



SPECIAL REPORT

## OPTIONS FOR BORROWERS IN FORECLOSURE

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## SPECIAL REPORT

### OPTIONS FOR BORROWERS IN FORECLOSURE

Although as an agent or investor working in the foreclosure market you will run across some borrowers who are losing their rentals and investment properties to foreclosure, in most cases you will be faced with borrowers who are losing their homes. Many times these borrowers know there is no solution for them that will allow them to keep their home. There may have been a divorce, which reduced the family income by half; there may have been a financial catastrophe forcing them to file bankruptcy; or there may have simply been a job loss reducing their income and ability to make the mortgage payment. In these situations, you will be dealing with individuals who will not be hard to convince that they should sell their property and, if necessary, complete a short sale to mitigate their credit damage.

However, in the foreclosure market, more than half of the defaulted borrowers you will be working with will be homeowners who want to first exhaust every effort to keep their home. As an agent, you will be doing these people a great service if you can provide a sound voice for them at this very stressful time of their lives. They need to have an expert they can trust regarding their foreclosure options. Many times, you just need to review the available options with them to bring them to the realization that listing their property and/or completing a short sale may be their only real option.

Lenders in today's foreclosure environment are doing everything possible to help borrowers keep their homes. Thus, frequently, homeowners may first be eligible for one or more loss mitigation options to at least temporarily save their home from foreclosure and which will allow them to continue to live in the property. In these circumstances, if you are able to guide them

toward an option that allows them to keep their home even for a brief period, you will have created a client for life.

Unfortunately, even if the homeowner is able to utilize one of the options which will allow them to remain in their home, in most cases they will be unable to meet the terms of the agreement they have made with their lender. They will then be placed back into the foreclosure pipeline. In these instances, if you have helped the homeowner attempt to save their home from foreclosure, they will return to you for additional guidance when the foreclosure is restarted. When the foreclosure has been restarted, it will probably now be time to list and/or short sale the property. When this situation arises, you will know that you helped the homeowner attempt to save their home and, when that became impossible, that you are there to list the home and/or complete a short sale for them to help mitigate the damage to their credit. In this special report you will learn what options homeowners in foreclosure have to stay in their property and what options they have to sell their property. Additionally, we will look at some other options which may give the homeowner some needed time or relief to accomplish their goals.

## 1. OPTIONS TO STAY IN THE PROPERTY

### a. General Options

#### i. Cure – Reinstatement

Once a borrower has been placed in default by the lender, they have an opportunity to cure the default, which is also called “reinstatement” of their loan. Borrowers usually have two separate time periods within which to reinstate their loan. The first time period is that which is provided in the borrower’s note and deed of trust. The note will allow them a specific time period to cure any default after receiving the written notice of default from the lender. In most instances, the time period to cure the default in the note ranges from 10 to 30 days. This time period usually is informally extended up until the time when the actual notice of default is recorded and the foreclosure action is commenced. Within this time period, the borrower is allowed to make up any back payments, late charges or other costs that may have been incurred by the lender to bring their loan back into good standing.

The second time period for reinstatement commences after the notice of default has been recorded. This time period is derived from state law. In most states, the borrower’s statutory reinstatement right expires five business days prior to the date of the Trustee’s Sale. The statutory right of reinstatement is an absolute right; it cannot be shortened or terminated by the lender. However, it is more difficult to cure a loan in this second time period because of the additional accruing expenses. Once the default is recorded, as it proceeds along the foreclosure time line, additional costs will be incurred which may include, but are

not limited to, recording costs, late charges, attorney's fees, service and posting fees, publication costs and trustee fees.

Many times when a borrower can provide adequate proof to a lender that they have a plan to reinstate their loan, trustee sales are postponed at the direction of the lender to give the borrower the additional time they need. However, only the lender can grant any extension to reinstate beyond the statutory period. In the event the borrower is able to cure the loan during this time, the loan is considered reinstated to its original terms and the borrower will again start to make the mortgage payments as it had before the loan was placed into default.

ii. Conventional Refinance

At all times before the foreclosure auction actually takes place and the property sold to a third party or reverts to the lender, the borrower has an absolute right to "pay off" the loan that is in default. This right extends to until the gavel falls at the auction. In most cases, this pay off of the defaulted loan occurs through a refinancing of the property with a new lender who extends a new loan to the borrower.

However, unless the borrower has substantial equity in the property, it is difficult to secure a conventional refinance because of the damage to their credit from the foreclosure. Further, there is usually insufficient equity in the property to generate enough new loan proceeds to fully pay off the old loan and all the costs of the foreclosure.

Even if they are able they are able to secure a refinance because they have substantial equity, the terms may be burdensome and the interest rate very high.

In this situation, the property will need to be refinanced a second time once the borrower's credit improves to pay off the new loan. Otherwise, many times the new loan terms are usually too much for the borrower to meet and the property ends going back into foreclosure again. However, a new loan even with unfavorable terms can buy the borrower more time to sell the property.

iii. Equity Loan

Equity lenders are commonly referred to as “hard money” lenders. A hard money loan is not based upon the credit worthiness of the borrower but is usually made solely based upon the borrower's equity in the property. The availability of an equity loan, whether it will be a junior loan generating proceeds sufficient to cure the default of the loan in foreclosure, or whether it will be a complete refinance of the property and pay off the defaulted loan, requires substantial equity.

In most instances, the equity criteria for such a loan would require that the amount of money being loaned not exceed 65-75% of the fair market value of the property. In some rare instances, it may go as high as 80-85% in a quickly appreciating market.

Because equity loans have onerous terms, which include substantial points paid by the borrower to obtain this type of loan (usually between 4-8 points) and very high interest rates (12-16%), it should only be used as a temporary measure to delay the foreclosure so the borrower can have additional time to complete conventional refinancing of the property or to list and sell the property. Many times the primary advantage of an equity loan is that it can be made very quickly

and without the normal time delays of a conventional loan. Equity loans can literally be funded in a matter of days. As a foreclosure auction approaches, the equity loan possibility should always be considered by a borrower with qualifying property.

b. Loss Mitigation Options

Since this recent wave of foreclosures began, lenders are now using “loss mitigation” tools at every opportunity. The word “mitigation” means to “reduce or lessen.” Thus, when lenders engage in loss mitigation with borrowers, they are trying to reduce the losses to their bottom line and return a non-performing loan back to performing status.

Loss mitigation options that allow borrowers to retain their homes at least temporarily are as follows:

i. Forbearance Agreement

When a lender agrees to this option, it is agreeing to temporarily “forebear” (postpone) from taking further foreclosure action on a defaulted loan. In essence, the lender places the foreclosure on hold. This is usually done when a borrower can demonstrate that the reason causing the default was temporary and they will be able to cure the default within reasonable time. This is usually 3-6 months or less.

ii. Repayment Plan

With this option, a lender agrees to allow the borrower to catch up the delinquent payments over time. This is usually accomplished by having the

borrower pay an extra amount in addition to their regular payment over a specified time period, usually not more than one year.

iii. Short Refinance

This is a new option that has only become available to borrowers in the most recent wave of foreclosures. It has not been utilized by many lenders to date, but is becoming more common. Much like a “short sale,” a “short refinance” occurs when the borrower is attempting to refinance the property but they are unable to generate sufficient new loan proceeds, because of insufficient equity in the property to pay off the foreclosing lender in full.

To qualify for this option, the borrower would present a “short refinance package” to the foreclosing lender justifying why this option should be granted to them. It should include detailed information about their financial hardship and the lack of equity in the property. Just as a lender would approve a short sale, they may approve a short refinance to get the non-performing asset off their books. This is certainly more advantageous to the borrower than a short sale, because it may allow them to continue to occupy the property, whereas in a short sale, they would have to vacate the property.

iv. Loan Modification

If the borrower can demonstrate that the hardship leading to their default was temporary but they cannot afford to pay an extra amount each month or they are struggling to pay the current payment, the lender may agree to modify the terms of the borrower’s loan. For example, the lender may add the missed payments to the back of the loan or add the total delinquent amount to the principle and re-

amortize the loan. Sometimes lenders even extend the term of the loan or reduce the interest rate to reduce the borrower's monthly payment to an amount they can afford to pay.

However, the loan modification option cannot be used if there are junior liens on the property. This is because a modification of a senior loan would impair the rights of the junior lien by affecting the total amount of debt that is ahead of the junior lien on the property. The junior lienholder has the legal right to rely on the state of the title and the amount of total debt on the property at the time it places its lien on the property's title.

v. Special Loan Programs

A new option that has appeared is a program that loans the borrower money to reinstate the loan and then secures the new loan with a new junior deed of trust on the property. This type of loan is usually funded by the "investor" insuring the defaulted loan, such as FNMA or FRMC, with the stated goal of keeping borrowers in their homes. The terms of these loans are generally very lenient, such as little or no interest, small or no payments with full payment only due whenever the home is sold or refinanced. This option has only been used infrequently, but is becoming more common. The homeowner must qualify by submitting an appropriate hardship package, which must include evidence of the borrower's ability to start making mortgage payments again, including the payment on the new junior loan. This option can be used by a borrower one time only.

## 2. OPTIONS TO SELL THE PROPERTY

In many instances, the homeowner will be unable to qualify for any of the programs above that would allow them to stay in the property or they have been approved for one of the above loss mitigation programs, but have been unable to finish the program. At that point, they must sell the property in order to resolve their financial difficulties. Other times it may simply be a realization by the borrower that it is in their best interest to sell the property and get out from under the defaulted loan.

### a. General Options

#### i. Conventional Sale

The debtor has sufficient equity in the property to market and sell it through the usual retail markets.

#### ii. “Seller Carry” Sale

Sometimes in order to close a transaction and pay off the defaulted loan, the seller agrees to carry back a portion of the financing to help a new buyer qualify to buy the property. However, the new loan will still need to generate sufficient cash proceeds to pay of the old loan in addition to the seller financed part of the transaction.

#### iii. Sell “Subject To”

This means that the seller has agreed to sell the property to a buyer “subject to” existing financing. This means the existing loans on the property are not paid off and are not assumed by the new buyer. The buyer, as part of the transaction, simply is required to bring the loans in default current and then continue to make the payments on the loans thereafter. Subject to financing is a violation of the

“due on sale” clause in the loans, so there is a risk the lender may accelerate the loan and make it immediately, fully due and payable.

b. Loss Mitigation Options

i. Short Sale

When the proceeds from the sale of a property are not sufficient to pay off the defaulted loan in full, the lender may agree to accept a “short sale.” This means the lender will agree to release the lien on the property even though it has not been fully paid. The lender, on some types of loans, may have the option to pursue the borrower personally for the unpaid balance of the loan.

A consideration for the borrower is that the unpaid portion of the debt may be considered “debt relief” by the IRS, which could result in additional taxable income for the borrower and for which they may owe taxes. All borrowers contemplating a short sale should always be advised to seek tax advice from a tax professional.

ii. Deed-in-Lieu

When a lender foreclosing on a property agrees to allow the borrower to deed the property back to the lender before the foreclosure is complete, it is called a “deed in lieu of foreclosure.” This can be advantageous to the lender because it gets the property back sooner and advantageous for the borrowers because they may have less damage to their credit by having their loans considered settled or paid.

This option will not work if there are junior liens on the property, because they would still be on the title after a deed-in-lieu-of-foreclosure is completed.

The only way to clear the junior lienholders from the title is to complete the foreclosure. In rare instances, some lenders will even pay the borrower money – usually limited to \$1,000 or \$2,000 – to obtain a deed in lieu of foreclosure because of the financial sense it makes for the lender to get the property back earlier.

### 3. OTHER OPTIONS

#### a. File Bankruptcy

The filing of a bankruptcy by a borrower automatically and instantly stops the foreclosure. This is called the “automatic stay.” Depending upon whether the borrower files a Chapter 7 or a Chapter 13, this tactic can be used to buy the borrower time to close a transaction or even could allow the borrower to retain their home while repaying the amount in default over a period of up to five years. However, because of the severe credit damage to the borrower, filing a bankruptcy should usually be one of the borrower’s last options.

#### b. Using Military Status

If a borrower is a member of the armed services on active duty and extended deployment, they can request the lender to temporarily postpone a foreclosure or eviction and even have the interest rate on their mortgage payments reduced. These rights are contained in the Servicemembers Civil Relief Act (SCRA). The SCRA can also even provide temporary relief from paying the borrower’s mortgage. To obtain relief, a military member must show that their mortgage was entered into prior to beginning active duty, that the property was owned prior to entry into military service, that the property is still owned by the military member, and that military

service materially affects the member's ability to pay the mortgage. Using the Courts to Delay or Attack

One effective, although usually costly, option is for the borrower to file a legal action against the lender asserting defects in the foreclosure process or errors or misdeeds by the lender with regard to the loan itself. Some possible grounds for a lawsuit are legally insufficient notice of the foreclosure, the failure of the lender to apply the borrower's payments properly or the failure of the lender to honor pre- or post-foreclosure agreements, such as loss mitigation programs, with the borrower.

c. Do Nothing

Many borrowers take no steps to stop the foreclosure or sell their property. This is because either they do not have any desire or motivation to do so or they are unaware of their options. Some borrowers simply do not care about the property or the foreclosure. A study by Freddie Mac in 2005 discovered that over 65% of the borrowers who lost their homes to foreclosure were unaware that they had any options to save or to sell their property. The main problem was the borrower's lack of knowledge and that they had no real place to turn to for sound advice. Knowledge of these foreclosure options is critical to agents to properly represent their client's interests. Additionally, making your clients aware of these options and helping them stay in their homes, even if for a little while, will generate loyal clients who will readily refer you to others and who will turn to you to sell their homes when that time comes.