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Foreclosure hurts long after home's gone, so cut a deal while you can Advertisement

By Sandra Block, USA TODAY

If you're lying awake at night, fretting about whether you'll lose your house to foreclosure, you may not be the only insomniac on your block.

More than 2.1 million Americans with home loans missed at least one payment last year, according to the Mortgage Bankers Association. Even more troubling, the rate of new foreclosures hit a record.

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The problem is likely to get worse. As adjustable-rate mortgages adjust to higher rates, many borrowers are finding they can't afford their payments. And the collapse of the subprime market has made it harder for those with tarnished credit to refinance.

But be aware: Even if your mortgage has become an intolerable burden, letting the bank foreclose could lead to a lifetime of hurt. Losing your home is just the beginning. A foreclosure will wreck your credit report for years, making it impossible — or at least extremely expensive — to buy another home, says David Jones, president of the Association of Independent Consumer Credit Counseling Agencies. If the proceeds from the sale of your home don't cover your loan, your lender might sue you to recover the unpaid balance.

Many borrowers who lose their homes to foreclosure haven't tried to negotiate with their lenders. That's unfortunate, because lenders are usually willing to work with borrowers to avoid foreclosure, says John Lamb, co-author of *Solve Your Money Troubles*. "With the number of foreclosures on the horizon, lenders are going to be more willing to work with people, because it doesn't do anybody good to have a glut of foreclosed houses on the market."

Ideally, you should call your lender before you miss your first payment, says Bob Walters, chief economist for Quicken Loans. If your payment is due on the first of the month, call before the 15th, which he says is usually when your lender will report the late payment to credit-reporting agencies. The longer you wait, the fewer options you'll have. Once your loan is declared in default, typically after you've missed three or four payments, you're "past the point of no return," Walters says. At that point, most lenders won't accept a partial payment of what you owe. Unless you can come up with the money to cover all your missed payments, plus any late fees, your lender will start foreclosure.

Avoiding default

If you're suffering a temporary financial setback, your lender may offer programs that will help you get back on track. They include:

- **Forbearance.** This is an agreement that lets borrowers make a reduced payment, or none, for a specific period. You might have to make larger payments once the crisis has passed. To qualify, you might need to show that you're expecting a bonus, a tax refund or other income that will let you catch up.
- **Reinstatement.** You agree to pay the full amount of your missed payments by a specific date. Reinstatement is sometimes combined with forbearance.
- **Modification.** Your lender agrees to change the terms of the loan to make payments more affordable. Your lender may agree to add missed payments to your loan balance or extend the term of your loan, reducing the size of your payments.

Before asking for forbearance or loan modification, be prepared to show that you are making a good-faith effort to pay your mortgage, says

Jim Svinth, chief economist for LendingTree.com, a website that helps consumers shop for mortgages. If you can demonstrate that you've reduced other expenses, the lender will be more inclined to negotiate, he says.

Svinth warns, though, that your ability to negotiate will also depend on which institution owns your loan. If your bank still has your loan in its portfolio, it can modify the terms or offer forbearance. But many lenders sell loans into the secondary market, where they're repackaged as mortgage-backed securities. In that case, Svinth says, the company that's servicing your loan might be unable to change the terms.

Moving on

If you're in a home you can't afford, loan forbearance isn't going to solve your problem. But even if you have to move, you can take steps to avoid foreclosure:

- Put your home up for sale. This may be the best choice, Walters says, if you've been in your home for several years and have built up some equity. If your local real estate market is strong, your lender may agree to forgo payments until the house is sold, says John Jones, a financial specialist at CompPsych, an employee-assistance program. The proceeds from the sale might cover your mortgage and selling costs.
- If you have no equity or your local real estate market is depressed, ask your lender to consider a "short sale." In a short sale, the lender agrees to accept the proceeds from the sale of your home, even if they don't cover the amount you owe.
- Ask your lender to accept a deed in lieu of foreclosure. If you can't sell, your lender may agree to take the deed to your home and cancel your debt.

There's one serious drawback to a short sale or a deed in lieu of foreclosure: You could find yourself stuck with a hefty tax bill. In most cases, debt forgiven by a lender is considered taxable income. Unless you have your debt eliminated in bankruptcy or can prove you're insolvent, you'll have to pay taxes on the canceled debt, says John Roth, senior analyst for tax publisher CCH. Many people don't realize that canceled debt is taxable, Roth says, until they receive a Form 1099C from their lender; a copy goes to the IRS.

So why opt for a short sale or a title transfer instead of foreclosure? For one thing, foreclosure won't get you off the hook, either. If the lender sells your foreclosed house for less than you owe, it might sue you for the balance. And if the lender writes off the remaining debt, you could still end up with a tax bill, Roth says.

Though a short sale or a title transfer will hurt your credit report, you might still be able to work with your lender to reduce the damage — which isn't possible with a foreclosure, Lamb says.

"Foreclosure is really a bad thing to have to go through," he says. "You have all this emotional baggage, as well as the financial consequences. It's certainly better to have some control over the process."

Have you been having trouble keeping up with your mortgage payment or had to deal with a foreclosure? Tell us what the experience has been like:

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