

Chapter 1

Keeping Your Home by Modifying Your Loan

In This Chapter

- ▶ Wrapping your brain around the loan modification concept
- ▶ Checking out other foreclosure alternatives first
- ▶ Prequalifying yourself and determining what you want
- ▶ Deciding whether to get professional help
- ▶ Preparing and submitting your loan modification application

If you're in the market for a quick primer on loan modification, you've come to the right place. This chapter introduces the concept of loan modification, explains the various ways a lender can modify a mortgage loan, assists in determining whether you're likely to qualify, and reveals what's involved, so you know what to expect.



Loan modification isn't the right foreclosure avoidance maneuver for everyone, so we list other common alternatives in this chapter and cover them in greater detail in Chapter 3. We encourage you to explore all your options before pursuing a loan modification.

Grasping the Loan Modification Concept

By definition, a *loan modification* is any change to the original agreement between borrower and lender. Assuming you qualify, a loan modification enables you to keep your home, lower your monthly mortgage payment, and catch up on any late or missed payments. In addition, your lender avoids the high cost of foreclosure, transforms a nonperforming asset into a performing asset, and removes a bad loan from its books.



Affordability is the key term in loan modification. If the loan modification results in an affordable monthly payment for the homeowner and is less costly for the lender than a foreclosure, it's a win-win solution for both parties. In the following sections, we discuss the various ways a lender can modify a loan to affordability. For additional details, check out Chapter 7.

Reducing and fixing the interest rate

During the run-up to the mortgage meltdown, many homeowners were suckered into *adjustable-rate mortgages* (ARMs) with low teaser rates. When interest rates rose, so did the house payments; in some cases, they jumped 50 percent or more. As rates were rising, property values were dropping, so many of these homeowners couldn't qualify for refinancing to get them out of trouble.

As a result, lenders are often willing to lower the interest rate, either temporarily or permanently. Loan modification rate adjustments are likely to come in one or more of the following forms:

- ✓ Reduced interest rate, sometimes below the going rate
- ✓ Converting an adjustable-rate mortgage into a fixed-rate loan
- ✓ Interest-only period to give borrowers time to recover their financial footing
- ✓ Step-rate adjustments, with a low rate for several months or years that increases gradually to avoid rate-adjustment shock

An interest rate reduction can result in considerable monthly savings. For example, dropping the rate from 7 to 5 percent on a \$200,000 30-year amortized mortgage reduces the monthly payment from \$1,330.60 to \$1,073.64, a monthly savings of \$256.96, or \$92,505.60 over the life of the loan.



During the writing of this book, ARMs were going the way of the dinosaur as lenders tried to stabilize the market and avoid a future mortgage meltdown. This shift away from ARMs may prevent future problems, but if you're stuck in an ARM now, you need to get out of it soon, and loan modification may help you do just that.

Extending the term

You probably have a 30-year mortgage with at least a few years or perhaps a decade or two of payments to look forward to. Although most homeowners want to pay off their mortgages as quickly as possible, stretching out the *term* (the number of years you have

to pay back the loan) can provide some relief for your monthly budget. Your lender may be willing to extend the term from whatever you have remaining on your mortgage to 30 or even 40 years.

Just because you have a 40-year mortgage doesn't necessarily mean you'll be making payments for 40 years. You can make additional payments to pay down the principal earlier. Extending the term gives you the flexibility to make larger payments voluntarily while obligating you to smaller monthly payments. This strategy can allow you to deal with fluctuations in your monthly income and expenses.



If your mortgage or loan modification agreement includes an early payment penalty clause, usually referred to as a *prepayment penalty*, make sure the penalty is phased out over a relatively short period — three years max. You don't want to get penalized for acting responsibly and trying to save some money.

Reducing the principal balance

If your lender can't achieve affordability by adjusting your loan's interest rate and term, it may agree to reduce the *unpaid principal balance* (the amount you owe on the loan) in one of these ways:

- ✓ **By forgiving a portion of the debt:** Under President Obama's Making Home Affordable (MHA) plan, this has become a more viable option for lenders who can recover a portion of their losses from the U.S. Treasury.
- ✓ **By deferring payment of a portion of the debt through principal forbearance:** For example, if you owe \$150,000 on a home that's currently worth only \$125,000, the lender may recalculate your payments using the \$125,000 amount and let you pay the remaining \$25,000 when you sell or refinance years later, hopefully after real estate values have recovered.

Dealing with delinquencies

When you miss a few house payments, your lender/servicer really starts to ladle it on with additional penalties and late-payment fees. Your lender has several options (all of which are usually negotiable) for collecting on missed payments and any associated costs:

- ✓ **Capitalizing delinquencies and other costs:** *Capitalization* consists of rolling any penalties and fees into the balance so that you pay them off over the life of the loan. Unfortunately, you also end up paying interest on those penalties and fees.

- ✔ **Waiving delinquencies and fees:** Your lender can choose to forgive the penalties and fees and then either capitalize the delinquent payments or negotiate a payment plan.
- ✔ **Negotiating payment plans:** Your lender may agree to an installment plan that enables you to pay the delinquencies, penalties, and fees over several months rather than as a lump sum. You may end up paying extra in interest, but you get to keep your house and buy some time.



If your lender/servicer is participating in the government's Making Home Affordable program, it's required to waive any penalties and fees. If your lender isn't a participant, push hard to have it waive any penalties and fees. Your lender shouldn't earn even more money from your misfortune.

Re-amortizing the loan

Amortization is a way of calculating monthly loan payments that keeps the payment the same every month and accounts for the fact that each payment reduces the principal. The end result is that the borrower pays way more interest with early payments and way less with later payments.



An average, everyday loan modification

Sherry Smith had been working two jobs to make ends meet, but when retail sales dried up, so did her part-time job at one of the nation's largest retail outlets. She could no longer afford the mortgage payment she'd been paying since June 2004 — \$752.03 on a \$96,467 30-year mortgage at 8.65 percent. Facing almost certain default, Sherry chose to do the right thing: She called her lender, described her situation, and requested a loan modification. The lender agreed and several weeks later offered to reduce her interest rate to 6.40 percent, lowering Sherry's monthly payment to less than \$600.

For most homeowners, this would have been the end of the story. Saving more than \$150 per month would have been enough, but again, Sherry did the smart thing: She requested a better offer because the payment still wasn't affordable for her. The lender took a second look at the numbers, dropped the interest rate to 5.60 percent, and extended the term, lowering Sherry's monthly payment to \$447.40. Now *that* was affordable!

Sherry is one of many homeowners who have negotiated affordable loan modifications with their lenders. With a little cooperation from your lender and perhaps some haggling at the negotiating table, you can keep your home, save hundreds of dollars per month, and save thousands over the life of your loan.

When you receive a loan modification, the lender re-amortizes (recalculates) your monthly payment based on the other modifications — the interest rate reduction, term extension, any principal reduction, and the capitalization of missed payments and any penalties or fees.



One way a lender can modify your mortgage is to re-amortize the loan over a longer period of time but retain the maturity date. If you go with this option, watch out for the last payment you make! For example, if you took out a 30-year mortgage in the year 2000 and paid 10 years on it, the lender could re-amortize over 30 years and still require you to repay the loan in 2030. In this example, you'd have lower monthly payments, but you'd also have a significant lump sum (balloon) payment due in 2030.

Considering Other Foreclosure Alternatives

Facing foreclosure, homeowners often assume they have only two options — pay up or move out. The fact is they usually have several options, including one or all of the following:

- ✓ **Forbearance:** Delays any collection activities, including a foreclosure sale, so homeowners have time to explore their options or obtain gainful employment.
- ✓ **Bankruptcy:** Is often an ideal solution for homeowners drowning in unsecured debt, such as credit card debt.
- ✓ **Loan modification:** Helps to make the monthly payment more affordable and allows homeowners to catch up on missed payments.
- ✓ **Reinstatement:** Allows homeowners to bring their payments current, as if nothing happened. This option is only for homeowners who have recovered from a temporary setback.
- ✓ **Refinancing:** Puts homeowners in a lower-interest, fixed-rate loan.
- ✓ **Short refinancing:** Puts homeowners in a lower-interest, fixed-rate loan for an amount less than is currently owed on the home.
- ✓ **Government loan programs:** Includes HomeSaver Advance (HSA) for catching up on late or missed payments. (For more about the HomeSaver Advance program, check out Chapter 10.)
- ✓ **Selling the home:** Allows homeowners to get out from under an unaffordable home and cash out any equity in it.

- ✓ **Short sale:** Involves selling a home for less than the unpaid balance without owing the lender anything after the sale.
- ✓ **Selling to an investor:** May be appropriate when time to explore other options is close to running out and the investor has the resources to save the home (and the integrity to help). This option often requires a substantial amount of equity that the homeowners are unable to tap into because of credit or employment issues.
- ✓ **Redemption:** Involves buying back the home after the foreclosure sale. This option isn't available in all states.
- ✓ **Deed in lieu of foreclosure:** Gives the property to the bank, and the homeowners walk away without owing anything on it.

We provide this grocery list of options only to make you aware of some viable foreclosure alternatives. For additional details about each option, turn to Chapter 3.



Finally, you can consider the following two options. But be aware that they aren't bona fide foreclosure alternatives because you still end up losing your home in foreclosure.

- ✓ **Abandoning the home:** This is only an option after you've exhausted all other options and can't deal with the lender.
- ✓ **Doing nothing:** This is one of the worst options, second only to falling victim to a foreclosure rescue scam.



If you're considering either of these last two options, beware of the possibility of a deficiency judgment. In states that allow deficiency judgments, your lender may try to force you to pay the difference between what you owed the lender and what the lender recouped through the sale of your home.

Do You Qualify?

The only sure-fire way to determine whether you qualify for a loan modification is to apply for one and see what happens, and that's really not all that sure-fire either. You could meet all the eligibility requirements and have your request denied due to a technicality or a mistake made by you or your lender.



If your house payment is unaffordable, apply for a loan modification, even if something you heard or read leads you to believe that you're ineligible. Keeping this in mind, the following list can help you determine whether you're *likely* to qualify; if these statements apply to your situation, your chances look pretty good:

- ✓ The house is your primary residence, not a second home or vacation property.
- ✓ You're committed to doing what's necessary to keep your house.
- ✓ You have sufficient income to afford a reasonable house payment.
- ✓ You experienced a qualifying financial hardship that has made your current house payment unaffordable. (Chapter 8 describes qualifying hardships.)



Eligibility requirements may vary among lenders and can change over time. Contact your lender (see Chapter 5) or consult a loan modification expert (see Chapter 4) to determine whether you're likely to qualify for a loan modification or other workout solution.

Assessing Your Needs

We recommend pursuing several foreclosure alternatives at the same time. List your property for sale, consult a bankruptcy attorney, research the loan modification option, talk to a mortgage broker about refinancing, and so on. Eventually, however, you need to make a decision about what you really want and what's best for you and any significant others living in the home with you.

At some point in the process, earlier rather than later, gather the family's decision makers, discuss your exit strategies, and determine which options are viable for you. Chapter 2 shows you how to crunch the numbers and perform a realistic assessment of your situation, Chapter 3 describes the available foreclosure alternatives to consider, and Chapter 7 helps you decide what to ask for.

Opting to Work with a Pro or Go It Alone

Loan modification is a team sport. You have to work with your lender or through a third-party representative to get 'er done. So which option is best? Read on to find out why we recommend hiring a pro and what you should do if you opt to do it yourself.

Hiring a pro

We recommend hiring an expert to represent you for several reasons, including the following:

- ✔ Your lender usually has an attorney representing its interests, so you should have your own representative defending your interests.
- ✔ You may have only one shot at submitting your application correctly. Having an experienced expert prepare your application is like having a headhunter craft your resume.
- ✔ A loan modification expert knows the system and how to work it for your benefit.
- ✔ An expert can quickly prescreen you, so if you probably aren't eligible for a loan modification, you won't end up wasting time, energy, and money trying to get one.
- ✔ An expert can take all the hassles off your plate, freeing up your time and energy to get a better handle on your finances.
- ✔ An expert is free from the emotional baggage that can undermine negotiations. Being emotionally involved, you're more likely to engage in arguments and make poor decisions.
- ✔ A seasoned pro knows immediately whether the offer a lender pitches is fair and square.
- ✔ You'll probably more than recoup the cost of hiring an expert from the amount of money he or she saves you by getting a better deal than you could on your own.

Lenders often try to dissuade distressed borrowers from hiring their own representation. After all, lenders often claim, "We'll modify your mortgage for free." Sure, they'll modify it, but are they going to modify it to true affordability? Chapter 4 has details on finding, selecting, and teaming up with a loan modification expert.

Dealing directly with your lender

Although we strongly encourage distressed homeowners to seek expert representation, we're aware that many homeowners are do-it-yourselfers. They fix their own plumbing, install their own light fixtures, hang their own wallpaper . . . nobody's going to convince *them* to pay an expert for doing what they can do on their own!

If you're an avid do-it-yourselfer, we applaud you. With the right training (provided in this book), you can get up to speed on the process, avoid common pitfalls, and negotiate an affordable loan modification. Just be sure to read Chapter 5 prior to contacting your lender and Chapters 11 and 12 to avoid the most common traps.

Getting Your Ducks in a Row

Successful preparation can optimize the outcome of your loan modification, so spend some time upfront getting organized, setting realistic expectations, and keeping track of *everything*. In the following sections, we reveal what you should be doing to prepare for and stay on top of the process.

Gathering essential documents

A loan modification application may be a short form that appears deceptively easy to complete. The complicated part is gathering all the documents and information you need to fill in the blanks and to submit as supporting documentation. In Chapter 6, we provide a list of commonly required documentation, but you can get a jump on the process by tracking down or preparing the following items:

- ✓ Existing mortgage document and note
- ✓ Most recent mortgage statement
- ✓ Monthly budget showing income and expenses
- ✓ Proof of income, including federal income tax returns, W-2s, and recent paycheck stubs
- ✓ Home valuation showing your property's current market value



If you live in a jurisdiction that allows real estate agents to provide home valuations, you may be able to obtain this document for free or a minimal fee. Don't pay for an appraisal unless your lender requires it. If your lender requires an appraisal, it will usually order the appraisal and bill you.

- ✓ Proof of financial hardship (if available), such as divorce papers, hospital bills, or notice of a rate adjustment on an adjustable-rate mortgage

If you hire professional representation, gather authorization letters giving your lenders permission to share information with your representative (Chapter 6 provides a sample letter).

Plotting the timeline

Few things are more nerve-racking than having to wait while someone else determines your destiny, and loan modification has plenty of waiting associated with it. You may submit your application and hear nothing for several weeks. To keep the stress of the waiting game at a dull roar, obtain some key dates and other information by asking the following questions:

- ✓ If you're hiring someone to represent you, how long is it likely to take to prepare your application?
- ✓ Does your application stop the foreclosure process? If not, will you be able to resolve this before the foreclosure sale?
- ✓ After submitting your application, when can you expect to hear something? If you don't hear something, whom should you call?
- ✓ When can you expect to have this all wrapped up? (A typical loan modification takes 30 to 90 days to complete.)



Your lender probably has a timeline for every stage in the process. It should have no problem sharing this information with you. Some lenders receive so many modification requests that it takes them three to seven days just to retrieve information faxed to them.

Logging all correspondence

Only really neurotic people keep detailed records of correspondence and phone conversations, but when you're fighting to keep your home, being neurotic isn't necessarily a bad thing. In fact, it can pay dividends later, particularly if a dispute arises between you and your lender about something that was said or not said, done or not done.

In Chapter 9, we provide a contact log sheet and details on how to keep accurate records. If you contact the lender before reading Chapter 9, make sure you do the following:

- ✓ Keep copies of all written correspondence and include the date and time you sent or received it.
- ✓ Jot down the name, employee ID number (if available), phone number, and extension of anyone you speak to; an overview of what the conversation was about; anything that was promised or resolved; and the date and time of the conversation.

Following the Process from Point A to Point B

Earlier in this chapter, in the section "Plotting the timeline," we encourage you to ask your lender several questions about the timing of the process so you know what to expect. Having a bird's-eye view of the loan modification process can also put everything into perspective, enable you to develop realistic expectations, and provide a context for understanding each stage of the experience.

The following sections provide tips on optimizing the outcome and negotiating the most affordable deal your lender is willing to offer.

Preparing and submitting your application

The kick-off to loan modification is the application process. In most cases, you can obtain the application form and instructions by doing one of the following:

- ✓ Visit the lender's Web site, and then complete and submit the application online, assuming your lender offers a secure online form (a few do).
- ✓ Download printable forms from the lender's Web site and mail them to the lender.
- ✓ Call and ask your lender or servicer to send you a loan modification application packet.



The *servicer* is the company that collects and processes your mortgage payments. It can be (but rarely is) the lender or investor that owns your mortgage. You'll probably be dealing with your servicer, even if we tell you to talk to your lender.

Whether you apply online or via snail mail, your lender probably requires that you submit supporting documentation: copies of your federal income tax return and W-2s to verify employment and income; a signed Form 4506, which allows your lender to pull your tax returns; recent bank statements; and perhaps even proof of financial hardship. Follow your lender's instructions to submit everything required. See Chapter 8 for details.

Playing the waiting game

Lenders typically require two to three weeks to process a loan modification application, which means you get to wait and wring your hands for two weeks. To add to your aggravation, your lender will probably continue its collection activities, so don't expect the collection letters and phone calls to stop while you wait.



Remain active during this processing period. Explore other options described in Chapter 3, including bankruptcy, refinancing, and listing your home for sale. You should have a plan B, C, and D to fall back on if your loan modification falls through. In addition, keep an eye on the timeline and check in with your lender if you don't hear something when you were supposed to.

Making your case during the homeowner interview

At some point in the process, you're likely to be required to speak with someone about your situation — your representative (prior to applying) or your lender (after you apply). The person conducting the interview tries to determine whether

- ✔ You're credible and are pursuing a loan modification because you really *need* one, not just because you *want* one.
- ✔ You're committed to doing what's necessary to keep your home.
- ✔ You experienced an eligible financial hardship.
- ✔ You have or will have the resources required to deliver on your end of the new agreement.

In Chapter 10, we show you how to prepare for a homeowner interview and communicate effectively with your lender.



Be careful when speaking directly to your lender. Anything you say can and will be used against you. This is another reason we recommend working through your own representative, who can filter what you say.

Structuring a workout plan

A loan modification is actually an addendum to your original mortgage, laying out only what has changed from the original agreement, so it's typically shorter. In most cases, the loan modification is structured to make one or more of the following changes to the mortgage:

- ✔ Reduce the interest rate
- ✔ Convert an ARM into a fixed-interest rate mortgage
- ✔ Extend the term
- ✔ Reduce the unpaid principal balance
- ✔ Institute a lower, more affordable monthly payment
- ✔ State the plan for catching up on any late or missed payments

You may or may not have input on how the lender chooses to modify your mortgage to arrive at the lower monthly payment, but you should have input during the negotiating phase. The Making Home Affordable (MHA) plan recommends that lenders take the following waterfall approach to arrive at an affordable payment:

1. Reduce the interest rate.
2. Extend the term if an interest rate reduction alone is insufficient in achieving affordability.
3. Forgive or forbear a portion of the unpaid principal balance if an interest rate reduction and term extension are insufficient.

Reviewing the lender's initial offer



A loan modification can adjust anything stated in the original mortgage, so you need to read it carefully (and have your attorney review and approve it) before you sign on the dotted line.

Lenders often present their plans as take-it-or-leave-it offers and give borrowers little time to respond. Don't cave in to the pressure by making a rushed decision. Review the lender's initial offer carefully, keeping in mind that the terms of the agreement are likely negotiable. In Chapter 11, we show you how to pick through the lender's initial offer without nit-picking your way out of a solution.



The most important part of any loan modification agreement is the monthly payment. Make sure it's affordable. If the agreement calls for *step-rate adjustments* (regular increases in the interest rate over time), find out what your payment will be with each adjustment. Make sure the worst-case scenario is still affordable.

Pitching your counteroffer

Unless your lender pitched you a golden egg of an offer, you probably want to negotiate one or more of the terms stated in the new agreement. You should always pitch your counteroffer in writing, and it should always include the following details about each clause you want changed:

- ✓ The clause itself, which you may be able to refer to by number
- ✓ The desired change using your preferred rewording, unless you simply want the clause removed

Chapter 12 can help you negotiate a better deal.



In real estate, everything needs to be in writing to be legally binding. Don't let anyone convince you that some understanding you reach outside the parameters of the contract is good enough. Get everything in writing.

Closing the deal: Now what?

After you sign and submit the loan modification agreement, your lender should provide you with copies of the executed agreement, signed and dated by all authorized parties. If you don't receive copies, or if the copies provided aren't signed and dated, request them from your lender. Your lender may also officially record the modification with the county register of deeds or the county clerk.

At this point, you've successfully completed the loan modification process and should have an affordable monthly mortgage payment. Your job now is to hold up your end of the deal by continuing to earn income and keep your discretionary spending in check. You don't want to go through something like this again. In Chapter 16, we provide ten tips for long-term success.

Taking Legal Action — Only If Necessary

As a borrower, you have rights. Your lender has the responsibility to honor those rights through full disclosure. Your lender isn't allowed to play a bait-and-switch, dangling an attractive offer in front of your nose and then sticking you with a high-cost mortgage. Several pieces of government legislation are designed to protect borrowers from unfair lending practices, including the following:

- ✓ **TILA (Truth in Lending Act)** promotes the informed use of consumer credit by requiring disclosures about terms and costs.
- ✓ **HOEPA (Home Ownership and Equity Protection Act)** is designed to curtail predatory lending practices, particularly the practice of placing homeowners in high-interest loans.
- ✓ **RESPA (Real Estate Settlement Procedures Act)** standardizes closing procedures and paperwork to keep transactions above-board and make the process less confusing for borrowers.

In Chapter 13, we cover these important pieces of legislation in greater detail. In Chapters 14 and 15, we show you how to use them to your advantage in negotiating a better deal with your lender.



Although these acts do allow victims to take legal action against violators, we usually recommend using these statutes to push for a settlement outside the courtroom. Litigation can be expensive, time-consuming, and aggravating.