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Avoiding Foreclosure: Basic Workout Options From Your Lender

If you aren't eligible to benefit from the federal government's Making Home Affordable program, you still may be able to work something out with your mortgage servicer.

Repayment Plan: Keeping Current and Catching Up

With a repayment plan, you arrange to make up missed payments over time and stay current on your ongoing payments. This approach is usually the most feasible and easiest to negotiate with your servicer. For it to work, your income will have to be able to cover both current and makeup payments.

For example, say you are four months behind on your payments of $2,000 a month, for a total of $8,000. Paying an extra $800 a month over the next 11 months would bring you current. Why 11 months, when you could pay back the $8,000 in ten? The eleventh month would account for 10% interest you'd likely be charged on the arrears. The actual numbers might be a little different, but you get the idea.

If you could pay only $2,400 a month (the $2,000 payment plus $400 to make up the arrears), your plan would be for 20 months, plus additional time to pay the interest. You might even get your servicer (or lender) to sign off on an agreement that gives you three or four years to get current.

The longer it will take you to catch up, the likelier it is that your servicer will have to get permission from the lender. If the lender will have to sign off on your proposed plan, and you are running up against your foreclosure sale date, you should definitely ask—in writing—for an extension that the servicer thinks will be sufficient to either work out an arrangement or give you time to fight the foreclosure. Some servicers will tell you right up front whether a proposed plan will work or is off the table. Other servicers will string you along. You'll just have to make sure that you aren't forgoing other possible solutions (such as bankruptcy, a court action challenging the foreclosure, a statutory reinstatement, or redemption of the mortgage), just because the servicer tells you the solution is "in the pipeline."

Don't Forget: Statutory Reinstatement or Redemption

Many states give you, by law, the right to reinstate your mortgage (make it current) or redeem the loan (pay off the entire loan). Typically, you must exercise them before the foreclosure sale date, although some states give you a period of time after the sales date to redeem the mortgage by paying it off in full (plus interest and costs).

If you think either of these options might work for you, pay attention to the deadlines. For example, if your state gives you only 30 days after you receive the notice of default to reinstate the mortgage, don't let negotiations drag on past that date, unless reinstatement is clearly not in the cards.

If you do have the financial ability to reinstate the mortgage, you surely can work something out with the servicer in regard to your missed payments, given enough time. If you need a reduced monthly payment, as well as a means to make up missed payments, reinstatement won't work; instead, you'll need to redeem the mortgage by refinancing it at a lower interest rate.

Forbearance: Getting a Break From Payments

Under a forbearance agreement, the servicer (or lender) agrees to reduce or suspend your mortgage payments for a period of time. In exchange, you promise to start making your full payment at the end of the forbearance period, plus an extra amount to pay down the missed payments. Forbearance is most common when someone is laid off or called to active military duty for a relatively short period of time and cannot make any payments now but will likely be able to catch up soon.

In forbearance, unlike a repayment plan, the lender agrees in advance for you to miss or reduce payments for a period of time. But both forbearance and repayment plans require extra payments down the line to bring the loan current. Forbearance for three to six months is typical; forbearance for longer periods is less so.

Modification: Lowering Your Payments

Unlike repayment plans and forbearance, mortgage modifications are designed to lower your monthly payments over the long term. You might be able to get a modification, but even if your lender is willing to make modifications in the right - circumstances, don't be too surprised if your attempt doesn't yield much.

Judging from the information available to me, many homeowners can't come close to making their current payments now or in the future. There are many reasons, including:

- Their income stream was disrupted by a layoff or injury and a new job at the same pay is just not available.
- They were in over their heads from the beginning, because of predatory loan practices or their own mis-statements about their income and debt load.
- Their interest-only loans caused the principal to reach a preset cap, which in turn dramatically pushed their monthly payment upwards to an unaffordable level.
- Their interest rates reset higher (currently not as big a problem as was originally feared, due to continued low short-term interest rates engineered by the Federal Reserve).
- Something happened in their life that required them to reprioritize their budget—for instance, a medical emergency or a child in trouble.

If you can't afford your mortgage payment now, or won't be able to in the near future, mortgage modification is the best approach to remaining in your house.

Here are some of the ways your servicer might modify a mortgage to reduce your payments and perhaps to reduce the outstanding balance of your loan to the value of your home:

- Reduce your mortgage's interest rate to the current market rate, if it's lower than what you're supposed to be paying now.
- Convert from a variable-rate to a fixed-rate mortgage, which could bring the payment down if the interest on the variable-rate mortgage has already reset, and will present a jump in payments if the reset looms in the near future.
- Extend the loan's repayment period—for instance, from 30 years to 40. This will bring down the monthly payment, but delay for many years the time when you can begin to build equity.
- Reamortize the loan. This involves adding the amount of the missed payments to the principal balance and issuing a new loan at a new interest rate for a new period of time. Reamortization can result in an increased payment (for example, if the interest rate stays the same or increases) or a reduced one (for example, if the interest rate is reduced and the loan period is increased).

Be Aware of Deferred Junior Mortgages

If your servicer agrees to a reduction of your mortgage principal and then the value of the house goes back up, the lender wants to be able to get some of its original principal back. To do this, the mortgage industry has come up with a device for recapturing some mortgage principal, called "deferred junior mortgages." These devices commit you to pay them off when you sell or refinance the house. They can't, however, be enforced by foreclosure or a lawsuit.

EXAMPLE: *Aura was recently laid off from a job paying $36 an hour and has found a new job paying $28 an hour. In the meantime, the house she bought for $240,000 two years ago has fallen in value to $180,000. To keep her house, Aura will need a substantial reduction in her payments. Because she has a good payment history and a decent credit score, the lender agrees to reduce the principal due on her mortgage to the house's market value ($180,000), which results in the reduced payments Aura needs to stay in the house.*

In exchange, Aura agrees to a deferred junior mortgage for $60,000 at 6% interest. Under the terms of this deferred junior mortgage, Aura will not face foreclosure or a lawsuit for failure to pay off the mortgage, but will have to pay it off if she refinances the principal mortgage or sells the house.

Three years later, Aura would like to sell the house. However, a sale will not generate enough cash to cover both the principal mortgage and the deferred junior mortgage, so Aura is stuck with the house until times get better or she gets rid of the deferred junior mortgage by filing for Chapter 7.

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