

## Foreclosure and Options for Avoiding Foreclosure

**Abstract** This chapter highlights that the six dominant decision-making pathways can definitely assist us in selecting the best pathway that can eliminate or reduce uncertainty as well as provide us, when necessary, the insightful means of problem solving. This chapter examines foreclosure and foreclosure options available to borrowers who wish to walk away from a property.

**Keywords** Deed-in-lieu of foreclosure · Short sale · Pre-foreclosure equity sale

Although there was less foreclosure activity nationwide in the first half of 2014 since before the housing bubble burst in August 2006, foreclosure continues to be an issue in some states and local markets. This is partly due to the fact that correction of the residential real estate market continues to be slow, despite the massive improvement in home prices. Although 312,000 homes in the United States regained positive equity in the first quarter of 2014, approximately 6.3 million homes or 12.7 % of all residential properties with a mortgage were still with negative equity (upside-down mortgages), and approximately 10 million (20.6 %) of the 43 million homes that have equity have less than 20 %. Borrowers with less than 20 % equity are almost as bad off as those with no equity as they oftentimes have a hard time refinancing

their homes, obtaining financing to buy another home, and/or covering the down payment necessary to purchase another home. Consequently, some of these borrowers are choosing to walk away from their properties. As mentioned in [Chap. 4](#), sometimes foreclosure is the right economic decision for a borrower after careful analysis (process thinking) of one's situation.

In this chapter, we will discuss foreclosure and foreclosure options available to borrowers who wish to walk away from a property. We will also provide real-life examples for each option to show in which situations they may best be utilized and explore how to buy another home after taking such drastic measures.

## FORECLOSURE

Foreclosure is the legal right of a lender to take ownership of a property when a borrower stops making payments on the mortgage loan. The foreclosure process is lengthy. A borrower who defaults on loan payments will first receive a warning from the lender in the form of a "Notice of Default" and then a grace period during which time he or she must make arrangements with the lender to either pay the outstanding amount owed or sell the property for less than is owed, which is known as a "short sale" ([mcfarlinlaw.com](http://mcfarlinlaw.com)). If the borrower cannot or will not pay the outstanding balance and no one buys the house during the short sale period, the property will be auctioned off to the highest bidder. However, the borrower can still stop the foreclosure by paying off the outstanding amount. If the borrower does not stop the foreclosure and the property does not sell at auction, the lender will take ownership of the property and get a real estate agent or liquidation auction to sell it.

## OPTIONS FOR AVOIDING FORECLOSURE WHEN WALKING AWAY

Although there should be no shame in foreclosure, there are options for borrowers who are 20 % or more upside down on their mortgage loans and decide to walk away from their property. These options include the following:

1. deed-in-lieu of foreclosure;
2. short sale; and
3. pre-foreclosure equity sale.

Borrowers and homeowners can obtain assistance with these options through (1) the Making Home Affordable Program, which is the federal government's plan "to help homeowners avoid foreclosure, stabilize the country's housing market, and improve the nation's economy" ([makinghomeaffordable.gov](http://makinghomeaffordable.gov)); (2) Hope Now, which is a voluntary alliance of nonprofit counselors, mortgage companies, investors, and other mortgage market participants; or (3) legal representation experienced in foreclosure law.

It is important to note, however, that these options can be complicated solutions and they must be negotiated properly. Consequently, it is advisable for homeowners to seek legal counsel. The benefits of having legal representation far exceed the cost. In terms of process thinking, the attorney will provide the homeowner with relevant and reliable information about foreclosure and foreclosure options and assist him/her in analyzing (judging) the homeowner's situation and making a decision to resolve the perceived problem (upside-down mortgage).

### *Deed-in-lieu of Foreclosure*

This is a process in which the borrower agrees to give back ownership of the property to the lender, and the lender agrees to forego foreclosure proceedings. Borrowers who owe much more than their property is worth and want to walk away from it tend to like this option because, in many cases, the lender can be persuaded to waive any "deficiency" (loan amount left unpaid) after the property is sold ([mcfarlinlaw.com](http://mcfarlinlaw.com)). However, most lenders have strict requirements and qualifications for a deed-in-lieu of foreclosure and the process can take a long time. Therefore, as mentioned above, it is best to have legal representation with this option ([mcfarlinlaw.com](http://mcfarlinlaw.com)).

### *Short Sale*

A short sale occurs when a lender allows a borrower to sell a home for less than the mortgage liens on the property before the foreclosure process is completed. The borrower is responsible for finding a buyer for the property and the lender or an authorized agent must approve of the sale. Once the lender approves the short sale, the borrower pays no deficiency. However, the Internal Revenue Service (IRS) could treat the difference between the selling price and the short sale price as income, unless directed otherwise.

Consequently, any homeowner considering this option should consult with a tax advisor or work with a short sale attorney ([mcfarlinlaw.com](http://mcfarlinlaw.com)). The short sale must be structured correctly in order for the borrower to avoid owing additional taxes.

Following is an example of a short sale McFarlin LLP successfully negotiated.

### *Example 1*

Marvin G. was having trouble in making his mortgage payments after his employer reduced his work hours and took away his opportunity to work overtime. When Mr. G. sought relief from his lender, he was approved for a trial plan agreement that reduced his monthly payments. Pursuant to the trial agreement terms, Mr. G. was supposed to make his first three payments and then the bank would modify his mortgage payment to a lower amount. However, after he made the first three payments, the lender refused to abide by the agreement to modify Mr. G's mortgage as promised.

Mr. G. contacted McFarlin LLP and they, in turn, filed suit against the lender, contesting the nonjudicial foreclosure process and breach of the forbearance agreement. The lender then offered Mr. G. a loan modification. However, after careful legal analysis of the situation, a loan modification did not seem to be the best solution to Mr. G.'s problem. His home was over \$200,000 underwater and it did not make any financial sense for him to hold on to it. Therefore, an agreement was secured from the lender to allow Mr. G. to complete a short sale.

When Mr. G. first came for legal advice to secure a loan modification, he was using the value-driven pathway to decision making ( $P \rightarrow I \rightarrow J \rightarrow D$ ); he allowed his perception to modify and select the information used in making that decision, downplaying the fact that he was \$200,000 underwater. After consultation with my firm, he was able to see the global perspective and make a better decision.

### *Pre-foreclosure Equity Sale*

This is when a borrower has been delinquent on payments and the lender accepts less than is owed on the property to settle the loan. It differs from a short sale in the degree of delinquency. With short sales, a borrower may have had only one or two late mortgage payments.

## BUYING A HOME AFTER FORECLOSURE OR FORECLOSURE OPTION

When a borrower forecloses on a property or takes advantage of one of the foreclosure options discussed, he or she can expect a significant reduction in their credit score. A foreclosure or a deed-in-lieu of foreclosure can result in a credit score drop between 250 and 280 points. A short sale can result in a credit score drop between 80 and 100 points.

However, the good news is one can still buy a home after the experience and after a waiting period, which is generally as indicated in [Table 8.1](#).

During the waiting period, there are several things one should do to increase the chances of securing the best home loan possible.

1. Reestablish credit by ensuring all bills are paid on time.
2. Routinely monitor credit score with the goal of raising one's score above 650.
3. Ensure stable employment.
4. Reduce monthly costs and save enough money to provide at least a 5 % down payment.
5. Adopt the mindset that a monthly mortgage payment should be no more than 40 % of your monthly income, after factoring in home insurance and taxes.
6. Prepare to explain why you took the action you did.
7. Research lenders to see which ones will more easily qualify you for a home loan. Veterans Administration (VA) and Federal Housing

**Table 8.1** Waiting periods for buying another home

<i>Option</i>	<i>Waiting period</i>
Foreclosure	5–7 years
Foreclosure (with extenuating circumstances) <sup>a</sup>	3–5 years
Deed-in-lieu of foreclosure	4–7 years
Deed-in-lieu of foreclosure (with extenuating circumstances) <sup>a</sup>	2–7 years
Short sale	1–2 years
Pre-foreclosure equity sale	1–2 years

<sup>a</sup>Extenuating circumstances include death of spouse, illness, job transfer, and injury resulting in disability (Weintraub)

Administration (FHA) are usually willing to offer good fixed rate loans to those who have gone through the short sale process.

8. Three months before looking for a property, get pre-approved for a mortgage loan.

### SUMMARY

Understanding the six dominant decision-making pathways can definitely assist us in selecting the best pathway that can eliminate or reduce uncertainty as well as provide us, when necessary, the insightful means of problem solving. This chapter examines foreclosure and foreclosure options available to borrowers who wish to walk away from a property. In addition, this chapter offers real-life examples for each option to show in which situations they may best be employed and discover how to buy another home after taking such drastic measures.

### REFERENCE

McFarlin LLP. Retrieved from <http://www.mcfarlinlaw.com/>.