until you can work out some kind of arrangement with the bank to bring the account current over time (see "Alternatives to Foreclosure" for some of these options).

B. What should I do if I have fallen behind on my payments?

It is important when you fall behind on your payments, or when you know you may have difficulty in the future, to act early. Here are some things that you should do while you are trying to figure out how to proceed:

1. DO NOT INGORE LETTERS FROM YOUR LENDER. If you are having problems making your payments, it is important to communicate. Call or write to your lender to clearly explain the situation. Be prepared to provide them financial information, such as your monthly income and expenses.
2. Stay in your home for now. There are some types of assistance that are only available to owner-occupants. This means that if you abandon the property, you may not qualify for assistance.

3. If you bought your home with a Veterans Administration (VA) guaranteed loan, call the VA office nearest you.
4. Work with a HUD-approved housing counseling agency, such as Legal Aid, to learn more about the options that may be available to you. Assistance from a HUD-approved housing counseling agency is free and housing counselors are trained to analyze your particular financial situation, and discuss the possible work-out options. If resources are available, Legal Aid may be able to assist you with submitting a work-out package to your lender and/or negotiate with your lender.

C. What if I don't or can't resolve the delinquency?

If your loan remains delinquent for several months, your lender will probably send you a notice asking you to cure (or re-instate) or the loan. This notice may inform you that failure to cure your default will result in the "acceleration" of your mortgage loan, meaning they will require you to pay-off your entire loan rather than only the delinquent amount.

If you do not cure the default, they will refer your case to the foreclosure department. This means that the lender is referring your case <u>internally</u> to the department that handles foreclosure cases. Technically, you are still not "in foreclosure" because no legal action has been taken to foreclose. The time it takes for the lender to actually file for foreclosure varies depending on the lender, and there is no way for you to predict when that will happen. For more information on the actual foreclosure process, see Legal Aid's Brochure "Foreclosure: Understanding the Legal Process."

III. <u>Overview of Alternatives to Foreclosure</u>

There are several alternatives to foreclosure, even for homeowners that have been delinquent for some time. This section provides an overview of some of the options that may be available to you. For more details on each option, see Legal Aid's Brochure, "Foreclosure: Possible Alternatives for Homeowners." A housing counseling agency, such as Legal Aid, can help you determine which options you may qualify for and would best suit your needs. The earlier you start working with the lender, the more likely it is that some kind of work-out agreement can be reached.

It is important to keep in mind that <u>it is not always possible for a homeowner to keep their home</u>, even if they want to. In those situations, the goal should be for the homeowner to make the smoothest transition possible, with the least amount of financial burden.

<u>Retention Options</u>

These are some options that may enable you to keep the home. Keep in mind that not all options are available to all homeowners, and that ultimately, approval of any work-out option is dependent on the investor's guidelines and requirements.

<u>Refinance:</u> If you have not fallen behind yet, but think you might fall behind in the future, you may be able to refinance. In other words, you could take out a new loan to pay off your existing

one. This option may help you if you are able to get a better interest rate and/or extend the term of your loan, so that your monthly payments decrease. You may qualify for this option if you have enough equity in your property AND a good credit history to qualify for the new loan. If you do not have enough equity to qualify for a traditional refinance, you still may be able to refinance through the government's Home Affordable Refinance Program. You must be current on your payments AND your loan must be owned be Freddie Mac or Fannie Mae.

<u>Short-term Repayment Plan:</u> Most lenders will first try to negotiate a short-term (90-120 days) repayment plan with you. Generally, you will be asked to begin making full payments plus a partial payment to get you caught up with on the loan. This option is most appropriate if your financial crisis is a temporary one, because failing to fulfill the agreement may result in an increased difficulty to secure your lender's cooperation.

<u>Forbearance/Special Forbearance:</u> You may be able to arrange an agreement with your lender to suspend or reduce your normal monthly payments for a period of time. At the end of that time, however, you will be required to remedy the delinquency with a lump sum reinstatement or repayment plan. You may qualify for this option if you can show that the cause of your default is a temporary one and that you will be able to resume making full payments in addition to your back payments.

<u>Loan Modification:</u> You may be able to modify some of the terms of your loan. This option can help you catch up by restructuring the arrearage and possibly lowering your monthly payments. There are different types of modifications, and they each have different qualification requirements.

<u>Partial or Advance Claim:</u> If you have mortgage insurance (MI) or an FHA loan, you may be able to obtain a partial claim from your MI company or the FHA to bring your mortgage current. Your lender may be able to work with you to obtain an interest-free loan from HUD. In a partial/advance claim, your MI company or the FHA basically gives you a small loan to pay off the delinquent balance. When the funds are paid to bring your mortgage current, a promissory note is executed, and a lien is place on your property until the note is paid back in full. Generally, these loans are interest-free, and are due when you sell your property, refinance your mortgage, or the mortgage matures. You may qualify if your loan is 4-12 months delinquent, not in foreclosure, and you are able to resume making full mortgage payments right away.

<u>Home Equity Conversion Mortgage (HECM or Reverse Mortgage):</u> If you are 62 years of age or older, you may be able to use the equity in your home to pay off your mortgage in full. This may be an option for you if you have substantial equity in your home and have a small balance remaining on your mortgage.

<u>Non-Retention Options:</u>

These are some options that may be available to you if it is not financially possible to keep the property.

<u>Straight Sale:</u> If you have sufficient equity in your home and can expect to sell your home within 90 to 120 days, you may want to consider selling your home. This would be an option if you are

willing to sell your home at or below market value to generate a quick sale, and, at the anticipated sale price, you will have enough to repay the outstanding mortgage balance as well as sales and transaction costs. Keep in mind that your lender may require to continue making full or partial payments on the mortgage while you are trying to sell your home to keep the overdue balance from growing.

<u>Assumption:</u> Although most mortgages prohibit assumption, to avoid foreclosure costs, many lenders will allow qualified buyers to assume your loan (take over payments). But, depending on when you obtained your loan, you may still be held responsible if the new owner defaults on the loan. Generally, you, or the new buyer, must be able to bring the mortgage current before the bank will even consider an assumption.

<u>Pre-Foreclosure Sale ("Short Sale"):</u> If you have been trying to sell your property for quite a while and have not received any offers that would cover your debt, your bank may agree to accept the highest offer you received and declare the debt cleared. However, depending on the borrower's financial ability, he/she may be asked to make a cash contribution to offset the amount of the debt being forgiven. In addition, the borrower may incur income tax liability for the amount debt forgiven. For more information, contact Legal Aid or a tax professional.

<u>Deed-in-Lieu of Foreclosure:</u> As a last resort, you may be able to surrender your home to your bank. Although you will lose your house, this may help your chances of getting another mortgage in the future. You may consider this option if you are in default, don't qualify for any other option, your home has been on the market for at least 90 days, and the total amount of liens on your home, if you have any, are less than the market value of the house. As with a short sale, this option is often very difficult to negotiate when you have multiple liens against the property. If applicable, you will also need VA, FHA, and/or mortgage insurer approval. You should also keep in mind that if you choose this option, the deficiency amount will be reported to the IRS as income and you may incur income tax liability for the amount of debt forgiven. For more information, contact Legal Aid or a tax professional.

IV. <u>Other Important Things to Be Aware Of</u>

A. **Beware of foreclosure rescue scams!** If you are approached by someone or receive a flier in the mail and it sounds too good to be true, it probably is. There are many people who may try to take advantage of your financial difficulty. A common scam is "equity skimming." This type of scam involved a "buyer" who offers to pay off your mortgage until your home is sold. This "buyer" may suggest that you move out quickly and sign the deed over to him/her. The "buyer" then rents out your home, does not pay the mortgage, and allows the bank to foreclose on the house. Remember that signing over the deed to someone else DOES NOT necessarily relieve you of your obligation on your loan.

   In addition to equity skimming, there are many other scams and scam artists who will take advance of you, including phony housing counseling agencies. Remember that HUD-approved housing counseling agencies WILL NEVER ask you to pay for their services. In general, you should be cautious of ANY service that requires you to pay an up-front fee.

Protecting yourself from scams – there are several things you can do to minimize your risk of being scammed:

- Don’t sign or be rushed into signing any papers that you do not fully understand
- Make sure to get all “promises” in writing
- Beware of any loan assumption where you are not formally released from liability for your mortgage debt and contracts of sale
- Beware of any service that tells you to make your mortgage payments directly to them instead of the bank
- Check with a lawyer or your mortgage company before entering into ANY deal that involves your home
- If you’re selling your home yourself to avoid foreclosure, check to see if there are any complaints against the prospective buyer

B. Your Other Financial Obligations

If you are facing default or foreclosure, you are probably struggling with more than just your mortgage. There are some key things to remember when you are prioritizing your financial obligations.

1. **Association Fees.** If you have an apartment owner’s or homeowner’s association fee, it is important to stay current. You are responsible for paying this fee until the title transfers through a sale or a foreclosure and you are no longer the legal owner of the property. If you default on your association fee the association DOES have the legal right to foreclose, and can do so much faster than your mortgage lender. In the event of an association foreclosure you will lose title to your property AND the right to occupy your property, but you will still remain indebted to your lender unless the new owner elects to pay off your mortgage debt.
2. **Second Liens.** It may be tempting to stay current on a second mortgage or Home Equity Line of Credit, although you cannot afford your first mortgage payment. However, if you are foreclosed on by your first mortgage, and your property is underwater, the payments you made to the second mortgage are payments that you will never get back. While developing a plan to deal with your debt obligations, it is important to consult with a credit or housing counselor to create an effective budget and prioritize your payments.
3. **Property Taxes.** If you pay the property taxes for your home directly, you are responsible for paying your annual tax bill until the title transfers through a sale or a foreclosure and you are no longer the legal owner of the property. If you default on your property taxes and your lender does not voluntarily set up an escrow account to pay them on your behalf you may lose possession of your property through a tax auction. If you lose your home at a tax auction you will lose title to your property AND the right to occupy your property, but you will still remain indebted to your lender unless the new owner elects to pay off your mortgage debt.
4. **Hazard Insurance.** If you pay your insurance directly it is your duty to keep a policy in accordance with your lender’s requirements for the property at all times. If your policy lapses because you did not or could not renew it, your lender may obtain or “force-place,” a new policy without your review or approval. These lender-placed

or force-placed policies are often significantly more expensive than an insurance policy you could have found on your own, and they usually do not provide the same level of protection. Your lender will require you to pay for this new policy until you purchase your own insurance and provide proof of coverage to your lender.

5. **Maintain the Property.** So long as you are the legal owner of the property it is your responsibility to maintain the property. Abandoning the property may violate the terms of your mortgage and, potentially, your insurance policy. If you intend to vacate the property and move elsewhere it is your duty to inform your lender and secure the property before doing so.

REMEMBER: This pamphlet is meant to give you general information and not to give you specific legal advice about your case. The law often changes. Each case is different.

For more information or assistance call Legal Aid at 1-800-449-4302
or access additional information at http://www.legalaidhawaii.org.