



SPECIAL REPORT:

What You Must Know Before Attempting a Loan Workout

Behind on Your Mortgage? Is Your Property Worth Less Than Your Loan? Is it Possible to Save Your Property? Your Credit?

Most people in America are aware of the unprecedented decline in housing prices which was triggered by the mortgage meltdown. This topic has been the subject of several shows on The Real Estate Guys™, so if you're not up to speed on it, visit www.realestateguysradio.com and download those past shows. The purpose of this special report is to provide people who are struggling to hold on to their properties with a foundational understanding of the options available, with a special emphasis on loan modification. The good news coming out of what seems to be an endless deluge of bad news about housing is that lenders are more flexible than ever before – and there is an entire industry of service providers that has emerged to help property owners through these tumultuous times.

According to RealtyTrac, a leading online marketplace for foreclosure properties, there were 2,203,295 foreclosure filings in 2007 in the United States. Default notices, auction sale notices and bank repossessions were reported on 1,285,873 properties nationwide during that year, up a whopping 75 percent from 2006. So, if you're struggling with your mortgage(s), you're not alone!

Meanwhile, the U.S. Dept. of Housing & Urban Development (HUD) and many other housing advocacy coalitions are working frantically to revise the foreclosure statutes, but the changes will not take place overnight. Most people already in default or on the verge of default should consider taking aggressive, proactive action to protect themselves and their properties. Don't count on new legislation or government aid being available in time (or ever) to help you if you're already "upside down" (you owe more than the property is worth) and behind on your payments.

Understanding Foreclosure

Most people understand that the basic function of foreclosure is for the bank to effectively repossess the property and then sell it in an attempt to pay off all or part of a defaulted loan. The technical details and specific procedures vary from state to state, and the laws that apply are those in which the property, not the borrower, is located. So if you own

property in another state, don't assume the laws work the same there as in your home state. Make sure you understand the laws and procedures of the state where the property is located. You can often obtain this information from the state's web site or through a real estate attorney licensed in that particular state. For purposes of this report, we're going to deal with generalities, so again, be sure you are familiar with the rules which apply to your property before making any important decisions.

The Foreclosure Process

The foreclosure process begins when a borrower defaults on mortgage payments and the lender files a public default notice, called a Notice of Default (NOD). In judicial foreclosure states, the NOD will often be accompanied by a "Lis Pendens" which puts the world on notice that there is litigation pending.

The entire foreclosure process is tightly regulated and lenders must follow very strict state specific procedures in order to protect their rights. The laws are primarily intended to protect the borrower.

Lenders must work with borrowers and provide them ample opportunity to make up delinquent payments before filing the Notice of Default. Once the NOD is filed, the borrower is allowed a period of time (usually 2 to 3 months) to "redeem the loan" by making up the back payments, fees and any penalties that have accrued. If you do so, your loan is now "reinstated". Though you may suffer derogatory entries to your credit report for being late, at least you won't have a foreclosure on your record. More importantly, the lender cannot immediately declare you in default should you miss another payment. If the loan defaults again after being reinstated, the lender must start the foreclosure process all over again.

If you aren't able to reinstate the loan, another option borrowers have is to work out a "repayment plan". With a repayment plan, all past due payments are divided into monthly payments and spread out over a period of time, usually six months or less. Obviously, a repayment plan is only a viable option for borrowers who fell behind for some temporary reason and now have the ability to not only make the current payment, but pay an additional amount as well.

Assuming no payments are being made, it may take six months or more for the lender to actually complete the foreclosure process. During that time, the lender collects no payments from you and may ultimately receive the property in poor condition. The lender may need to upgrade the property before it can be resold. Then the lender must hire a real estate agent (for a fee) to market the property and compete with all the other properties on the market, including non-REO¹ properties, in order to convert the property into cash. When there are lots of properties on the market and values are dropping, this can be a very unattractive scenario to lenders and one of the reasons why you have a good chance at getting your loan modified.

¹ REO is a term commonly used for Real Estate Owned by the lender.

The foreclosure process typically ends in one of four ways:

1. The borrower reinstates the loan by paying off the full defaulted amount (all the past due payments and penalties) during a grace period which is determined by state law. This grace period is also known as the pre-foreclosure period. It begins with the first missed payment and ends with the public sale of the property.
2. The borrower sells the property to a third party during the pre-foreclosure period. The proceeds from the sale allow the borrower to completely or partially pay off the loan and avoid having a foreclosure on his or her credit history. In the event of a partial payoff, the borrower can either bring cash to the closing to pay off the shortfall or ask the lender to accept the partial payment as payment in full. The latter is called a “short sale” and must be approved in advance by the lender.

With a short sale, the lender is effectively discounting the debt in order to settle the matter without the risk and expense of foreclosure. The lender is under no obligation to accept a short sale offer. In virtually every case, the borrower will not be permitted to receive any of the sales proceeds. In some cases, if the borrower can't bring cash to the close, the lender may ask the borrower to sign a new unsecured note for the shortfall.

Why would a borrower go through the hassle of selling a property when they are not going to receive any proceeds? Primarily to avoid a foreclosure on their credit report and/or a potential “deficiency judgment” if the proceeds aren't enough to pay off the loan in full (more on this shortly). If you decide to pursue a short sale as an exit strategy, be sure to work with a local real estate agent who knows your market and is experienced in short sales. Selling a property short can be a lengthy and frustrating experience depending on how fast the lender takes to approve the offer. With the glut of properties in foreclosure, many lenders' workout departments are overwhelmed with work and it can take many weeks to get short sales approved.

3. The property goes to auction and a third party buys it. If the property sells at auction for an amount less than the note, state law and/or the loan contract may provide the lender the right to pursue the borrower for the shortfall or deficiency.
4. The lender takes ownership of the property, usually with the intent to re-sell it on the open market. The lender can take ownership in a number of ways:
 - a. If, at the public auction, no bids come in which are sufficient to pay off the loan, the lender may decide to take possession of the property themselves in the hopes they can sell it later for a better price. Here, they effectively “buy” the property for the cost of the note.
 - b. The lender accepts the “deed in lieu” of repayment. In this case the lender agrees to simply accept title to the property as payment in full for the loan, thus foregoing the

foreclosure process. It is a voluntary surrender of the property by the borrower to the lender. Lenders are under no obligation to accept a Deed in Lieu offer. As you might expect, the lender's willingness will be based upon the estimated market value of the property, the time and expense of the foreclosure process in the particular state, and the condition of the property and any concerns they have about how it (and its market value) may deteriorate during the pre-foreclosure period.

Whatever the means by which the lender takes title to the property, once they have it in their possession, it is commonly referred to as REO (Real Estate Owned by the lender).

Foreclosure is a long and costly process for everybody involved. The good news is that the lender cannot simply repossess your property the moment you miss a payment. More importantly, in most cases, they don't want the property. This is especially true if there is no equity in the property, which is a very common scenario in today's market. In such cases, lenders are typically open to a modification.

Being Deficient Can be Taxing - The Vitamin BK Option

Although this report is focused on getting your loan modified and avoiding foreclosure, it's important that you understand all your options - and those of the lender. If you end up being foreclosed on and the sales proceeds don't completely pay the mortgage off, then the lender may have the right to pursue a "deficiency judgment" against you. A Deficiency Judgment is a legal claim the lender is issued by the court for the amount the sales proceeds that were short of paying off the loan.

For example, if you have a \$300,000 mortgage and the property sells at auction for \$200,000, then your payoff is \$100,000 deficient. Depending on the state your property is in and what your loan documents say, the lender may seek a judgment against you for \$100,000. If the lender simply writes the balance off as bad debt, then the IRS may consider it "debt relief" to you and charge you income tax on it²! So now you have lost the property *and* have a big income tax bill to pay, but no money to pay it with. Ouch!

Because people often run up their credit cards and exhaust their savings trying to pay their mortgage, even after the property is foreclosed and the mortgage is gone, a big tax bill can be devastating. If this describes your situation, you may also want to consult with a bankruptcy attorney. A bankruptcy can sometimes wipe out credit card bills, tax bills and deficiency judgments and give you a fresh start.

Important note: As soon as you realize you are in an unsustainable situation (that is, you will not be able to keep up on your payments for the long term) be sure to set aside some funds to pay for the professional help you'll need to reorganize your obligations. If you expense all your cash and credit resources trying to fend off the inevitable, you will

² As we often say, we aren't tax or legal advisors, so we highly encourage you to consult with your own professional tax and legal advisors.

ultimately end up in the same place of not being able to make your payments, but you won't have any money to hire the lawyers and tax advisors you will need to help you.

Negotiating with the Lender

In every negotiation, there are certain essentials you must have in order to enhance your chances of success:

- Knowing very clearly what you want and what you are willing and able to do to get it
- Understanding what the other party wants and what they may be willing to do to get it
- Knowing what each party's leverage points are; that is, what pressures exist which will help drive the other party toward a compromise?

Must I Be Late to Get Attention?

Some people like to show up "fashionably late" to parties to avoid getting lost in the crowd, but with some lenders, when it comes to loan workouts, it is no longer necessary to be late to get their attention. Every lender is different, but the deluge of defaulting borrowers is opening lenders up to the notion that it might be wise to negotiate with a borrower who is calling in advance of being late. So, if you see a train wreck coming, you may want to initiate negotiations early in the process and see what the lender is willing to do.

Hardship is the Key

Fortunately, we're hearing success stories about borrowers who have strong balance sheets, good credit ratings and steady jobs getting loans modified. In other words, you may not necessarily need to be on the verge of bankruptcy, unemployed and months behind on your payments in order for your lenders to be willing to negotiate with you. However, you must have a real and plausible hardship. That is, something substantial must have changed from the time you applied for the loan and the time you are asking for a modification. Unfortunately, negative equity, severe price declines or change of heart are not legitimate hardships.

So what qualifies as a true "hardship"? Keep in mind that each lender's standards vary, but generally speaking, the following items are considered qualifying hardships:

- Reduction in Income (employment or rental on subject property)
- Mortgage Payment Increased (adjustable loan)
- Negative Amortization Loan
- Divorce
- Death of a Spouse
- Medical Condition or Disability
- Failure of Business

The point is that you can't just ask for your loan to be re-done because your upside down on the property and don't want to pay as much. That was a risk you took when you decided to buy the property. But if something changed that was out of your control that

makes it now impossible for you to sustain the payments for the long term, then the lender may be willing to modify the loan - even if you're not late and have savings in the bank.

Who's on First?

It's very important to note that you and the lender will look at equity differently. If you have subordinated financing (also known as "junior liens" or "second mortgages"), then *you* may have no equity. But from the first mortgage holder's position, there still may be available equity in the property. Unlike you, the holder of the first mortgage has no obligation to pay off the junior liens. So, if there is enough value in the property to pay off the first in full, the lender may decide to foreclose or accept a deed in lieu, before they would accept a short sale or a loan modification which reduces the principal balance.

On the other hand, if the estimated fair market value of the property is insufficient to pay off even the first mortgage, then the first mortgage holder may be very open to a short sale or principal reducing loan modification. Therefore, it's a good idea to have a pretty accurate idea what your property is currently worth before making decisions about how to proceed. You can get a fairly useful estimate of a property's value without having to pay for a formal appraisal. Simply contact a real estate broker who specializes in your area and property type (preferably someone who has experience in short sales) and have them prepare a Comparative Market Analysis (CMA) or Broker's Price Opinion (BPO).

Once you know the property's estimated fair market value, you can determine the amount of any equity (positive or negative) from both your perspective (taking into account junior liens) and from the first mortgage holder's perspective. Keep in mind that in order for a junior mortgage holder to foreclose, they must completely pay off or otherwise satisfy the first mortgage holder. So, although you will eventually need to deal with the junior mortgage holders, most of your efforts will be focused on the first mortgage holder.

When You're #2, You Try Harder

If you do have a second mortgage and there is not enough equity in the property to pay off both the first and the second, then you will typically find that the second lender is unlikely to initiate foreclosure proceedings. They are often very willing to discount their mortgage, especially if the first mortgage holder has begun foreclosure. We've heard of several cases where the second mortgage holder proactively offered to accept as little as 10% or less of the outstanding balance (that would be \$10,000 for payment in full on a \$100,000 loan!). This is because the second mortgage holder realizes that getting something is better than getting nothing, so if they think the first mortgage holder is going to foreclose, they will take pennies on the dollar to settle before their lien is completely wiped out by the foreclosure.

We've also seen second mortgage holders drop interest rates from 12-18% all the way down to 3% or less! This is a more likely scenario if you can demonstrate to the second mortgage holder that you are able to maintain the first. It isn't that the second mortgage is being nice, but in their own self-interest, they know if they can lower your payment so you

can afford to pay the first, then the first mortgage holder won't foreclose thereby extinguishing the second's collateral.

Got Equity?

If you are one of the unfortunate³ few who actually have equity in your property, you will find the lenders are much less likely to negotiate. Why? Because they believe they can sell the property and recover the entire balance of the loan. This is why we are fans of big first loans. If you have a property with a small first and a big second, then the first mortgage holder is unlikely to budge. The good news is that the second mortgage holder may be more flexible.

The bottom line is that if you have substantial equity in the property and cannot afford the payments or are unable to get a loan against the equity to provide temporary liquidity (although you should never consume equity!) you probably have the option to sell. While losing the property is bad, losing both the property *and* the equity is worse! But if you really don't want to sell, then you certainly can and should approach the lender for help. However, understand that the lenders are interested in money. They will do whatever they think will make them the most money – or at least cost them the least. If you get to keep the property in the process, that's fine with them, but helping you keep your property is NOT their top priority, no matter what they say.

If you have substantial equity in a property, but are suffering a temporary inability to make the payments and don't want to sell, then in addition to approaching the lender for forbearance or a modification, you may consider a "hard money" loan through a broker or friends and family. We'll talk more about Forbearance and Hard Money shortly. Another option is to sell some of your equity⁴ to friends, family or an investor, but that's a topic for another report!

Make a Statement

Once you've determined your equity (or lack thereof) from both your perspective and the lender's, you also need to determine your cash flow. There's no point in wasting everyone's time (including yours) if you really can't afford to keep the property. So determining and documenting your income is important.

When you approach the lender for a workout, the first thing they will ask for is financial statements. Often, they will want to take your information over the phone on a recorded call. They will also have forms for you to fill out. It's really like applying for the loan all over again. Here's what they'll typically be looking for:

Balance Sheet – This is just a list of your assets (what you own) and liabilities (what you owe).

³ Refer to earlier broadcasts of The Real Estate Guys™ where we discuss equity stripping as a hedge strategy.

⁴ Refer to earlier broadcasts of The Real Estate Guys™ for discussions on equity sharing strategies.

Income Statement – This is a list of your income and expenses.

Bank Statements – All of them; usually for the last 2 to 6 months.

Tax Returns – Usually for the last two years.

W2, 1099 - Usually for the last two years. If you're self-employed, they'll want to see your company's P&L and bank statements for the last 2-6 months.

Lease Agreements – If you own rental property, the lender will want to see the rental agreements – even on properties they don't hold the loan on. It's simply about documenting your income from all sources.

Hardship Letter – This is your personal narrative on why you fell behind on your payments, why a loan modification is necessary, and how and why you believe that you will be able to get and stay current after the modification.

Do the Math

Though each situation is different, the lender is typically looking at your financials to determine what you can afford. Their goal will be to have your debt-to-income (DTI) ratio at something less than 40%. Many lenders are using a more complete analysis and examining ALL of the borrower's expenses (not just debt) such as groceries, gas, medical, etc. They want to make sure that your new payments and all your other expenses don't exceed 100% of your income. What a good idea! Of course, this is something you should also know BEFORE you get on the phone with the lender.

Also, the lender will also want to see some cash reserves so that if something unexpected comes up, you have some place to turn before skipping your mortgage payment. So you don't have to be down to your last dime to get a workout!

We think it's a good idea to crunch your own numbers. It's a skill you should have as a homeowner and certainly as an investor. To determine DTI, just add up all your monthly debt payments and divide it by all your monthly income. Keep in mind that rental income may be discounted by 25%, so if your lease agreements show \$1000 per month gross rent, you may only get \$750 credit towards your DTI. Again, some lenders are allowing 100% of the rental income to be counted when they do a complete budget analysis and not just a DTI analysis. You should do both.

Also, unlike a traditional mortgage application, in today's times, many lenders are willing to give you credit for income that would be disallowed in conventional loan underwriting, such as income derived from the renting of rooms in your personal residence. So if you have unusual sources of income, even those which are difficult to document, be prepared to discuss them with the lender if they help get your ratios where they need to be to qualify for the loan modification.

Play “What If?”

Now that you know what your DTI and real world budget are based on the current mortgage payment (which was likely higher than 40% or you’d probably be paying the mortgage), you can play with the loan balance and interest rate to lower your payment until your DTI is below 40% and or until your total expenses are equal to or less than 100% of your income. To do these loan calculations, you will need a loan amortization calculator. If you don’t happen to have a loan amortization calculator, we have one you can use at www.equityhappens.com/calculator⁵.

Lenders are more willing to reduce the interest rate than they are to discount the face value or principal balance of the loan. Therefore, see if you can get your DTI on target simply by lowering the interest rate. If you get down to 3% and still can’t get the DTI in line, start reducing the principal balance until the DTI is below 40%. Obviously, this isn’t an exact science, but it will give you an idea where you’re at. And, as we’ve said, the 40% ratio isn’t set in stone either, so don’t give up if you can’t make the numbers work. What’s most important is that you’re realistic about what you can afford. Just because the lender says you can afford it, doesn’t mean you can. So put together an honest budget and make sure you are negotiating for something that you can really keep up in the real world.

Compared to What?

If you’ve read our book Equity Happens (available at www.equityhappens.com), then you know “Compared to What?” is one of our favorite questions. This is the question the lender will be asking when trying to decide what to do. It’s a question you should ask yourself all the time.

In this case, if you’ve done the math and concluded that a principal balance reduction is required to get the DTI into proper range, then you need to compare the proposed reduced loan amount to the net market value of the property. Remember, the lender will not get the full market value if they sell the property (and neither will you). There will be sales expenses and maybe even repairs and carrying costs which will come off the top and reduce the net proceeds to you or the lender.

We think it’s safe to assume that it will take the lender at least 10% of the sales price to cover costs. So if the property’s current fair market value is estimated at \$150,000 the lender might actually realize about \$135,000. It doesn’t matter how big the mortgage is, that’s all they can expect to get.

So, in our previous example, if the lender is holding a \$200,000 mortgage, they already know they will lose a lot of money if they foreclose. But does that mean they would reduce the mortgage principal balance down to \$135,000 or even \$150,000? Maybe. But if they could get \$135,000 cash and not have the risk of another default, they’d probably want the cash. A more likely number would be something north of \$150,000. Again,

⁵ You must enter the specific URL because the calculator is only for special people like you who actually read our stuff!

every situation is different. Currently, the general feeling is that real estate values are still subject to decline in the short term (which is all the lender cares about at the moment), and there is mounting political and social pressure to modify rather than foreclose, so lenders tend to be more willing to renegotiate. If prices started rising and the political winds change, then all bets are off. The best thing to do is to simply look at the situation from the lender's perspective and try to offer them an option that is more attractive than foreclosure.

Tell Me What You Want, What You Really, Really Want

Up to now, we've assumed that you want to keep your property. But do you? If the property is your primary residence and your credit is shot, you probably want to fight to stay in your home because getting a loan on a new home would be very difficult. However, if you still have good credit, you might be able to sell your problem property and buy a new home that is more affordable. Even if you're upside down, you may be able to negotiate a deed-in-lieu or short sale that doesn't show up on your credit report. One thing nice about loan modifications is that they don't have a negative effect on your credit score.

If the property you are trying to save is an investment property, the decisions are a little less emotional and personal. Without digressing too far from our main topic, here are some things to think about when deciding if you want to keep an investment property:

- a) What are the prospects for long term appreciation? This isn't a report on market analysis, so we won't discuss how to determine the long term prospects for a property except to say you should consider the supply of competing properties, the demand for such properties and the trends in the local market place in terms of population and job growth. If you're optimistic the property will appreciate to become worth more than your loan, then you may be willing to go through the effort to hold on to it.
- b) What is the condition of the property? Even if you get the loan modified and fix the cash flow problem, if the property has lots of deferred maintenance and is or will shortly be in need of significant capital improvements, you may not realistically be able to keep it if you don't have the cash reserves to maintain it.

Credit Score or BS?

If you decide you want to keep the property, you need to decide what you're willing to do to keep it. One of the biggest leverage points the lender has is your concern for protecting your credit score. It used to be that lenders would only negotiate with a borrower once they had defaulted. Thankfully, today lenders are becoming more enlightened. In the bigger interests of the overall economy, having lots of people with damaged credit will continue to be a drag on an economy that is primarily debt driven. Just ask the auto industry. When people can't borrow, they can't buy. Part of getting through these difficult financial times is helping people maintain a good credit score.

If you're in an unsustainable loan (you can't make the payments for the long term), then you may need to make a decision between your credit score and your balance sheet⁶. When you are going deeper into debt (borrowing more money through credit cards, personal loans, or negatively amortizing mortgage payments) or liquidating assets (using savings, selling stocks, cashing out retirement accounts, etc.) to feed your negative cash flow, then sooner or later, you will exhaust your balance sheet and start missing payments anyway. At this point, you will have sacrificed both your balance sheet *and* your credit score; and you'll have only your income to work with going forward.

Unfortunately, we see too many people who vainly try to protect their credit score by sacrificing their balance sheet – without any real strategy for how to handle the long term problem: negative cash flow. Loan modifications are part of dealing with negative cash flow. Sometimes, you may need to accept damage to your credit score in order to effectuate a loan modification. The good news is that you may be able to negotiate for the lender to remove negative entries from your credit report as part of the modification. Absent that, it may be possible to fully or partially repair your credit score⁷ after the modification is completed.

It wouldn't surprise us to see lending policy, and perhaps even legislation, implemented which would provide some type of grace for borrowers whose credit was otherwise excellent, but was damaged during the "mortgage crisis" of 2008-09 (we hope it won't last longer than that!). Obviously, you can't count on that, so there is no easy answer. You just need to understand and think through your options and then make the best decision you can.

The Nature of the Beast

Now that you're organized and have some idea what you think you can do and what the lender might be willing to do, it's time to decide when and how to approach the lender. But before you do, it's helpful to understand the way the mortgage lending industry is organized.

With all of the press coverage of the mortgage meltdown, you've probably heard the term "Mortgage Backed Securities" or "MBS". The proliferation of MBS over the last decade is a major part of what fueled the run-up in real estate prices as Wall Street funneled trillions of dollars into mortgage lending. The reason this is important to you is that in some cases when you go to talk with "the lender", you may hear that they don't have the authority to renegotiate your loan. Why? Because your loan has been placed in a large "pool", converted into a security (similar to a stock or bond) and sold to one or more trusts. Sound complicated? It is!

⁶ A Balance Sheet (sometimes called a Net Worth Statement), lists all of your assets (what you own) and your liabilities (what you owe) and reflects your net worth.

⁷ While there are many companies who offer credit restoration services, be careful! This is an industry that is plagued with fraud. Do your homework!

So let's back up a little and explain who all the players are and what they do. This will help you make sure you are speaking to the right people and, more importantly, help you understand (especially if you're dealing with a variety of different lenders), why some lenders respond differently than others.

When you apply for a mortgage, you usually deal with an "originator". This might be a mortgage broker, or perhaps a loan officer for a retail mortgage bank or a retail bank (the kind with branches that takes deposits). If the loan is originated with a broker, it will almost always be placed with a wholesale mortgage bank that actually funds your loan. If your loan is originated by a loan officer at a retail mortgage bank, your loan may be funded by that particular bank. Sometimes the retail mortgage bank will broker the loan to another wholesale bank that will fund the loan. The same is true for a mortgage originated at a retail bank, though often a retail bank will keep the loan rather than broker it or sell it. As complicated as all that was, that's only the first step!

Most mortgage banks, whether wholesale or retail, will almost always take your newly originated loan and package it up with many other loans they have originated, and sell it into the "secondary market". If the loan conforms to certain guidelines (a "conforming loan"), they might sell it to a government sponsored enterprises (GSE) like Fannie Mae or Freddie Mac. Sometimes the sale is to institutional investors (funds, trusts, etc.) through Wall Street. Sometimes the sale is to a portfolio lender. A portfolio lender is an institution that acquires, through direct origination or purchase from other institutions, loans that it holds in its portfolio. In other words, they want to collect the interest over time, as opposed to those firms which make money "flipping" the mortgage to a third party. The point is that there is still a lot of action long after your loan was funded and you took possession of the property.

Here's where it comes back to you. Whether your loan was placed into a Wall Street blender and poured out into a variety of securitized derivatives, or it is held in portfolio by a single entity, you will be making your payments to a "servicer". A Servicer is responsible for collecting the payments and delivering the money (less a servicing fee) to the entity who owns the loan. In some cases, the Servicer and the lender are the same entity, but in many cases the Servicer is simply a vendor to the mortgage holder and you probably don't even know the mortgage holder's name. If you've gotten to the point where you have been given a Notice of Default or a Notice of Sale, you may see some weird name you've never heard of (many with the word "trust" in them). What you need to know is that no matter where your loan is, you're going to be dealing with the Servicer. Fortunately (or unfortunately) the Servicer is easy to find. They're the ones who send you your statements and all the friendly collection letters, and who will call you several times a day when you fall behind on your payments.

The other thing you need to know about servicers is that they have a contract with the mortgage holder. This contract may prohibit them from making certain concessions to you without "investor approval". Any request for a reduction in principal balance will usually require investor approval. So, although it feels like you're being given the runaround or

the representative is playing a “good cop, bad cop” game with you, it’s probably a legitimate requirement.

Want a Good Workout?

Most servicers have two departments that deal with delinquent or potentially delinquent mortgages. One is the “debt collection” department. You can probably tell by the name what they do. The other is the “loss mitigation” department. The Loss Mitigation departments are usually the people empowered to modify your loan (or at least negotiate subject to investor approval).

Almost all of the “love letters” and phone calls you get from the Servicer will be from the Debt Collection department. When you call in and ask to speak with someone, if you are already behind, you will almost certainly be directed to the Debt Collection department. This is sometimes true even if you ask for the Loss Mitigation or Loan Modification departments, so be careful to know who you are talking to. Unfortunately, some Debt Collection departments masquerade as the Loan Modification departments to try to get you send money before any real deal gets made.

As you can probably guess, it is the Loss Mitigation (sometimes called “workout”) department you want to get to. Sometimes that’s easy. Sometimes you will be routed and re-routed to the Debt Collection department, whose job it is to collect money. They are skilled professionals and will make every attempt to collect money. Since this report is about modifications, we won’t spend any time on dealing with debt collectors except to say that there are strict laws debt collectors must follow. We think it’s a good idea to be aware of those laws, which are under the Fair Debt Collection Practices Act. In all cases, keep detailed records. You also may want to record your phone conversations (the lender will be), but make sure you notify the person you are speaking with that you are doing so or the recordings won’t be useful in any type of subsequent legal action.

Let’s Make a Deal!

If you have one or more properties that are “upside down”, you may still have an opportunity to save them and avoid severe dings to your credit (or both!) by negotiating a workout on your loans. Servicers and their investors (collectively, the “Lender”), faced with overwhelming numbers of defaults, potential foreclosures, as well as substantial political and social pressures, are more willing than ever before to renegotiate loan terms. But remember, the person on the other end of the phone is NOT motivated or compensated for helping you. Their responsibility is to mitigate (reduce) the loss or potential loss to the Lender. Whatever solution you are aiming for must be perceived by the Lender as the lesser of evils, or they will likely pick a different path. This is why, as we discussed earlier, it’s very important that you understand all of *their* options and look at the situation from *their* perspective.

In general, the Lender has the following options:

1. Collect (Reinstatement). This is their first choice. They just want you to pay and will do everything possible to get you to do so until they are convinced you can't. If the foreclosure time clock has begun (it starts with a Notice of Default), then when you pay your loan current, you stop the clock. If you're late again later, the lender has to start the whole foreclosure process over again.
2. Forbear. This is when the lender allows you to skip one or more payments, and then takes the past due amounts and has you pay them back over a period of months (in addition to your regularly scheduled payment). This is typically their second choice. Forbearance can be a great way to help a borrower get over a temporary financial set back. However, if the foreclosure clock is ticking, forbearance does NOT restart it. If you miss a payment under a forbearance agreement, the Lender can pick right up where they left off. It's like hitting the pause button on your DVD player, whereas a Reinstatement is like hitting the restart button.
3. Foreclose. Though the Lender doesn't want the property, they will take it and sell it to settle the debt if they think you aren't going to pay and foreclosure is the shortest path to the greatest amount of cash. Obviously, the greater their equity (the difference between their loan the current fair market value of the property), the more tempting foreclosure will be. Of course, the opposite is true also.
4. Term Extension. By adding additional time to the term of the loan, the Lender can preserve the principal value and interest rate, but still deliver a payment reduction to the borrower. This only works on fully amortized loans (loans for which each scheduled payment reduces the principal) because it reduces the size of the principal payment each month.
5. Interest Only. By completely eliminating the principal pay down (amortization) on a fully amortized loan, the Lender can provide a smaller payment without reducing the principal owed on the note or the interest rate.
6. Rate Reduction. Almost unheard of until property values fell sharply, a rate reduction preserves the principal value of the loan, but reduces its profit to the lender. Depending on what they paid for the underlying funds, the Lender usually has some room to reduce the rate in order to provide a payment that is deemed affordable.
7. Principal Reduction. The Lender hates this, but it's an option when the others aren't enough to create an affordable payment and the property value has declined so much that foreclosure is less attractive.
8. Negative Amortization. Although technically this is an option (unless regulators take it away), it is very unpopular with just about everyone. Negative Amortization is where the loan payment is so small that it doesn't even cover the accrued

interest, which is added to the outstanding principal balance, thus *increasing* the loan amount over time. If you're upside down, it will only make you more so, thus (from the Lender's perspective) more likely to walk away at a future date.

As a side note, if you have an FHA loan and under certain circumstances, you may also qualify for a "partial claim" mortgage. A Partial Claim places a subordinate loan (2nd mortgage) for the amount of your past due payments. For more information about the Partial Claim option, visit www.hud.gov.

Of course, the Lender would be happy to have you refinance the property with another lender and pay them off. This is generally only a possibility if you have lots of cash sitting around, the property has lots of equity and would be accepted by a "hard money"⁸ lender (assuming you don't qualify for a conventional refinance), or if you are able to find a private party (friends or family) to make you a private loan.

While every lender has a department which handles loans that are in trouble, not all lenders are created equal. Some are definitely harder to work with than others. Moreover, virtually all of them are swamped with many more loans in trouble than they expected, and it may require considerable perseverance for you to establish and maintain contact with whomever has the responsibility for your account. Sometimes you don't have an assigned representative, in which case you'll find developing continuity difficult. Again, it is very important that you keep accurate, detailed notes of whomever you speak with (name, agent # if applicable), including dates, times, phone numbers, conversation details, etc.

DYI or Pro?

One of the other decisions you will need to make is whether to attempt to negotiate with your lender yourself – or would you be better served to hire a professional? Because of the dramatic increase in the number of defaults and foreclosures, an entire industry has emerged that barely existed a few years ago. Loan modification companies are everywhere, advertising and making promises about their ability to help you. But what do they do that you can't do yourself? Are they worth the fees? How can you tell a good loan modification company from a bad one? There are lots of things to think about, so we'll try to address some of these items for you.

A good portion of this report was dedicated to providing you with a foundational education about the foreclosure process, options available to help you avoid foreclosure, tips on how to get organized before approaching the lender (or a loan modification company), and many other things you should consider before putting time and money into trying to save your property. If you found all of that overwhelming and intimidating, then you may be a good candidate to hire a professional to represent you. On the other hand, if you have experience in negotiations and feel comfortable with the subject matter and have adequate time for the task; or if you simply don't have the money to hire someone, then doing it

⁸ The term Hard Money simply refers to funds provided through private investors (an individual or a pool), who lend based on the equity in the property and not necessarily on the income or credit of the borrower.

yourself may be a viable option, though there is the argument that there is a benefit to being “arms length” from the negotiation.

We tend to favor hiring professionals in most circumstances, whether it’s for representation in a purchase or sale, legal or tax matters, property management or repairs, or even working on our cars. Professionals bring to the job greater technical expertise, a broader base of experience, and often relationship capital that we just don’t have. Active loan modification companies are able to leverage the experiences they gain from all of their clients into helping you.

If you do decide to go it alone, then we’ve already covered most of the information you’ll need to proceed. We’ll focus the remainder of the report on discussing how to choose and hire a professional.

Getting the Right Mod Squad

The loan modification industry is relatively new, growing rapidly and changing quickly. But to keep things simple, you can categorize loan modification companies into two basic categories: firms run by licensed attorneys and those which are not. Rules vary from state to state, so we aren’t able to provide an exhaustive analysis of the various agencies which regulate the industry. Quite often your state’s Department of Real Estate is involved in providing oversight to loan modification companies. Attorneys also answer to their state bar association, which provides an additional degree of accountability. Because of the number of problems reported with loan modification companies, the state attorney general’s office and sometimes even the FBI get involved in prosecuting scam artists. It’s always a good idea to check with these agencies to see if a company you are considering working with has a negative history. One thing to watch out for is a non-attorney firm asking for an upfront fee to work on your case. While it is standard practice for attorneys to request a retainer or upfront fee to take your case, many states prohibit non-attorneys from doing so. In any case, even though you may be desperate for help, don’t be shy about asking questions. Any reputable firm should be able to happily provide adequate answers.

Our personal preference is to hire a law firm to handle loan modification negotiations - and not just any law firm, but a firm which specializes in this type of work. There are certain advantages to having an attorney handle your negotiations:

- a) Attorney Client Privilege – The information you share and the discussions you have with your attorney are privacy privileged. Even a court cannot force your attorney to reveal this information. You may not have anything to hide, but in some cases you may find that the loan application you submitted and the one that the lender reviewed and approved are different. Why? Sometimes the original application is modified after you’ve signed it. If you signed an updated copy at the closing table without reviewing it carefully (how many people read all the documents at the closing table?), then you may have signed a document that isn’t accurate. If the lender were to file a fraud claim against you, the conversations with your loan modification attorney would be protected.

- b) RESPA Violations – Loan modification attorneys are very familiar with the Real Estate Settlement Procedures Act (RESPA). The laws deal with proper disclosure and predatory lending. If your lender violated RESPA when originating your loan, your attorney will catch it, and it provides additional leverage in the modification negotiation.
- c) FDCPA Violations – Here again, a loan modification attorney will be familiar with the Fair Debt Collection Practices Act. If your loan defaulted and the lender violated your rights while trying to collect, an attorney will know how to use this as additional leverage in the modification negotiation. This is why it is very important to keep good notes and records, including recording voicemails and conversations (again, remember to notify the other party when recording a live conversation).
- d) Professional Status - Just because someone is an attorney doesn't mean they are professional, but generally speaking, when your attorney contacts the lender it carries more weight than when a non-attorney calls. We wish we didn't have to say this, but there are some lenders who attempt to bully or sweet talk borrowers into giving up their rights or settling for less than what they need.
- e) Stop the Phone Calls – Once you appoint a legal representative, you can have all of the communication handled by the attorney. No more incessant or embarrassing calls at home or work!

If you are seriously considering hiring a professional, it is usually best to get them involved *before* you make contact with the lender. The professionals we've spoken with tell us that one of the biggest challenges they have is getting involved and trying to negotiate after the borrower has already been in communication with the lender.

Worth the Price?

Fees for loan modification vary from firm to firm. Just as cheap isn't necessary the best value, neither does high price assure quality. Of course, it may simply come down to what you can afford.

Fees can range from \$2500 to \$7500 or more per property. Some firms will charge hourly or a percentage of the savings, while flat fee pricing has grown in popularity. Only you can decide what is reasonable for you. We think if we can recover the fee from the loan modification savings in 6 months or less, it's probably a pretty good deal. Of course, you don't know what kind of a deal you're going to get when you plunk down your money. If you opt for a firm which charges on the back end (which is great for you if they're any good), make sure you pay them. Many law firms won't put in any time before you pay the fee and can you blame them? The demographic they serve is in financial trouble, which is reasonable. It just isn't smart to invest time and money in a potentially non-paying prospect, especially one that is already facing financial difficulties. However, if you have your financial information organized as described in this report, many firms can give you a

quick assessment of your case at the front end. Make it easy on them (and yourself) by being organized!

It's also a good idea to understand what the firm's policy is with respect to refunds on unsuccessful modifications. We don't think it's reasonable to get all your money back if the modification fails, because the modification company can't control what the lender will or won't do, but it might be fair to get a partial refund. Many firms won't take your fees or will return them if they can quickly determine that your situation isn't likely to result in an acceptable modification. This again is why it is so important to be organized from the beginning.

The Rest of the Story

Obviously, there is much more to talk about, but this is a report, not a book! We encourage you to keep listening to The Real Estate Guys™ radio show for additional information. We also invite you to share your experiences with us at guys@realestateguysradio.com. As our listeners share their experiences with us, we will glean lessons and share them on the radio, in our newsletters, on our web site and in future special reports. Of course, we will be careful to protect your privacy!

If you're looking for professional help with a loan workout, check out the "Sponsors" page of The Real Estate Guys™ web site (www.realestateguysradio.com).

We wish you great success in your real estate investing – and in your loan modification efforts in particular. Remember: cash flow controls mortgages and mortgages control property, and over time the right property tends to go up in value. If you believe your real estate will be worth more in 10-20 years, then work hard to hold on to what you have – and acquire more while it's on sale!

Happy Investing!

The Real Estate Guys™
Robert Helms and Russell Gray
(with a huge special thanks to Bob "the Godfather" Helms for his help with this report)

The Real Estate Guys™ radio program has aired weekly since 1998. Find out more at www.RealEstateGuysRadio.com. For additional help with your real estate investing, visit the Sponsors and Resources pages on our web site!