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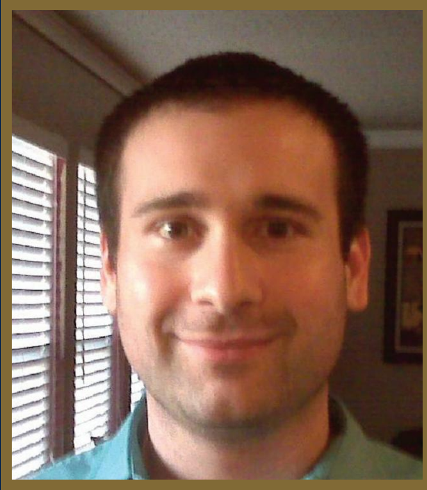

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Financial Literacy:

Mortgage Loss Mitigation Options

by Steven Palmieri

Loss mitigation is a tool which has been used for years by lenders designed to prevent home foreclosure through the negotiation of a mortgage term with a homeowner. Starting in 2007, loss mitigation departments experienced tremendous growth with lenders as a result of a sharp increase in delinquent and foreclosed homes. Now, as "too big to fail" financial institutions are failing due to a lack of liquidity, it is clear that no business model is safe from today's unforgiving financial market. Property investors are no exception. In today's dynamic real estate market, property investors who were once profiting from a strong business model are now finding themselves searching for survival solutions as mortgage delinquencies increase.

Loss mitigation solutions are designed to provide new loan terms that will stabilize the risk of loss by the lender. These new terms are usually achieved from working out either a Reinstatement, Special Forbearance, Loan Modification, Deed-in-Lieu of Foreclosure, Short Refinance, or Short Sale with the lender. This article briefly explains these different options, which in today's market can often take several months to complete, so property managers can make an informed decision when it comes to surviving this illiquid market.

Property managers can negotiate a loss mitigation solution either directly or by hiring a professional company to do so on their behalf. The benefit of hiring a professional company is that they usually are more well informed of what each lender's criteria are and, as a result, can invest the time necessary to effectively negotiate each workable solution. The government has even supported loss mitigation ever since "predatory lending" and loan securitization were linked together ten years ago. In 2000 HUD recommended that FHA establish teams of loss mitigation specialists to work as a liaison between lenders and borrowers who were in danger of foreclosure. It is important that an individual or firm that is negotiating with a lender speaks directly with the loss mitigation department each time a call is made. Often times, communicating with the collection, customer service, or escrow departments may provide misinformation from the lender pertaining to the status of a loss mitigation workout.

Major lenders are equally concerned about cash flow and liquidity in this market as individual property investors. Lenders know less money is lost when they successfully negotiate a "workable loan solution" for a customer than when they foreclose on a home. The end result of a foreclosure is that the property is often held by the lender for up to a year or more as a class of property known as Real Estate Owned (REO) while the lender tries to sell the home.

The different types of loss mitigation workable loan solutions can be classified as follows:

Reinstatement – a reinstatement is an option a lender gives the borrower prior to foreclosure. Reinstatement of a loan is achieved when the past principal and interest debt is satisfied by the borrower as well as any legal fees incurred by the lender. Reinstatement requires the full mortgage debt to be brought current; therefore, many borrowers do not have the money required to exercise this option.

Special Forbearance – a Special Forbearance is a repayment option which allows the borrower to repay the delinquent loan amount over several monthly installments rather than in one lump sum. Loan repayment terms usually do not exceed 36 months. The special forbearance is good for a borrower who has had a temporary financial setback, but who can now afford the monthly payment plus special forbearance payment. The borrower's credit report will continue to report "delinquent" through the term of the special forbearance.

Loan Modification – a loan modification is a process whereby a borrower's loan is modified by means of either lowering the interest rate, reducing the principal balance, 'fixing' adjustable interest rates, increasing the loan term, forgiving payment defaults and fees, or any combination of these. The modified loan term replaces the original loan term and both the lender and the borrower are bound by the new terms. A loan modification is good for a borrower who has experienced a long-term financial hardship.

Deed-In-Lieu of Foreclosure – a deed-in-lieu of foreclosure is a process whereby the borrower voluntarily deeds the home back to the lender in exchange for a release from all obligations under the mortgage. This option, which helps the lender avoid costly foreclosure legal proceedings, until recently was reserved for homes that had equity; however, lenders in today's economy are performing a deed-in-lieu of foreclosure for homes with negative equity as well. This option may not be accepted for a borrower who can financially make the mortgage payments.

Short Refinance – a short refinance is a process whereby a lender reduces the principal balance of a borrower's mortgage in order to permit the borrower to refinance with a new lender. The reduction in principal is designed to meet the loan-to-value guidelines of the new lender (which makes refinancing possible). This option may work if the borrower is still current on the mortgage, but can prove that the current loan terms are unsustainable.

Short Sale – a short sale occurs when a property is sold and the lender agrees to accept a discounted payoff, thus releasing the lien that is secured to the property upon receipt of less money than is actually owed. A short sale typically is executed to prevent a home foreclosure. A lender often will choose to allow a short sale if it is believed that doing so will result in a smaller financial loss to the lender than foreclosure.

Property investors know the value of having a good CPA and real estate attorney. Having a reliable credit management and loss mitigation negotiation firm is equally valuable for the long-term survival of a property investment firm. Investor solutions are rarely achieved by simply mitigating the loss of one home in a portfolio. Rather, it is becoming increasingly important to review the entire debt and credit portfolio with the property investor in order to a create long-term solution. Being able to help an investor improve his credit profile after the workable solution process has been finished is a vital ingredient to an investor's financial success. Doing so will allow the investor to once again use his credit as a tool to have access to much needed capital to grow the business in the future.