

A Guide to Avoiding Foreclosure

Courtesy of Principled Properties

Foreclosure occurs when the homeowner is unable to pay the mortgage on the property. Ultimately, the lender forecloses upon the home, selling it to cover the amount owed by the homeowner.

The homeowner not only loses the home; they also lose all equity that they had in the home. If homeowner owed just \$100,000, but the home sold for \$500,000, the bank typically gets to keep that additional \$400,000 in equity.

This past decade has seen sky high foreclosure rates. In fact, the statistics are startling. The following facts and figures were released by the FDIC (the Federal Deposit Insurance Corporation, a government agency that strives to safeguard the banking industry and consumers).

- **1 in 300 homeowners will go into foreclosure in the United States.**
- **Over half of Americans live paycheck to paycheck.**
- **Nearly half of all Americans possess \$5,000 or less in liquid assets such as IRAs and savings, making it difficult to survive in the event of a job loss or other financial stressor.**
- **It's estimated that 1 million American homes go into foreclosure each year.**
- **60% of homeowners say they don't fully understand the terms of their mortgage.**
- **In every U.S. classroom, there's at least one child who's at risk of losing their home due to foreclosure.**
- **6 in 10 homeowners who have missed a mortgage payment say they weren't aware that their lender offers programs for individuals who are having a hard time making the payments.**

The key to avoiding foreclosure is understanding why and how an individual ends up in a situation where they're facing foreclosure. It's also essential to know the options that are available to a person who's facing foreclosure.

The Causes of Foreclosure

Foreclosure can arise as a result of many different circumstances. Understanding the causes that lead up to foreclosure can enable individuals to plan and prepare for the unexpected.

Job Loss and Layoffs

Job loss and layoffs can be devastating and unavoidable. It's impossible to guard against job loss, but establishing an emergency fund --- enough to cover expenses for at least 90 days --- is always a wise decision. Many individuals also fail to realize that they may be eligible for unemployment benefits, so this is something to consider and research if you've lost your job.

Establishing multiple income streams is generally ideal, but not always possible. With multiple income streams, you have a bit more leeway, as if one stream dries up, there's a chance that the other income streams will continue to flow.

Illness, Injury and Death

An illness, injury, accident or death of a family member and bread winner can be devastating to a family. The loss of this person's income can be extremely difficult and it often leads to a situation where the individual's family is facing foreclosure.

It's generally not possible to avoid illness, injury and death, but there are measures you can take to ensure your family remains afloat. Life insurance is one solution. Another solution is to obtain insurance that will cover your expenses in the event of an injury or illness. And, of course, there's also the option to save money and maintain sufficient liquid assets which would enable your family to survive financially for at least three months.

Adjustable Rate Mortgages

Adjustable rate mortgages can bring tremendous financial difficulties to a homeowner. Generally, homeowners opt for an adjustable rate mortgage at a time when the real estate market is strong and interest rates are low. As a result, they start out with a very affordable monthly payment.

Over time, the rate adjusts to a higher level and the individual's monthly payment skyrockets. This often coincides with economic decline, and for many, this spells job loss or cut-backs, which only causes the problem to snowball. Therefore, it's always best to opt for a fixed rate mortgage, as it will not fluctuate over time.

Mechanisms for Avoiding Foreclosure

There are a few different options available to individuals who may otherwise face foreclosure.

Selling the home is typically the first consideration that comes to mind, but this is by no means the only option available.

Ideally, individuals should be saving a portion of their income, enabling them to establish an emergency fund that could support the family for a minimum of three months. Of course, this isn't always financially viable. For those who don't have sufficient savings or liquid assets available, there are some options to consider.

Short Sales as a Mechanism for Avoiding Foreclosure

Short sales provide homeowners with a viable option for avoiding foreclosure. A short sale involves a situation where the mortgage lender agrees to accept a lump sum payment that's less than the total amount owed by the debtor.

For instance, let's say a homeowner owes \$300,000. In the case of a short sale, the mortgage company may allow the homeowner to sell the home for \$275,000. This represents a \$25,000 loss.

Generally, the mortgage company releases the debtor from his or her obligations, even if the home's sale price came up 'short' of the total amount owed.

In other cases, the individual may need to re-pay the remaining \$25,000.

A short sale is preferable over foreclosure because the homeowner can walk away with less damage on their credit history. This makes it easier for the individual to recover financially.

Refinancing to Avoid Foreclosure

Refinancing can provide homeowners with an option that enables them to avoid foreclosure by lowering the monthly payments.

A refinance can lower a homeowner's payments in two ways:

- *the interest rate is lowered, so the homeowner pays less interest over the life of the loan; or*
- *the term of the mortgage is lengthened, so instead of paying it back over the course of 25 years, the homeowner may opt to pay it back over 30 years.*

The only problem is that in order to refinance, you generally need to be current on your mortgage payments. Therefore, it's wise to refinance *before* you miss payments and go into default on the loan. Of course, many financial problems cannot be anticipated. But in cases where it's possible to anticipate a problem, it's best to take action immediately and refinance a few months before you expect to run into trouble.

Programs for Homeowners in Trouble

There are some programs available to homeowners who have missed mortgage payments and are struggling financially.

Some of these programs are offered by the lender; other programs are offered by the state or federal government.

These programs vary in terms of their approach. The program may involve eliminating penalties and late fees, to establishing a special program to re-pay the past due amount over time. For instance, let's say you missed two monthly payments and have a past due amount of \$3,000. The lender may agree to allow you to pay an additional \$500 per month over six months.

Other programs essentially forgive the missed payments, and then perform what more or less equates to a refinancing, with the term of the mortgage extended and/or the interest rate reduced.

Additional Tips to Avoid Foreclosure

It's essential to underscore the importance of communicating with your lender. While lenders often take a hard-nosed "pay us or else" stance, the reality is that they stand to lose a lot of money if the house sells for less than what's owed (and that says nothing of the money that the company would have received in interest payments over the life of the loan.)

In short, your lender doesn't want to foreclose on your home. In recent years, many lenders have implemented programs designed to help homeowners who are in a bad financial situation.

It's also important to note that programs change over time. So if you failed to qualify for assistance in the past, that doesn't necessarily mean that the same would be true today.

Financial experts also recommend that homeowners make a payment every month, even if it's not the full amount due. This not only shows a good faith effort

on the part of the homeowner, but it also looks good on your credit report and this can also prevent you from entering foreclosure proceedings.

Many homeowners fail to realize that lenders have a lot of leeway when it comes to when and if they initiate foreclosure proceedings. So stay in communication with your lender to discuss the situation. Also make it a point to send regular payments --- even if it's less than the total amount due --- because this can be enough to keep you out of foreclosure until you find a viable solution to your financial dilemma.

If you wish to sell your home, the team here at Principled Properties is happy to assist. We work with homeowners throughout Philadelphia and the surrounding region. We invite you to call Principled Properties today at 215-720-1365.