

# Dollars and Sense

## How to Negotiate a Pre-foreclosure Workout Agreement

By JUSTIN H. DION, Esq.

**P**rior to the recent downturn in the real estate market and turmoil in the sub-prime lending industry, a pre-foreclosure workout was extremely rare. Historically, because the housing market usually increased a homeowners' equity, banks were generally better off foreclosing to obtain most, if not all, of the money they were owed.

As the housing market began to decline, so did the equity in many debtors' homes. Simultaneously, as the equity decline excelled, so did the mortgage lenders' confidence that they were going to be adequately paid from a foreclosure sale. Accordingly, mortgage lenders are now in a position in which they must look at alternative options to avoid the substantial financial loss caused by foreclosure. In turn, homeowners can now negotiate pre-foreclosure workouts with more confidence.

### Basic Observations Regarding Pre-foreclosure Workout Negotiations

As lenders vary in their willingness to negotiate pre-foreclosure workouts, there are no guarantees that a workout will be successful. Surprisingly, the first step in a workout is making sure the homeowner knows who their lender is. In today's market, many lenders sell their mortgage loans. In addition, it is not unusual for a homeowner to have two separate mortgage-purchase loans structured in a way that allows them to avoid paying private mortgage insurance (PMI).

In this scenario (known as '80/20 loans'), the first mortgage is usually for 80% of the total loan amount, and the second mortgage for the remaining 20% is usually at higher interest. This arrangement can result in two different banks holding the loans, both of which will each need to be identified and contacted for negotiated purposes.

As there is no set workout formula, every lender will use a different settlement analysis and

be moved from collections, which primarily employs standard collection techniques, to mitigation, which employs negotiation tactics to reduce the bank's loss.

### Preparing an Effective Hardship Letter

Although negotiating a workout may ultimately save the lender money in the long run, the lender still wants to make sure the debtor truly cannot afford to

debtor's problems and create some degree of sympathy. Although a hardship letter must have a personal tone, it is generally a good idea to have the letter reviewed by an attorney knowledgeable about pre-foreclosure workouts.

To make sure the debtor is on the same page as the lender, it is generally advisable to request a breakdown of the exact amount owed for both the total payoff and the current arrears. In addition, since the debtor is also ultimately responsible for the bank's foreclosure fees, it is usually advisable to request that the bank suspend all foreclosure work pending an opportunity to negotiate a workout solution. This will keep costs down and enhance the odds of a successful negotiation.

*Surprisingly, the first step in a workout is making sure the homeowner knows who their lender is. In today's market, many lenders sell their mortgage loans.*

will review different factors, including the homeowner's payment history, credit rating, and the details of their present financial situation. Almost all lenders will want some evidence of a compelling hardship that has created the recent inability to repay the loan in full. Lenders are usually more inclined to negotiate a workout if the financial problems were not self-imposed, but rather were caused by factors outside of the debtor's control (i.e., job loss, medical problems, divorce, etc.).

Next, after locating the current holder of the loans, it is important to then be sure the account is with the correct department of the bank. Most lenders have a collection department and a loss-mitigation (workout) department. It is generally best to request the account

make normal mortgage payments. In addition to reviewing the debtor's finances, a well-crafted hardship letter should explain why negotiation is in the lender's best interest. It should be drafted in a manner that tells a personal story explaining why the debtor has fallen behind and lacks the ability to get caught up.

The letter should always be honest and straightforward; however, it is acceptable to stress points that are most advantageous to your request. A great deal of the negotiation process is based upon developing a level of trust with the bank. If the bank discovers that facts in the hardship letter are untrue, the bank may cancel further negotiations and simply proceed to foreclosure. The hardship letter should attempt to personalize the

### Proposing a Realistic Solution

The hardship letter should also propose a solution. The bank is in the business of loaning money, not owning houses. If you propose a solution where the bank can recoup more money than it would in a foreclosure, the bank will be more inclined to negotiate and find a reasonable solution. The debtor must also show that they will be able to make the negotiated payments proposed in the hardship letter. Typically, a workout proposal may include one or more of the following proposals:

- **Lump-sum Cure:** If the debtor can make a lump-sum payment for the full amount presently due, the lender will be generally happy to accept pay-

ment; however, depending on the loan documents, the bank could refuse to accept payment if the debtor has developed a pattern of being in default. The exact terms of the mortgage should be reviewed to see how this issue is specifically addressed.

• **Loan Modification:**

Perhaps the debtor fell behind on the mortgage payments because of some financial hardship; however, their finances have now improved to the point that the debtor can now resume their normal monthly payments, but they cannot cure the arrearages. In this situation, the debtor may request that the unpaid months simply be moved to the end of the loan.

• **Loan Reformation:** If the debtor cannot afford the monthly payments because they are simply too high based on an adjustable rate mortgage, the debtor can propose that the lender adjust the interest rate to create an affordable monthly payment.

• **Refinance:** Although a struggling debtor's credit score may be low due to the current mortgage repayment issues, if a new loan from a different bank can be obtained at a reasonable interest rate, the debtor can seek to refinance and pay the first bank in full via the refinance proceeds.

• **Full Sale or Short Sale:** If a debtor realizes that they cannot afford their house, they may seek to sell it and pay off the debt in full (as long as the bank is paid prior to the conclusion of a fore-

closure sale). Unfortunately, if the market indicates negative or minimal equity in the property, a full sale may not be financially feasible. In that situation, the debtor can propose a short sale.

A short-sale proposal would allow the debtor to sell the house and pay the lender less than the full amount owed in exchange for the lender marking the loan satisfied and issuing a mortgage discharge. This option will prevent the bank from having to take risk at a foreclosure sale; however, the lender will typically not allow the debtor to receive any sale proceeds. In addition, it is possible that a short sale may have some negative tax consequence; thus, a debtor considering a short sale should also consult with a tax professional.

• **Deed in Lieu of Foreclosure:** If the debtor has come to the conclusion that the house cannot be maintained or sold, it is also possible to offer to sign over the house to the bank in exchange for forgiveness on the mortgage. This allows the bank to obtain title without all the costs associated with a foreclosure, and it also helps the debtor get rid of the house without being foreclosed on and sued for a mortgage shortfall. This option may also affect tax filings; thus, a consultation with a tax professional is highly recommended.

As the workout negotiation process can be lengthy and time-consuming, it is important that you propose the option that is in your best interest. However, alternative options should be considered in case the bank doesn't agree with the debtor's first choice.

## Proceed with Caution

It is advisable that anyone looking to do a mortgage workout consult with a professional to help navigate the pitfalls and traps. Unfortunately, it appears there are also many unscrupulous workout agents, thus it is important to investigate your agent's credentials and rate of success before spending any time or money. A few important points to be aware of follow:

- If the person assisting you is not an attorney, check to find out if their business is registered with the Better Business Bureau;
- Be wary of a professional who promises results, because workouts are never certain;
- Request names and speak with past clients; and
- Be sure to carefully read and understand all documents you sign.

Some disreputable people will attempt to take advantage of homeowners facing a foreclosure by proposing questionable remedies. A homeowner must be exceedingly cautious if asked to do one of the following:

- Sign the deed to the house over to a third person, who indicates they will attempt to resolve the foreclosure on the debtor's behalf;
- Sell the house to a third person for a nominal dollar amount, with the understanding that the new owner will let the debtor "rent" the property for a reduced amount; or
- File a bankruptcy if the sole intent is to merely stall the bank's legitimate attempts to foreclose on its collateral without any hope of reorganization.

## Bankruptcy — Sometimes a Helpful Solution

If an attempted workout is ultimately not feasible, filing a Chapter 13 bankruptcy will temporarily stop all foreclosure activity and allow time to repay mortgage arrearages.

However, in most cases, a bankruptcy will not change the terms of the mortgage or the obligation to continue making normal monthly payments. In fact, a Chapter 13 bankruptcy will impose a requirement that the debtor make an additional monthly payment to the bankruptcy trustee, who will then apply some of the payment towards the mortgage arrearages. If ultimately unable to make normal monthly payments, a Chapter 13 bankruptcy will usually not be an advisable option.

For most people, their home is their most valuable asset. An unanticipated financial catastrophe will cause most people immediate fear and panic. Although a financial disruption is a serious matter, with the help of an experienced workout or bankruptcy attorney, a rational solution may be attainable that will both allow the bank to get paid and allow someone to keep their home. ♦

*Justin H. Dion, Esq., is an associate with Bacon & Wilson, P.C., where he specializes in consumer and corporate bankruptcy as well as real estate matters; (413) 781-0560; jdion@baconwilson.com*