

Foreclosure occurs when a borrower fails to make payments on his or her mortgage. The lender then obtains a court order to repossess the property and sell it to recoup the mortgage.

### **Types of Foreclosure**

There are several types of foreclosure. Judicial foreclosure and foreclosure by power of sale are the two most common. In judicial foreclosure, the residents must move out of the home in a specified period of time. The sale of the mortgaged property is then conducted under the supervision of a court. When the home is sold, the proceeds are first used to pay back the first mortgage. Any remaining proceeds will go to other lien holders and then finally the borrower, if anything is left.

With foreclosure by power of sale, the lender can sell the home without the supervision of the court. A "power of sale" clause, however, is usually required in the mortgage contract in order for this type of foreclosure to occur. In addition, this type of foreclosure does not provide the lender with a deficiency judgment. This makes it difficult to obtain title insurance for the property. Like a judicial foreclosure, once the home is sold, proceeds must first go to pay off the mortgage and any other lien holders.

While these are the two most common types of foreclosure, there are also other types of foreclosure. Since foreclosure laws can vary in each state, if you are facing foreclosure, it is best to obtain legal advice in your area.

### **How to Avoid Foreclosure**

If you can no longer meet your mortgage payments, do not be embarrassed. The first step is to contact your lender. Your lender may be open to some of the following options:

Forbearance: Lenders may be willing to postpone taking legal action against you and let you work out a repayment plan that is feasible for you.

Repayment Plan: Lenders may let you spread out the missed payments over a longer period of time. You would pay a little extra in your future payments to make up for those that were missed.

Note Modification: Lenders may change the parameters of your loan. For example, they may freeze your rate on an adjustable loan. They could also extend the term of your loan.

Refinance: The lender may add the missed payments back on to the balance of the loan. This is only available if you have sufficient equity and meeting lending requirements.

Debt Forgiveness The lender might waive your obligation on some of your missed payments. This, however, rarely happens.

### **How to Stop Foreclosure**

Sell Your Home: Sell your home and use the proceeds to pay off the mortgage.

Short Sale: If your home is worth less than your mortgage, talk to your lender about a short sale. In a short sale, the lender agrees to selling the home at market value and forgiving the remainder of the loan. A short sale affects your credit but not as bad as a foreclosure.

Deed-in-Lieu of Foreclosure: In this scenario, the lender signs over the property's deed to the lender in exchange for closing the loan. Deed-in-lieu of foreclosure, however, affects your credit the same as foreclosure.

### **Short Sale & The Seller's Credit**

Sellers will take as big a hit on their credit by going through foreclosure as giving the lender a deed-in-lieu of foreclosure. Points lost on a FICO score are as follows:

**Foreclosure or Deed-in-Lieu of Foreclosure.** Both of these solutions affect credit the same. Sellers will take a hit of 200 to 300 points, depending on overall condition of credit. This means if a seller's FICO score before foreclosure was 680, it could dip as low as 380.

**Short Sale.** The effect of a short sale on a seller's credit report is identical to that of a foreclosure. The ding on credit will show up as a *pre-foreclosure in redemption status*, which will result in a loss of 200 to 300 points. This means a short sale with a previous FICO of 720 will see it fall from 520 to 420. The effect on a consumer's credit report, foreclosure vs. short sale, is the difference between being hit by a train or a bus. Here's why: Waiting period before buying another home.

**Foreclosure or Deed-in-Lieu of Foreclosure.** A seller who wants to buy another home after foreclosure will end up waiting about 36 months before a lender will offer any kind of interest rate that makes sense.

**Short sale.** A notation on a consumer's credit profile of "settled for less than owed" (short sale) precludes the consumer from obtaining an institutional loan for 24 months, depending on the lender's program and regardless of FICO score. Fannie Mae guidelines require 24 months seasoning, and there's no way to get around this.

**Short Sale/Foreclosure Deficiency Judgments.** The bad news is a seller could be subject to a deficiency judgment for the difference between the loan amount and the amount paid. In California, purchase money loans are not subject to deficiency judgments. Hard money loans, equity loans and refinances are subject. Some states have laws regarding personal guarantees, which could also result in a judgment, if the home owner is held personally liable for loan repayment. The lender has sole discretion whether to pursue a judgment in those instances when the judgment is permitted. *(Tim & Julie Harris, Harris Real Estate University)*