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How to Avoid Foreclosure

Resources are available to help homeowners prevent repossession

by Aisha Iman Jefferson

June 17, 2008 -- With home foreclosures reaching record highs and circulating news reports about heavyweight boxing champion Evander Holyfield and iconic TV host Ed McMahon fighting to keep their multimillion-dollar dwellings from reaching the courthouse steps, housing industry experts say borrowers can avoid a similar fate. The rate of foreclosure starts and the percent of loans in the process of foreclosure are the highest recorded since 1979, according to the Mortgage Bankers Association (MBA), a national real-estate finance industry organization that tracks mortgage delinquencies and foreclosures.

The delinquency rate, which includes loans that are at least one payment past due-but doesn't include loans in the process of foreclosure-was at 6.35% at the end of March, up 1.51% from the year before, according to the MBA. During the same timeframe, the percentage of loans in the foreclosure process was 2.47%, nearly double the 1.28% from the previous year. California, Florida, Nevada, Arizona, Texas, Michigan, Ohio, and Indiana are among the states hardest hit by foreclosure rates.

The amount of foreclosures began accelerating during the latter half of 2006 due to defaults on high-cost loans, such as subprime and adjustable-rate mortgages, or ARMs, made to high-risk borrowers, causing the U.S. housing bubble to burst and a credit crunch to ensue. With ARMs, the interest rate resets from a lower introductory, or teaser, rate to a higher percentage rate, causing a spike in the house payments.

Thirty-nine percent of foreclosure starts in this country involved subprime ARMs; 23% involved prime ARMs; 19%, prime fixed-rate laons; 11%, subprime fixed-rate loans; and 7%, FHA loans, according to the MBA.

By some estimates, 61% of the people who got subprime loans would've qualified for a cheaper, conventional, 30-year, fixed-rate loan, says Kathleen Day of the Center for Responsible Lending, a nonprofit consumer group, adding that a disproportionate number of black and Hispanic families received subprime loans.

Jeffery R. Hayward, a senior vice president at Fannie Mae, says some homeowners facing financial challenges dig themselves deeper by avoiding their mortgage lender. "There's a myth out there that if you run into trouble, don't call the bank," Hayward says. "[Not calling] is the worst thing you could do. If you run into trouble, you should call your mortgage servicer immediately," Hayward says. "The servicer is really going to want to try to work your loan out. In some cases they won't be able to, but you're really not going to know until you call them."

Given the volume of exotic loans in the marketplace, practicing diligence and patience is a must when contacting lenders. "Keep calling until you get somebody," Hayward says.

Once making contact, lenders could offer to spread the defaulted payment over future payments, reduce the interest rate or loan balance, he says.

"If you have a bad subprime loan, a repayment is not going to help you. What you need is a workout plan," says Day, explaining that a workout plan would reduce the loan to a fair market value or freeze the interest rate either permanently or semi-permanently for about five years. On the other hand, a repayment would take the amount owed and spread it out on top of the current payments. Day says repayment plans work best for people who've gone into trouble because of a one-time event such as illness, job loss, death, or divorce.

"If the fundamental problem is the loan itself then you need a workout plan and not a repayment plan," Day says.

Since July 2007, nearly 1.6 million homeowners have avoided foreclosure through workouts which include loan modifications and repayment plans, according to HOPE NOW, the private sector alliance of mortgage servicers, counselors, and investors working to help prevent foreclosures.

If the loan can't be worked out Hayward suggests doing a deed in lieu of foreclosure where the mortgage lender will accept ownership of the home in place of the money owed on the note, or a short sale, which requires the homeowner to sell the home for less than the outstanding balance of the loan with the mortgage lender forgiving the remaining debt owned. Either of these options will help homeowners have a more orderly and planned exit of their property, Hayward says.

If borrowers aren't getting any satisfaction from their lender's decision, seek advice at a legal aid clinic, Day suggests. "It may be that you can challenge the term that you were given," she says.

For first-time homebuyers, Hayward suggests taking a homeownership mortgage or financial counseling course where counselors would conduct a budget overview and examine potential buyers' spending patterns to ensure they'll end up in a home they can afford. He also suggests first-timers make sure everyone involved in the process is trustworthy and reliable.

"This is the most important financial decision people will make in their lifetime. You should feel good about when you do it," Hayward says.

In an effort to help lending partners and communities survive this economic climate, Fannie Mae, which has a federal charter and operates in America's secondary mortgage market to ensure that mortgage bankers and other lenders have enough funds to lend to home buyers at low rates, has established its Keys to Recovery Initiative and foreclosure prevention for existing and first-time homebuyers.

If Fannie Mae owns the loan, borrowers who owe more than the amount their home has been appraised will have the opportunity to refinance their property up to 120% of its appraised value, Hayward says. Another measure formed through a partnership Fannie Mae has with Durham, N.C.-based nonprofit, Self-Help Credit Union (**www.self-help.org**), would allow families on the brink of foreclosure the opportunity to remain in their homes on a rent-to-own basis. The 70-year-old mortgage funding giant also renewed its partnership with the National Council of State Housing Agencies to provide up to $10 billion in financing through the end of 2009 for qualified first-time homebuyers.