LOSS MITIGATION OPTIONS CONVENTIONAL MORTGAGES

Chicago Volunteer Legal Services, Access to Justice Program

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I. Overview of Loss Mitigation

Loss mitigation ("loss mit") is a powerful practical and legal tool in avoiding a foreclosure. Consumer Financial Protection Bureau (CFPB) Regulations define a loss mitigation option is "an alternative to foreclosure offered by the owner or assignee of a mortgage loan that is made available through the servicer to the borrower." 12 CFR 1024.31.

Loss mit options for conventional, forward mortgages fall into two groups: **home retention** and **non-retention** (or negotiated exit). Options also vary between government-backed (GSE and FHA and VA loans) and private loans. Loss mit options for reverse mortgages depend upon the type of default, which are covered in the second half of the presentation. Which options are available depend upon the borrower's goal, verified income, length of the default, and the loan balance. Additional factors may make the borrower ineligible, such as the type of property or if the borrower already received certain loss mit options in the past.

Loss mit problems can also be raised as legal issues in the foreclosure. CFPB regs require servicers to timely review loss mit applications, provide substantive answers, and freeze foreclosure proceedings when a complete application is under review. 12 CFR 1024.41. Violating these requirements can give rise to a RESPA claim if paired with the error resolution procedures in 12 CFR 1024.35. Botching loss mit can also gives rise to state statutory and common law claims and affect the process during case management, judgment (Rule 114), and in the lead up to the sale.

Loss mit options are typically reviewed according to a waterfall. If the borrower is not approved for one option, the lender moves down the list and reviews them for the next.

- Home retention
  - Reinstatement
  - Forbearance
  - Repayment plan
  - Modification
  - SUN Initiative (not bank program)
- Non-retention
  - Short sale
  - Deed-in-lieu
  - Consent judgment

II. Home Retention Options

a. **Reinstatement.** *If the borrower has enough in savings and can afford the mortgage, they may be eligible for reinstatement.*

   i. Overview:

      1. Reinstatement is bringing the loan current by paying the lender the missing payments (arrears) plus any court costs and attorneys' fees as permitted by the mortgage in one lump sum.
      2. A borrower has the absolute right to reinstate the mortgage within 90 days of being served under the Illinois Mortgage Foreclosure Law (IMFL). Standard mortgage instruments also give the borrower until judgment to reinstate, and many lenders accept reinstatements all the way up to the sale.
      3. To reinstate, the borrower must ask the lender or its attorneys for a reinstatement letter. The letter will cite a figure the borrower must pay by a certain date to bring

the loan current. If the borrower complies with the letter, the loan is brought current and the foreclosure is dismissed. The borrower then resumes normal payment.

ii. **Hardest Hit.**
  1. The Illinois Hardest Hit Fund (IHHF) is administered by the Illinois Housing Development Authority (IHDA). The Program pays to reinstate a borrower's mortgage through a forgivable loan if the borrower is eligible.
  2. Factors:
     a. The arrears (including costs) must be under $35,000.
     b. Borrower must experience at least a 15% reduction in income around the time of the default.
     c. Borrower cannot have received IHHF funds previously.
     d. The property must be borrower's primary residence.
     e. Borrower must be able to afford mortgage payment moving forward.
  3. The program is a good option for borrowers who hit a rough patch or who can't get another modification.
  4. Borrowers must apply through a housing counselor.
  5. The best scenario is a 1, 2 punch: First a Hardest Hit reinstatement to cover the arrears followed by a loan modification to reduce the payment.
  6. CVLS argues a borrower has submitted a "complete application" for a HHF reinstatement to the servicer for CFPB regulations when IHDA requests a reinstatement figure from the servicer.

iii. **Chapter 13 Bankruptcy.**
  1. A Ch. 13 BK is a forced reinstatement. The lender must accept the arrears in equal monthly payments spread over 3-5 years.
  2. The borrower must be able to afford the existing payment plan the trustee payment and ongoing expenses.
  3. CVLS does not handle Ch. 13s, but LAF does, and many private attorneys do.

b. **Forbearance.** *If the borrower had a temporary reduction in income but can pay any arrears in a lump sum at a later time, they may be eligible for a forbearance.*
  i. During a forbearance, the lender agrees to temporarily accept less than the full monthly payment due. When the forbearance period is over, the borrower has to catch up with all missing amounts in a lump sum or through a repayment plan.
  ii. Forbearance agreements should be in writing!
  iii. Forbearance does not cure any default.

c. **Repayment plan.** *If the borrower cannot afford to bring the loan current in one lump sum but can afford to pay the arrears over time in addition to the regular monthly payment, they may be eligible for a repayment plan.*
  i. Repayment plans are most feasible early in the delinquency when the arrears are still low.
  ii. Fannie and Freddie:
    1. Repayment plan payment cannot exceed 150% of usual PITIA mortgage payment.
    2. First 90 days of default: Don't need to apply, can't exceed 6 months.
    3. After 90 days: Need written application, can't exceed 12 months without GSE approval.
  iii. FHA:
    1. At least $300 in surplus income, and
    2. 15% of gross and 85% of surplus income must be enough to repay arrearages within 6 months.

d. **Modification.** *If the borrower cannot afford to bring the loan current either through reinstatement or forbearance but can afford to pay the loan back at reasonable terms, they may be eligible for a modification.*

i. Overview:
    1. A modification cures the default by recapitalizing the arrearages and resetting the payment terms. Unlike other options, it changes the terms of the original loan.
    2. A borrower usually has to be at risk of default to get a modification, but an actual default is not required.
    3. To get a permanent modification, most programs require the borrower to complete a trial payment plan of three or more months to show they can manage the new payment. If they successfully complete the plan, the lender should offer the permanent modification.
    4. Although most banks had to review for Home Affordable Modification Program modifications during the foreclosure crisis, that is no longer required. Only Fannie, Freddie, the FHA, and the VA (somewhat) require standard options.
    5. To review for possible modifications, CVLS recommends standard online calculators for advocates. CVLS can provide these when you're handling a CVLS case.

ii. Fannie and Freddie: The Flex Mod!
    1. What the borrower gets and when depends on when the apply and the mark-to-market loan to value (MTMLTV) ratio.
    2. The resulting mod must have:
        a. The same or lower monthly payment,
        b. 40 year term, and
        c. Possible forbearance.

iii. FHA: Refer to CVLS CLE on loan modifications, May 10, 2017.
    1. The FHA follows a very strict waterfall, which depends on borrower's income:
        a. Forbearance
        b. Standard Loan mod
        c. FHA HAMP
            i. Stand-alone partial claim
            ii. Stand-alone modification
            iii. Modification with partial claim

e. **SUN Initiative.** *If a modification is not possible or advisable because the home is severely underwater, the borrower may be eligible for the SUN Program.*

i. SUN is an acronym for Saving Urban Neighborhoods. It is a short sale buy-back program run and funded by Boston Community Capital.

ii. SUN is not a bank or government program. It's run by a third-party non-profit.

iii. Process:
    1. Borrower applies and gives SUN info on income and value of property.
    2. If borrower is eligible for a SUN loan with a principal balance of the FMV of the property, they will pre-approve the borrower for that loan and start negotiations with the lender.
        a. SUN loans are 30 years with around 6.25% interest rate and shared appreciation feature.
        b. During the negotiation process, borrower saves up down-payment for SUN, usually equal to 3-4 months of the proposed payment.
    3. SUN tries to get original lender to short sale for FMV. SUN can be very aggressive in their offers here.
        a. SUN is clear during negotiations and closing they intend to sell property back to homeowner.
        b. The lack of an arms-length transaction sometimes scuttles the deal, especially for FHA loans.

4. If SUN is successful, SUN sells property back to homeowner using down-payment and pre-approved SUN loan. Success rate is around 35%.
5. Intent is for homeowner to refinance and be left with a standard mortgage for the amount the home is worth.

III. **Non-Retention Options.** *If the borrower cannot afford to retain the home or doesn't want to and is concerned about their personal liability, they may be eligible for a non-retention option.*

a. **Overview:**
   i. Non-retention options surrender the property to the lender early. In exchange, the lender agrees to waive any personal liability.
   ii. Non-retention options make sense when the home is underwater, and the borrower is concerned about their personal liability or when the borrower wants to unload the property quickly.
   iii. Non-retention options are marginally better for a borrower's credit than a foreclosure. But the damage is usually already done when they miss mortgage payments, and credit shouldn't outweigh more practical considerations.
   iv. Non-retention doesn't make sense when the borrower is collection proof (i.e. elderly and only getting Social Security and pension), when the borrower has a bankruptcy discharge, or where the homeowner is not liable because they didn't sign the note.
   v. Junior liens will likely get in the way of short sales and deeds-in-lieu but not consent judgments.
   vi. The borrower may have to pay taxes on any forgiven debt.

b. **Short sale.** 735 ILCS 5/15-1401.1
   i. In a short sale, the borrower sells the property to a third party for less than the amount owed on the mortgage. In exchange, the bank forgives the remaining personal liability.
   ii. The purchase price needs to be near market price.
   iii. The transaction needs to be arms-length and usually involves an affidavit in which the seller swears they have no connection with the buyer.
   iv. CVLS does not assist with short sales. Usually, the homeowner hires a listing agent and closing attorney, who are paid out of the proceeds of the sale.
   v. Short sales are a pain the…

c. **Deed-in-lieu (DIL).** 735 ILCS 5/15-1401
   i. In a DIL, the borrower deeds the property to the bank "in lieu of" (instead of) foreclosure. In exchange, the bank forgives the remaining personal liability.
   ii. The borrower must usually list the property for at least 90 days and forward any purchase offers to the lender.

d. **Consent judgment.** 735 ILCS 5/15-1402
   i. In a consent judgment, the borrower "consents" to a judgment of foreclosure. Title vests immediately in the lender, and the lender forgives any remaining personal liability. The borrower must usually move out in 30 days.
   ii. Consent judgments can usually go through despite minor liens. However, the borrower's personal liability under those liens (if any) remains.
   iii. Consent judgments are the only non-retention option effectuated through the foreclosure process.