



FACING FORECLOSURE? 9 options

By Liz Pulliam Weston, MSN Money

Real estate markets are slowing. Interest rates are ticking up. And the phones are ringing at ByDesign, a Los Angeles-based credit counselor, as homeowners start to panic about not being able to make their mortgage payments.

"The number of people asking for appointments to talk about foreclosure is definitely up," said Susan Ulaga, the nonprofit service's senior vice president of counseling. Rising rates "are really putting a crunch" on homeowners with adjustable-rate loans.

Nearly a quarter of the nation's mortgages have rates scheduled to reset this year or next, which means higher payments for millions of homeowners. How many will default isn't known, but the Mortgage Bankers Association, which tracks delinquencies and foreclosures, expects a "modest" uptick in both by the end of the year.

If you're in danger of falling behind on your mortgage, or if you're already delinquent, it's important to know what's ahead and what your options are. Usually, the faster you move, the more choices you'll have about your financial future.

The timeline

30 days: Your troubles actually start as soon as you miss a single payment. Lenders may not contact you until you've skipped a second payment, but most will report the first late payment and every subsequent delinquency to the credit bureaus. Even a single late payment can devastate your credit score, the three-digit number that lenders use to help gauge your creditworthiness. Each subsequent "late" further decreases your score, making it more difficult and expensive to get a loan or a refinance that might help your situation. In addition, lenders typically tack on late fees of 5% or so for each missed payment.

90 days to one year: Eventually, if the payments aren't made, the lender will file a "notice of default" with a local courthouse and send you a letter saying that the foreclosure process will start unless you make good the missing payments.

How quickly the notice is filed depends on the individual lender. Some hold off if you contact them to work out a payment plan or otherwise explain your situation. Others are more aggressive and start the process as soon as possible to try to protect their investment.

"They may do it as early as 90 days, or as late as a year," explained Anthony Hsieh, president of LendingTree.com. "It really depends on the lender's temperament."

Usually, this notice means that the amount you owe has shot up as well, since the lender typically adds substantial fees to cover its legal costs.

The notice of default "is a big threshold," Hsieh said. "Once you get into that state, it's a whole different world. Your options are fewer."

The notice of default is generally picked up by the credit bureaus, further depressing your credit score and making refinancing the loan extremely difficult.

(In addition, the notice tips off scam artists that you're in trouble and may be vulnerable to various "equity skimming" schemes. One common ploy: The scam artist promises to take over your payments, but instead rents out your house and keeps the rent payments as pure profit. The home goes into foreclosure, your credit is trashed and you've lost any equity you had in the home.)

90 days more: Borrowers typically have 90 days from the notice of default to make up the deficit before the lender sends out a "notice of sale," which sets a sale date for the house (typically within the next 15 to 30 days).

Some lenders will allow you to keep your original loan if you can make up the missing payments plus any late fees and legal charges. Others will insist you refinance with another lender. You can also halt the foreclosure, at least temporarily, by filing a lawsuit or filing for bankruptcy. For either legal option to work, you'll have to be able to come up with a payment plan to fix the deficit.

Your options

Lenders today typically offer a variety of solutions for people who have fallen behind on their mortgages. Among them:

- Temporarily reducing or waiving payments.
- Setting up short-term repayment plans to help you make up the deficit.
- Adding the unpaid balance to the principal of your loan and increasing your payments slightly to cover the extra amount.

If you have certain types of loans, you may have even more options. If you have a mortgage insured by the Federal Housing Administration, for example, you may qualify for an interest-free (and payment-free) loan to get your mortgage current. The money doesn't need to be paid back until you pay off the mortgage or sell the house.

If you can work out a solution with the lender quickly enough, you can contain or even avoid serious damage to your credit. That's among the reasons housing experts typically urge you to call your lender as soon as you know you'll have trouble making a payment. This is good advice, but trickier than it may seem at first, for two reasons:

Lenders can make it tough to get to the right people. The folks you want to talk to are in the "loss mitigation" department. But many lenders don't routinely route borrowers to that department until they've missed several payments. Until then, you might be dealing with the lender's collections department, which typically offers one option: Pay up now. If you're serious about keeping your home, you may have to really push to get to right people.

"The loss mitigation department (is) where the options are really going to open up," ByDesign's Ulaga said.

You have to be able to make the payments. If you agree to a lender's "workout" or "loan modification" solution and then fail to make the agreed-upon payments, you'll be in a world of hurt. At best, you'll have "a lot fewer options the second time around," Ulaga said. More likely, Hsieh said, the lender will simply accelerate the foreclosure process.

This can be a big problem if the financial crisis that caused you to fall behind isn't over. If you don't know where you're going to get the money to make the payments, trying to work out a solution with your lender will be tough.

"If you're honest like that, (lenders) are not going to want to work with you," said New Jersey bankruptcy attorney John Amorison. "If you're dishonest, you breach the agreement."

That's no reason to hide from your lender or ignore its letters, Hsieh said. Even if you can't work out an agreement, keeping in contact is usually the right choice: "At least you know where you stand."

Filing a lawsuit or bankruptcy carries similar risk: If you don't have the money to make the payments, the foreclosure can proceed, and you may have further damaged your credit score.

9 steps to getting out of this mess

So what to do? First, you'll need to take a hard, clear-eyed look at your financial situation. To that end:

Make a budget. Sketch out a spending plan for the next several months, including expected income and expenses. See what costs you can trim to free up as much money as possible for home payments. You may need to pay the minimums, or even less, on other debts. In certain very limited circumstances -- such as when you are absolutely sure your financial hardship will be short-lived -- it may make sense to skip payments on some bills so you can pay your mortgage. Read "How to not pay your bills" to learn about the consequences that may follow. Another option: borrowing money from friends or family, or tapping retirement funds. Do the latter only if you're convinced you can make future payments; you don't want to drain your retirement funds if you're only going to end up losing the house.

Consider getting help. Legitimate credit counseling services, those associated with the National Foundation for Credit Counseling or the Association of Independent Consumer Credit Counseling Agencies, typically have housing counselors that can help you evaluate your options. Or you can find a housing counseling agency approved by the Housing and Urban Development Department by calling (800) 569-4287. If you have a Veterans Administration loan, you can call (800) 827-1000 to get a referral to a financial counselor.

Check your refinance options. If you have equity in your home, your credit rating is relatively intact and your lender hasn't yet filed a notice of default, you may be able to get another loan with more affordable payments. An experienced mortgage broker, preferably one affiliated with the National Association of Mortgage Brokers, can let you know your options. Be cautious about jumping into another risky loan, though: adjustable, interest-only or "option" mortgages might just put off the day of reckoning and you could find yourself facing even higher payments down the road.

Be realistic. Many times, Amorison said, people struggle to hang on to a house that they simply can't afford when they'd be far better off without it.

"People are just too tied to their homes," Amorison said. "It's just property."

That may seem harsh, but it's far better to sell a home while you still have equity and some semblance of a credit score than to have it taken away in foreclosure.

Get organized. If you are going to try for a loan modification, you'll need to prepare a small mound of documentation. The lender will specify what it wants, but typically you'll need to supply the details of your financial situation, a budget, documentation of your hardship (a letter from your doctor explaining an income-reducing illness, for example, or your layoff notice from your employer) and a "hardship letter" that outlines, in heart-rending detail, the circumstances that led you to fall behind and the improved prospects that will allow you to get your financial life back on track.

You may also want (or be required) to provide a market analysis of your house, Ulaga said, to document how much equity you have in your home. A real estate agent can typically prepare this for free in exchange for the chance of winning your business should you decide to sell.

Leaving home

If a loan modification or refinance isn't possible or feasible, your options come down to these:

Sell the house. If you have enough equity in your home to allow you to pay off your mortgage in full, after deducting any real estate agent commissions, then a quick sale is usually your best option. You'll preserve what's left of your credit score and your equity, leaving you in a much better position should you want to buy another home in the future.

Offer a deed in lieu of foreclosure. If you can't sell the house for what you owe, but you're not deeply "upside down" on your mortgage, this may be an option: you propose handing over the deed to your home and your lender agrees to release you from your mortgage. This usually keeps you from having to pay any deficit that might be owed on the property, while the lender avoids further legal costs related to a foreclosure.

Lenders can't be forced to accept a deed, however. Typically, lenders require that the borrower make "a really good effort" to sell the home first, Ulaga said, and show that their delinquency was due to "unavoidable hardship" before they'll agree to a deed in lieu of foreclosure.

Negotiate a short sale. If you owe substantially more on your home than it's worth, you may be able to get the lender to accept less than it is owed by negotiating a "short sale." You essentially sell the house for whatever you can get, and the lender agrees to accept the proceeds and not go after you for the deficit.

A short sale can further damage your credit scores, often showing up as a "settlement" that indicates you paid less than you owed. You may also face an IRS bill on the unpaid debt, which is generally considered income to you. A skilled negotiator may be able to avoid these consequences or at least minimize them, so you may want to consider getting an experienced attorney's help.

Allow the foreclosure to proceed. This is generally the worst choice. In some states and in some circumstances, the lender can even go after you in court for any deficit between what the house eventually sells for and what you owe. An attorney or housing counselor can let you know if that's a possibility.

Even if the worst happens, though, the damage to your financial life needn't be permanent. If your situation improves, you may be able to get another mortgage, at a reasonable interest rate, within a few years. For more details, check out "Bounce back fast after bankruptcy" for suggestions on how to rebuild your credit after financial disaster.

Liz Pulliam Weston's column appears every Monday and Thursday, exclusively on MSN Money. She also answers reader questions in the Your Money message board.

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