What to Do When You Default On Your Mortgage

No lender wants to foreclose on a mortgage. Foreclosure costs them more money than they can make back from the foreclosure sale. Therefore, lenders do not foreclose in order to make money, but only reluctantly as a way of limiting losses on a defaulted loan. This is why, if you get behind on your mortgage payments, your lender will work with you to devise a practical plan to cure the default and bring the loan current. In order to do so, however, you must stay in communication with your lender and be honest in evaluating your financial situation.

If you are falling behind in your payments, or know that you are likely to in the immediate future, there are some steps that you should take before talking with the lender about alternative payment arrangements.

First, you need to prepare a monthly list of your income and expenses, using realistic figures based on your current financial situation. You will also need to put together a complete financial disclosure package, showing your assets and liabilities, including all debts and monthly payments and when they are due. Pay stubs, unemployment check stubs or other proof of current income should be in the package, along with two years' tax returns. Prepare a written explanation of your situation for the lender and offer any plan or suggestion you may have on how you can bring the loan current.

Listed below are examples of "Loss Mitigation" options you can speak with your lender about in order to resolve your delinquent mortgage payments. Remember, you need to ask for your lenders, "Loss Mitigation" Department.

Reinstatement or Repayment Plan: A reinstatement or repayment plan might be used for borrowers who have fallen behind on their mortgage payments but are able to subsequently resume making their monthly payments. Under this arrangement, the lender increases the regular monthly payment until the delinquency is repaid.

Partial Mortgage Insurance Advance Claim Payment: This approach might be used if a mortgage insurer is involved (either the Federal Housing Administration or a private mortgage insurer). Under this approach, a one-time payment is made by the mortgage insurer to the lender to cover all or a portion of the default. In these cases the borrower is required to sign an interest free note for the amount of the advance claim payment payable to the insurer of the mortgage. The repayment of the note is scheduled to coincide with the borrower's ability to pay when they get back on their feet and structured to the individual's circumstance. At the latest, the note is usually due on the sale or transfer of the property. The details on this program may vary among mortgage insurers.

Forbearance Agreement: A repayment plan based on the borrower's financial situation that may include a temporary reduction or suspension of payments for a specific length of time. Often used when the borrower has a reduction in income or increase in expenses that is not expected to be permanent.

Mortgage Modification: A refinancing of the debt and/or extension in the term of the mortgage loan that allows the borrower to catch up by reducing the monthly payments to a more affordable level. Used for borrowers who have recovered from a financial problem and can afford the new payment amount. Modifications could include lowering interest rates, adding payments to the end of the loan term, paying off small amounts of arrearages each month, adding a lump sum payment due at pay-off, or simply lowering payments for a set period of time.

Loan Assumption: An arrangement where a qualified borrower agrees to assume responsibility for repayment of the mortgage.

Pre-foreclosure or Short Sale: This is where a lender can agree to accept the proceeds of a pre-foreclosure sale in satisfaction of the loan even though the proceeds may be less than the amount owned on the mortgage.

Deed-in-Lieu of Foreclosure: The borrower voluntarily deeds the property to the lender in order to avoid a lengthy foreclosure, additional accrued interest, and expenses. Typically used when attempts fail to sell the house prior to foreclosure.