The Massachusetts Homeownership Collaborative

FORECLOSURE PREVENTION COUNSELING:
A MODEL CURRICULUM

The following is a curriculum for an overview of foreclosure prevention developed by the National Consumer Law Center. It is intended to be taught to a group of homeowners who are facing potential foreclosure. However, foreclosure prevention is very case-specific and anything more than the broad details outlined here is more appropriately addressed with clients individually, on a case-by-case basis.

The objectives of this curriculum are to give homeowners an understanding of how foreclosures work and methods for avoiding foreclosure; to assist homeowners in establishing realistic objectives; and to provide information that will allow homeowners to set up a realistic going forward budget that maximizes the amount available to make mortgage payments given their situation.

There is a great deal of information included here, but it can be covered in a one-day course. Individual homebuyer counselors should select the appropriate information and tailor it to meet the specific needs of the group which they are counseling.

I. Background

A. Introduction and Caveat

This course is designed as an overview. It contains a great deal of information, and not all of it will apply to everyone in this class. Foreclosure prevention is very case-specific, and although you will learn many tools to help you avoid or work through foreclosure during this class, individual situations must be dealt with on a case-by-case basis. Counseling services are available from a variety of non-profit organizations, most of which charge nothing or a nominal fee.

B. Understanding Debt and Foreclosures

1. Secured vs. Unsecured Debt: It is important to understand the difference between secured debt and unsecured debt because the type of debt helps you to determine its priority. Your mortgage is a secured debt. That means you have offered something as collateral, your home. If you do not pay the mortgage, the owner of the mortgage can foreclose and take the home. Unsecured debt, such as most credit card bills and doctor bills, does not include collateral. You will want to prioritize your debts, in most if not all situations paying secured debts before unsecured debts. You should realize that you will often receive more phone calls from unsecured creditors than secured. This should not cause you to increase the priority of the debt.

2. Default and Acceleration: Under most mortgages, if you miss a payment the bank can hold you in default and call the entire amount of the mortgage due. This is known as accelerating the mortgage. Remember that the lender should receive your payment by the date it is due and the late payment date should only be used as a last resort.

3. Massachusetts Foreclosure Timeline: Foreclosures are governed by state law. In Massachusetts, lenders may foreclose quickly with relatively little notice to homeowners. Your mortgage and note may provide for protections and notices above and beyond those required by Massachusetts law alone.

Once the foreclosure sale takes place, you no longer own the property and in most cases no longer have any defenses or legal rights that can be raised regarding the mortgage. If you are facing foreclosure, you should take steps to resolve the delinquency sooner rather than later.

It is very important to understand from the beginning of the case any deadlines which you may face. The most important of these deadlines will always be the foreclosure sale date. In most cases, a foreclosure sale will terminate your ability to put a foreclosure alternative in place. If you do not know the status of your pending foreclosure, contact the mortgage servicer, or the servicer's attorney and request an update. You should let your counselor know <u>immediately</u> if you receive any notices related to foreclosure.

<u>C. Understanding the Workout Process</u>

1. Why Banks Consider Workout Requests: Mortgage holders lose money on most foreclosures. They incur legal fees and other expenses for the foreclosure and subsequent eviction. They also have carrying costs before they sell the foreclosed property. If the property is worth less than the amount owed by the former owner, the mortgage holder loses the difference between what the former owner owed and the property=s current value. The mortgage holder also loses the interest that would have been paid over the life of the loan had the foreclosure not taken place. And, foreclosed properties bring down the values of the other homes in the area.

2. What is a Workout? A workout allows you to enter into an agreement with the mortgage holder to change how you pay your mortgage off or otherwise avoid foreclosure. There are different types of workouts, and they will be discussed later.

3. Who's Involved in the Workout Process? The workout process involves many different people, though not all of the people listed below will be involved in every case.

> *A Counselor*, often with a HUD approved non-profit housing counseling agency, provides advice and assistance with completing the necessary paperwork. Also serves as a reality check on the situation and as a liaison between the lender and the homeowner. Though counselors are often extremely dedicated and capable, they cannot solve every problem.
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> *A Servicer or Lender* (customer service, collections, loss mitigation, foreclosure), for our purposes is the entity that collects the monthly mortgage payment. Although a call to customer service may be sufficient for most situations, when you fall behind on the

mortgage, it is necessary to speak with someone who has the expertise and authority to provide the necessary assistance. The collections department generally tries to collect the amount due and may be reluctant to reach any type of workout. The loss mitigation department tries to limit the loss that the mortgage holder or investor may suffer if the property goes to foreclosure. The loss mitigation staff is trained in the different types of workouts available. The foreclosure department implements the foreclosure and is responsible for following things through to sale. These departments are not always in the same branch or even the same state, and that can pose communication problems. It is important to keep track of what is said, when it is said, and who said it.

An Investor (Fannie Mae, Freddie Mac, others), buys mortgages on the secondary market. When you take out a loan from a local bank, the bank will probably not hold the mortgage for 30 years. In many cases the mortgage will be sold to an organization like Fannie Mae or Freddie Mac and the money raised from the sale will then be loaned to a new borrower. The local bank may continue to service the loan (collect payments etc.). The investor plays an important part in the workout process because the investor must approve most workouts.

A Private Mortgage Insurer generally provides mortgage insurance for the mortgage holder if you paid less than 20% down when the property was purchased. This insurance protects the mortgage holder in the event of a foreclosure. PMI companies must pay money to the mortgage holder in the event of a foreclosure. Therefore, the company has an incentive to help prevent foreclosures. PMI companies have their own loss mitigation departments that will usually work with you if you are facing difficulties. The PMI company will have to approve certain workouts before they can be implemented.

An Attorney will represent the mortgage holder as part of the foreclosure. You may have your own attorney too.

A Real Estate Agent helps you sell the property. It is important for the broker to understand the situation so that they know what you want to accomplish, a short sale or a sale to pay off the mortgage, and also how quickly the sale must take place. You should verify that the broker has had experience with pre-foreclosure sales.

4. Problems to Avoid

<u>Creeping Deadlines:</u> Do not wait as deadlines approach. Time is the enemy with foreclosures. Mortgage holders will not stop the foreclosure process while considering workout requests. You should not let time slip away thinking that everything will be okay. Proceed with all options simultaneously until the situation is resolved. Options become very limited as the foreclosure sale approaches.

<u>Payment Agreements on High Rate or Abusive Loans:</u> If you have a high rate loan or a loan that you feel may violate the law, you should contact an attorney. It is generally unwise to sign a repayment agreement or workout if there may be a valid defense to the original loan. Seek out an attorney who can review the original mortgage documents.

Scams: Foreclosures are a matter of public record and there are people who use the information for their own financial gain. You should be wary of people or organizations that promise to prevent the foreclosure.

D. Knowing What You Want

People seek foreclosure counseling for a variety of different reasons. You should tell the counselor what it is that you want so that the counselor can provide help that is consistent with your needs. You need to understand your range of options because some choices will be more appropriate than others. For example, if you want help to show your servicer that you have made the payments which the servicer claims are delinquent, you will need a different kind of help than someone who wants to put a workout plan in place. A counselor can review your financial situation and provide you with the options that are available and perhaps suggest alternatives that you may not have considered.

II. Getting Started

Facing the Foreclosure - Budgeting. In this part of the process, you must determine the amount available on a monthly basis going forward to devote to mortgage payments. Both income and expenses must be evaluated. The goal is to set up a budget which maximizes the amount available to make mortgage payments, but which is realistic given your situation. You will need to determine both whether income increases and expense reductions are possible.

Step 1: Current Budgeting

Establish your current income and expenses as realistically as possible. Income and expense worksheets can be used as a tool for making these calculations.

Step 2: Establish the Reasons for the Default

The reasons for the default should be explored and documented. This will later serve as the basis for preparing a hardship letter and will provide some clue as to the economic problems that need to be resolved to restore stability and prevent foreclosure.

Step 3: Set up a realistic going forward budget, with the maximum possible commitment for mortgage payments.

This step requires that you and your counselor evaluate your current budget to determine whether realistic and appropriate choices are being made. It is important to examine both income and expenses to see whether you can free up additional money for ongoing mortgage payments. Some common questions to be evaluated are:

Income Side:

1. Do you qualify for public assistance, food stamps, or medical benefits which you are not taking advantage of?

2. Do you have assets other than the home, which can be sold to generate money to contribute to a workout on the mortgage? Some examples may be life insurance policies, unnecessary automobiles, boats, vacation homes, valuable collectibles, retirement benefits which go beyond legitimate needs, stocks, bonds, etc. You may have to make difficult choices in this area.

3. Do you have a realistic possibility of increasing your employment income in the short term, based on job prospects, return from disability leave or the ability to take on a second job or overtime hours? If you have realistic possibilities and need some time to see if they can be realized, this may be a basis to try to have the foreclosure put into a short-term holding pattern by agreement with the mortgage holder. If the income becomes real, then a long-term proposal can be made.

4. Do you have a realistic possibility of a lump sum award on social security, workers compensation or based on a lawsuit? Do you have a right to a tax refund? If so, this can be treated as an asset, which can be used to deal with the default. (**Note:** As part of any workout, the mortgage holder will want to see your two most recent federal tax returns. You should be sure all returns have been filed.)

5. Is there a relative who is willing to help out? If so, what can be done to formalize the arrangement in order to make the income from the relative something which you and the mortgage holder can reasonably rely on in making plans for a workout?

6. For multi-family properties, is there a way to create or increase rental income? If the problem is nonpayment by a tenant, can something be worked out on a cooperative basis with the tenant? If not, can eviction and a replacement tenant be managed quickly? If the problem is that the income-producing unit is not rented, is there a way to assist in getting the property rented in the near term? If repairs are necessary, is there assistance available to help get those done?

Expense Side: Each current expense should be evaluated to determine whether there are ways to minimize it on a going forward basis. Different types of expenses must be treated differently.

1. Other Mortgages: Preventing foreclosure by the first mortgage holder will be an empty gesture if another mortgage lender has the right to foreclose. Therefore, a plan must be worked out to deal with second mortgage payments. If it is a high rate or other abusive mortgage, sometimes a legal defense can wipe out the debt entirely. Otherwise a plan must be made to make both current ongoing payments and to deal with any default.

2. Tax and Water Liens: Failure to pay taxes or water and sewer bills can result in a lien on the property. These liens can be a problem if the taxing authority seeks to foreclose. A plan should be worked out to deal with the underlying debts. Most taxing authorities have special programs for people who can afford to pay a debt in installments. On a going forward basis, water conservation may be useful as discussed below in connection

with other utility bills.

3. Other liens: Some other creditors may have liens on the property as a result of a court judgment. This may make them more aggressive about collection because they can "execute" (foreclose) on their liens if they are not paid. A plan should be worked out to deal with these creditors, but not at the expense of a mortgage workout. They can be treated as a lower priority because these creditors in most cases prefer to sit and wait for the property to be sold and their liens to be paid from the proceeds. They do so to avoid incurring the costs of executing on their liens. (Note that this dynamic may be different in some areas, where there is more of a tradition of holding execution sales of property.)

4. Utilities: There are five potential issues in seeking to minimize utility payments. These are:

a. Availability of Utility Assistance: LIHEAP (Low-income Home Energy Assistance Payments) may be available as a contribution to home heating costs. Lower income homeowners may qualify. Where appropriate, applications should be made through the local energy assistance agency. (Note: The House of Representatives has voted to eliminate this program, so that it may not be available in future years.)

b. Many utility companies have low-income rate discounts for low-income consumers. Applications should be made directly to the utility company.

c. For reducing bills on a forward going basis, homeowners should consider seeking home energy audits from their local utility companies as well as weatherization benefits through the local energy assistance agency.

d. For dealing with back bills, homeowners should apply for payment agreements. The agreements should be for the longest possible term and should minimize the required initial lump sum.

e. Other miscellaneous relief may be available. For example, in some jurisdictions, statutes or regulation may prevent shut off if a homeowner has special medical considerations. If this is the case in your area, back bills can be treated as a slightly lower priority.

5. Property Taxes: In most, but not all cases, these will be treated as part of the mortgage escrow payment. Whether or not they are included in escrow, available exemptions and deferrals should be examined to determine if the tax bill can be lowered. Depending on the locality, these may include, residential exemptions, elder and handicap exemptions, veteran exemptions, and hardship deferrals. Another issue for evaluation is excessive assessment based on a misappraisal of the property and the possibility of an abatement of the tax bill generally. (However, this may require that the taxes first be up to date.)

Remember that if the taxes are collected as part of the escrow, the servicer will most likely pay them, even if the homeowners are in default. These amounts will be part of the arrears. However, if the taxes are not escrowed, they have to be dealt with as an item in the homeowners' budget. If they are not paid, a lien will result and that lien will be a default under the mortgage. Tax liens should be addressed as discussed above.

6. Property Insurance: Lowest cost insurance should be explored. The property should be insured for the value of the dwelling rather than for the full value of the property, because the land itself cannot burn down. You should contact your insurance agent to see if any reduction of coverage is possible either for the short or long term. (Like the property taxes, insurance may or may not be handled as part of the escrow. In either case available reductions should be explored.)

7. Credit Card Bills, Medical Bills, and Other Unsecured Debts: No money should be paid on these debts (not even minimum payments) ahead of the mortgage workout payments, since these types of creditors cannot foreclose on the property except in very rare circumstances. Only if there is money left over after a workout should that money be devoted to a plan on these debts.

8. Student Loans: Student loans are a special case of unsecured debt since the agency that guaranteed the debt will have a right to take tax refunds and sometimes to garnish wages. Homeowners should call their student loan agency and insist on "a reasonable and affordable payment agreement." Every student loan guaranty agency is now required to make this type of an agreement by Department of Education regulations. Payments under such an agreement can be as low as the homeowners have a realistic ability to afford. Entering into such an agreement and making the necessary payments will stop collection activity.

9. Other Expenses: You will have other ongoing expenses. Each and every expense should be evaluated to see if it can be realistically reduced or eliminated. In some cases you will be faced with tough choices such as, for example, eliminating a $50 per month smoking habit in order to make a rational workout proposal. Your counselor can make suggestions, but you must make the final choices.

10. Home Repair Needs: A budget item requiring special consideration is home repair needs. Obviously, there is no point to protecting a home that is uninhabitable because you cannot afford basic repairs. The mortgage holder may be willing to consider paying for some home repair costs if they are essential to preserving the collateral. Alternatively home repair grant programs and other assistance should be evaluated. Home equity loans should be treated as a last resort since they will increase your burden to make monthly payments to avoid foreclosure.

Step 4: Put money aside to commit to the workout plan.

Once a realistic budget is reached and it is clear how much is available each month to commit to the mortgage, if you want to try to keep your property, you should start putting money aside each month (possibly in a special savings account) to commit to a workout agreement. Having a lump sum available will make the workout easier and will demonstrate your commitment and ability to follow through. If no workout is possible, then the money can be used to arrange alternative housing.

Step 5: Get exact totals on the amount of current mortgage payments, the arrears and the balance due on the mortgage.

The mortgage holder may be willing to provide you with a variety of options which we will discuss later. An essential prerequisite to evaluating the options is a complete understanding of the current mortgage situation including the amount of current payments, the amount of the arrears and the total due on the mortgage. This information **must** be obtained **from the servicer.** Most servicers will require you to sign an “Authorization to Release Loan Information" letter before they will provide any information. You should review the information to determine if there are discrepancies, lost payments, or other errors.

<u>Current Mortgage Payments</u>

An initial evaluation is whether you can afford your current monthly payments on an ongoing basis. The monthly payment should be broken down into "P.I.T.I." That is -- the principal and interest should be separated from the taxes and insurance. The taxes and insurance are also called the "escrow" charge. Not all loans include an escrow payment. Remember that taxes and insurance must be paid, whether through escrow or by you directly, and those amounts must be included in evaluating what you can afford to pay in the future. When determining the amount of money which you have available to pay the mortgage and escrow, it is useful to calculate the monthly expenses without the mortgage and escrow. That way when you subtract the expenses from the monthly income, you are left with the amount available for the mortgage and escrow payment. If you then subtract the escrow payment, you will be left with an amount that represents what you can afford to pay on the mortgage.

<u>The Arrears</u>

The arrears are the total of all missed payments, plus any foreclosure fees and costs that have come due. For example, if you have a $1,000 monthly payment and are five months behind, you owe $5,000 in back payments, plus any money **actually expended** by the servicer for foreclosure related fees and costs. This may include attorney fees, inspection fees, reappraisal fees and other similar fees.

<u>The Total Amount Due on the Mortgage</u>

This will usually include: 1) outstanding principal balance, 2) unpaid interest, 3) unpaid escrow balance (if there is an escrow account), 4) foreclosure attorney fees, and 5) other foreclosure costs. Late charges may also be included. Generally, if a workout is possible, the servicer will waive late fees if a request is made. (**Note:** The total amount due on the mortgage cannot be obtained by adding the arrears to the outstanding principal balance because the arrears include some unpaid principal. If the two numbers were added this would be double counted.)

Step 6: Fill out the budget papers and obtain necessary documentation of income and expenses.

If a workout is possible and desired, you will need to fill out the necessary budget forms and obtain verification of income and expenses. Forms are available from your servicer. Ask for a workout package. Income verification can be in the form of tax returns, benefit award letters or other proof appropriate to that type of income. Expense verification needs are usually flexible, but it is helpful to have copies of bills.

Step 7: Making Realistic Choices

Once the budget is complete, it is very important to make realistic choices from among the available alternatives to foreclosure. For example, you may not want to keep the property, but would nevertheless like to avoid foreclosure because of the credit implications. On the other hand, you might want to keep the property at all costs including making choices, which to others would appear to be unacceptable sacrifices. The counselor will not substitute his or her judgement for yours; however, the counselor may need to point out unrealistic or inappropriate expectations.

The counselor should help you understand the various options and should work to obtain a result that is as consistent as possible with what you want. In extreme circumstances, the counselor may need to withdraw from the case. This may occur if you propose to make misrepresentations to the mortgage holder or if you are unable to bring your expectations into line with the possible outcomes.

III. The Workout

A. Workout Options: What Types of Agreements are Possible?

This part of the process involves reviewing the workout options available from the mortgage holder to determine whether there is a way for you to resolve your default. It is important that the proposed resolution be realistic from your perspective because a failed workout will only leave you in a worse position than you were in at the outset. If no proposal is possible, or if you have other objectives, other strategies should be explored. No matter which strategy is chosen, you should understand the pros and cons of each available option.

There are a variety of options to analyze. Your counselor should strive to recommend a solution that is the best possible solution for the mortgage holder while also being realistic and financially possible for the homeowners. As a practical matter, that standard must be met in order to obtain the mortgage holder's approval for the workout.

Reinstatement: The borrower gives the bank all of the back payments and starts making regular monthly payments.

Partial Reinstatement: The borrower pays at least one-half of the back payments first and agrees to a repayment plan for the rest of the amount owed.

Repayment Plan: The borrower makes the regular mortgage payment plus an additional amount toward the back payments until the delinquency is paid (usually no longer than 12 months). If the bank sets up a repayment plan, make sure it is reasonable. Do not agree to a plan that will not work.

Forbearance: The bank agrees that for a limited period of time it will accept a lower monthly payment or no monthly payment. At the end of the forbearance agreement the account must be brought current.

Loan Modification: The bank agrees to change one or more terms of the loan. By changing the terms, monthly payments may be reduced. Possible changes include: reducing the interest rate, extending the term of the mortgage and adding the arrears to the unpaid principal balance of the loan. These changes may be used in combination. The mortgage holder will want you to make some type of contribution toward the back payments as part of the modification. Any proposed modification of the mortgage will require calculation on a financial calculator to determine whether the changes will result in payments that you can afford.

Short Sale: A short sale is a sale of the property for less than its value to avoid foreclosure. If you cannot afford to keep the home, you may prefer a short sale to foreclosure because the consequences to a credit record are less dramatic. The mortgage holder will generally review each proposed short sale on its merits and will consider agreeing to postpone the foreclosure if you have a buyer and a signed purchase and sale agreement. Mortgage holders usually will not agree to short sales involving family members or others with a close personal relationship to the homeowners. (This prevents below market price deals which do not get a fair return to the mortgage holder.) In cases involving family members, the same result can be achieved by looking at "delinquent assumptions" discussed below. Anyone else who has a lien on the property, and the private mortgage insurer, if there is one, must also agree to the short sale.

Make Whole Sale: This option should be pursued if you have equity in the property and feel that you may not be able to afford to keep the home. You do not need the mortgage holder=s approval for a market sale unless you want to have a foreclosure sale date postponed. If you merely need time to sell the property at fair market value to avoid loss of equity in the foreclosure process, the mortgage holder may be persuaded to consider postponing a sale if the value is high enough to protect its interest during the sale process and the property has been listed with a broker. When you sell the property, the money from the sale pays off the mortgage and any other liens on the property.

Delinquent Assumptions: In a delinquent assumption, the mortgage holder allows a third person(s) to substitute for you under the terms of the existing mortgage. The person(s) assuming the loan have to pay the delinquency or have an acceptable plan for paying the delinquency, and they have to qualify as a substitute borrower. The mortgage holder will not generally reduce any part of the debt being assumed; however, the mortgage holder will sometimes consider modifications of the interest rate. An assumption may make sense if there is a family member who wants the property or another willing buyer who will step into your shoes as the existing owner.

B. Making the Proposal and Meeting All Documentation Requirements

Proposals can be made to the mortgage holder or the servicer, and you should determine the mortgage holder's preference. Documentation, which is routinely required (such as income verification), should be submitted with the application. Other documents may be required and should be supplied on request. The workout package must be complete before the bank will review it, and you should keep copies of all material submitted to the bank.

If an agreement is reached, the servicer or mortgage holder will need to draw up the necessary forms to finalize the workout. You should work with your counselor and the servicer to make sure the forms accurately reflect the workout terms and that they are signed and promptly returned.

Sample List of Required Documentation (will vary from bank to bank)

Signed and dated letter that **briefly** explains what happened
One month worth of pay stubs or other proof of income
Two most recent signed federal tax returns and W2s (3 years if self-employed)
An accurate budget showing all of your monthly income and expenses
A list of your assets (cars, bank accounts, etc.)
A list of your liabilities (mortgages, loans, liens, other outstanding debts)
Divorce decree or death certificate (if applicable)

C. Other Responses to Default and Foreclosure

Even when the goal is to develop a workout procedure between you and your mortgage holder, you should know that you may have other options.

Special Programs for HUD, FHA and VA Mortgages: Depending on the type of mortgage you have, you may be entitled to special assistance to resolve your mortgage delinquency.

Refinance: This option allows you to payoff your mortgage by taking out a new mortgage. Sometimes it makes sense to refinance. You should contact a legitimate lender and proceed carefully, avoiding large fees and high interest rates.

Deed-In-Lieu: You cannot afford to keep the home and give it back to the bank. Do not ask for a deed-in-lieu when there is equity in the property or when a short sale is possible. The bank will not accept a deed-in-lieu if there are other liens on the property. You should request as part of the agreement a reasonable amount of time to find alternate housing and that the mortgage holder formally agree to waive any further collection efforts including collection of a mortgage deficiency. Finally, if a deed in lieu is offered, the mortgage holder should be asked to inform the appropriate credit reporting services since this may make it slightly easier for you to obtain new credit. (**Note:** You should understand that a deed in lieu will not entirely fix your credit report.)

Bankruptcy: Bankruptcy can be an effective way for you to keep your home when faced with foreclosure. A chapter 13 bankruptcy allows you to reorganize your debt and pay it back according to a plan which you develop and which is then approved by the bankruptcy court. This is most useful if you have experienced a temporary decrease in income but can now afford to resume monthly payments while paying the arrearages over time. In addition to the payments on the delinquency, you must be able to continue to pay the regular mortgage payment. Bankruptcy can be pursued regardless of the outcome of workout discussions. This is not a full description of the bankruptcy process. If this is your choice, you should consult a qualified bankruptcy attorney.

Litigation: If you believe that the servicer has made an error and the legitimacy of the default and/or the amount of the default are called into question, this should be brought to the servicer's attention. If the servicer refuses to correct the error or if you are not satisfied with the servicer's action, then it may be appropriate for you to consider litigation. Another situation where litigation may be appropriate is where the loan appears to have been abusive. (For example, if a mortgage was made in connection with home improvements which were not completed properly or in some cases involving very high interest rates or other abusive terms, legal defenses may be available.) As with the bankruptcy option, if you wish to pursue litigation you should contact an attorney.

Walking Away: If you do not want to keep the home or are unable to afford the home under any potential set of circumstances, it may be best to "walk away" from the property. This option works best if you are not concerned about a negative credit rating or if your credit rating is already poor. It can also work when a deed in lieu does not, because of other liens on the property. Some people favor this choice to avoid continued headaches associated with homeownership.

IV. Questions and Answers