Saving Your Home from Foreclosure â€“ Part 2

Second in our Series

In our first article on Saving Your Home from Foreclosure, we discussed interest only loans and Option ARM mortgages. We talked about the costs associated with each type of loan and the problems consumers are having with making their monthly payments once these loans "adjust". While this knowledge may be helpful for anyone considering a new mortgage, it will do very little to help those that already have such a mortgage and facing financial difficulty. So in this article, we’re going to talk about coming up with a strategy to deal with the problems caused by these loans.

If you have an interest only or Option Arm mortgage and it has already adjusted to a conventional loan, then you may already be faced with financial problems. And if you have one of these types of mortgages and have received notice from your bank that it is about to adjust, then you may be worried about how you will be able to keep your home once your payments go up. Either way, you need to come up with a strategy to address this issue, and the place to start is in defining your goals.

The first question you need to ask yourself is, "Do you want to keep your house or sell it?" Owning a home is the American dream. But when you find yourself lying awake in bed, night after night worrying about paying your mortgage, that dream can become a nightmare. Consequently, selling the house may be the answer to solving your financial problems. Unfortunately, because the housing market has slowed down considerably, selling your house may not be that easy.

Once you determine what your goal is, to keep the house or sell it, then you need to start working on a plan to accomplish the goal. As you start down this path, it’s important to formulate a back-up plan at the same time. We’ll talk about this as we go.

Keeping Your House

Buying a home is an emotional purchase and most buyers are probably going to want to hold onto their house. In the end, that may not be possible but you will not know that until you really examine all of the options available to you.

If your goal is to hold onto your house, and you currently have an interest only or Option ARM mortgage, then the chances are that you are going to try to refinance. But for this to happen, you need to keep up your monthly payments. Not just your mortgage payments, but all of your other bills as well. As soon as you fall behind in payments, your credit score will drop and refinancing will become a lot more difficult and more expensive. It may even become impossible.

This means that you may need to make some difficult choices. You may need to cut back on your day to day expenses… things like Starbucks, eating out and cable TV. You may also need to borrow money from family or friends. The important thing is to keep current on your payment obligations.

As you are considering your refinancing options, you need to take a close look at your current mortgage. Pull out your mortgage paperwork and go through it. You need to find out if it includes a prepayment penalty. If it does, you need to know when that penalty period ends.

Prepayment penalties are very common in interest only and Option ARM mortgages. Over the past few years, many mortgage brokers found that by including prepayment penalties on their loans they could get paid much higher commissions from the lenders they work with. The longer the penalty period, the higher the commission rate. A lot of consumers have no idea that there is a prepayment penalty on their existing loan until they try to refinance.

Prepayment penalty periods typically run anywhere from 1 to 5 years. As a consumer, if you are not planning on moving soon then you may want to consider agreeing to a short prepayment penalty period when refinancing or purchasing a home; one to two years. That’s because the chances of you refinancing your home again in such a short period of are probably small, but by agreeing to a prepayment penalty the interest rate on your loan will be reduced. This could save you a great deal of money over the life of your loan.

Agreeing to a long prepayment penalty period is very risky however. Anything beyond two years is probably too risky.

If your loan does have a prepayment penalty in it, that is not the end of the world. When refinancing you can usually include these penalty payments in the amount of your new loan, but there are cases where the penalty amount will make a new loan impossible. You will want to talk to whoever you use for you loan about this.

The next things you will want to look at are the types of loans available to you. The chances are that if you can’t afford the adjusted payment on your existing loan, you won’t be able to afford a fully amortized conventional loan. Even so, you should look at these.

A fully amortized conventional loan is a loan that has you making interest and principle payments for 30 years. Ideally, you would want to have a fixed rate loan. This would mean that your monthly payments would never fluctuate over the course of your loan. Using the example from our last article, a fixed rate loan for $250,000 with a 7% interest rate would have you making a monthly mortgage payment of $1,663 for 30 years.

If this is not an option for you, then you may want to consider a Hybrid loan. This is essentially an Option ARM but it has some features that can help you stabilize your finances. As with other Option ARMs, these loans can actually make your financial problems worse over time so you need to use them properly. Hybrid loans will offer you a fixed interest rate and fixed payments for up to five years. As with other Option ARMs, these mortgages allow consumers to make a minimum payment that is less than the interest being charged on the loan. The average consumer should NEVER choose this payment option (see the previous article for more information). Ideally, consumers using Hybrid loans should be making both principle and interest payments. These loans will also give you the option of a 30 year or 15 year payment cycle.

The nice thing about a Hybrid is that it will allow you to lock in your interest rate and payment amounts for a period of several years, even if you can’t qualify of a conventional fixed rate loan. This could be the breathing room you need to keep your house. If not, it could provide you enough time to sell your house without going into foreclosure or bankruptcy.

I Just Want Out!

Perhaps you’ve decided that keeping your house isn’t an option. Or maybe, you’ve decided that getting out of debt is more important to you that holding onto your home. Either way, you will need to find a buyer. In a down market this can present a challenge so, again, you need to come up with a strategy.

The first thing to keep in mind is that your lender does not want to own your home. In fact, most lenders will be more than happy to work with you to keep you out of foreclosure if you are having financial difficulty. You just need to know that there is a right way and a wrong way to contact lenders. How you go about this will be largely determined by the strategy you choose.

Even if you are going to sell, refinancing may be something you need to consider. It’s very important to note here that if you are refinancing and then selling your home, you don’t want to take out a loan that has a prepayment penalty of any sort.

The reason to refinance prior to selling is to keep your house payments affordable while you look for a buyer. And the place to start is with your existing lender. That’s because many lenders are actively working with consumers who have interest only or Option ARM loans to get them into new, more affordable loans.

But let’s say that you are already having financial difficulties. Maybe you’ve missed a few payments on your credit cards, or you’ve have a few late utility bills. In this case, you may not be able to get a new loan. Even so, you should call your lender. You want to ask for the lender’s Loss Mitigation Department. Don’t just call the customer service number on your invoice and expect the person on the other end of the phone to help you. You may actually need to make several calls, and escalate through various levels of management to get to the person you need to talk to. Just be sure you are polite at all times and remain calm.

A good strategy to get to the Loss Mitigation Department is to call the company’s main switch board. If your lender is a publicly traded company, you should be able to find their main phone number pretty easily by going to Google and typing in the company name and the phrase "financial profile" (including the quotation marks). You’re looking for Yahoo!’s financial profile page for the lender. Once you call the number, simply ask for Loss Mitigation for home mortgages.

Once you get through to these people tell them that you are having financial difficulty paying your mortgage and that you plan to sell your house. Ask them to work with you. In the current market, most lenders will try to help you out.

If you are determined to sell, then you should get your home listed as quickly as possible. Selling a home can take months, so the sooner you begin the process the sooner you should begin to see offers.

When you select a realtor, pick someone who is familiar with your area and who sells a lot of homes. A good place to start is with your local Sunday paper. Look for agents who have a lot of listings in your neighborhood and who have made many sales. When you contact the agent, ask for references and a list of the properties that they have sold in your neighborhood over the past six months. Remember, a real estate agent is supposed to work for you; therefore you should treat your initial conversation with the agent like a job interview, with you as the hiring manager. In most cases, you should probably interview several candidates.

Once the offers start coming in on your house, don’t think that simply because someone offers less money than you owe to your lender that the offer is no good. Although lenders don’t like to admit it, they may be willing to allow you to sell your house for less that you owe on it. This is called a "short sale" and it does need to be approved by the lender. In the current market, a short sale is often a much better alternative than foreclosure for both the lender and the person who owns the home.

In our next article, we’ll talk about some less obvious alternatives to refinancing or selling to help you keep your home out of foreclosure. We’ll also talk a little about your legal rights when shopping for a loan.

by Jim Malmberg

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