

June | 09

Consumer Loan Modification Manual

Mike Wayman

Clear Steps and Instructions on How to Process a Loan Modification On Your Own

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Chapter 1: Introduction

A Message from Mike Wayman

Everyone deserves their shot at a loan modification but not everyone has the financial means to hire a professional. The hope of this book is that it will fulfill the needs of those that cannot pay a loan modification company thousands of dollars to save their homes. While the financial crisis in America is beginning to show signs of stabilization on a macroeconomic scale, this means very little to the family or individual that has suffered a serious economic or personal hardship.

Just like a paid client expects results in the loan modification business, so too should anyone that invests their time and money in to purchasing an ebook or manual on how to do loan modifications on their own. What I want to stress is that anyone can do their own loan modification, however, the process is time consuming and can be draining. To avoid these problems I focus on first getting organized and putting everything in an easy to understand format for your lender. If you can get organized properly, you have a great chance of getting your loan modification done without wasting time and without needless anxiety. I wish you the best of luck in your journey.

Who is Mike Wayman?

Mike Wayman has over twenty-five years of experience in the financial services industry covering the full spectrum of financial products. His business skills are demonstrated by his ability to take a company from a concept to a reality as a successful entity. In addition to being a successful business entrepreneur, Mike has distinguished himself for over fifteen years as a Police Officer and Deputy Sheriff. Along with many notable achievements, he has been awarded the Courage Under Fire Commendation Medal.

Mike is a dedicated family man and has been married for twenty-six years, is the father of two grown children and is an active member of the business community. Over the years, Mike has generously donated his personal time and effort to help his friends and neighbors find financial solutions to their problems. As Founder and Chief Executive Officer of Financial Hope for America, Mike hopes to provide a host of financial services that meets the growing needs of everyone across America that is struggling with the current financial crisis.

Chapter 2: How to Process a Loan Modification Yourself

What is a Loan Modification?

A loan modification is a change to the loan contract which is agreed to by the lender and the homeowner. The lender modifies the existing loan(s) in order to work with the homeowner because of a hardship. The purpose is to help make the loan(s) more affordable. Usually loan modifications are in the form of a rate reduction and/or fixing the rate for a certain period of time. In the past, loan modifications were only utilized when a borrower was delinquent and suffered a hardship such as a job loss, divorce, or illness.

Now, borrowers can obtain modifications from their lender for unaffordable rate adjustments on adjustable rate mortgages. The earlier the homeowner addresses the issue, the better the chances are of negotiating a fixed rate and a payment that is manageable.

If the homeowner can afford their home and but not their current mortgage then they may be eligible for a loan modification. A key factor that is required in every

loan modification submission is the existence of a hardship. The hardship can be temporary in nature or permanent, but the borrower must be able to prove the hardship.

The following are a sample of hardships that get loan modifications approved:

1. Adjustable Rate Mortgage Reset-Payment Shock
2. Illness of the Borrower
3. Illness of a Borrowers Family Member
4. Curtailment of Income
5. Loss of Job
6. Abandonment of Property
7. Property Problem
8. Inability to Sell the Property
9. Inability to Rent the Property
10. Mortgage Servicing Problems
11. Transfer of Ownership Delays
12. Reduced Income
13. Failed Business
14. Job Relocation
15. Death of the Borrower
16. Death of Spouse or Co-Borrower
17. Death in the Family
18. Incarceration
19. Divorce
20. Marital Separation
21. Military Duty
22. Medical Bills

23. Damage to Property (natural disaster or unnatural)

Notice that “My Realtor lied to me” and “My loan officer/broker lied to me” is not on this list. Keep this in mind when you write a hardship letter. Documenting the hardship is very important to the lender’s or servicer’s loss mitigation department and will be verified during the approval process. Without proper documentation, your file may be flagged as fraudulent. You definitely do not want this to happen for obvious reasons and it will slow down the process or terminate the process completely. There are two important things to remember about loan modifications:

1. A loan modification should be requested only if no other reasonable options are available and/or the homeowner is experiencing a hardship.
2. Loan modifications are designed for homeowners who can afford their homes but not their loans.

Are You Qualified for a Loan Modification?

Lenders and servicers will, in general, look for one thing when you submit a modification request. They look for a documentable hardship of course, but at the end of the day if they decide to grant your request for a loan modification all they really want to know is if you can afford the new payment(s). This is the big secret behind getting a loan modification approved.

There is, however, an art to making loan modifications work. You must disqualify yourself from your old payments and at the same time qualify yourself on a new payment structure. It sounds complicated and it is at first but you will quickly learn important strategies for effectively processing loan modifications.

To understand what the lender or servicer considers qualified, you have to know how lenders calculate your income. The income you can use to qualify for a modification is different from traditional income calculations used to qualify for

traditional loans. Moreover, the difference in the qualification guidelines is typically in your favor.

For a modification, you can qualify based on your documentable total household income. As such, you can count income from almost any source: Grandma's SSI, income from child day care services, from a second job paid under the table, etc. so long as it can be proved. Proof must be in the form of bank statements, 1099's or in some other documentable form as outlined in the submission paperwork you will provide the lender. In addition, if only one of two spouses was on the original loan, the other spouse's income can count so long as it is documentable. Once you calculate all documentable monthly income from all household sources you then have what you can present to the lender as the new qualifying income.

To calculate a qualifying monthly mortgage payment, use the benchmark fully amortizing 5.00% rate on whatever the new balance might be, counting arrearages if they are added back into the loan. WARNING: this is only for a general qualifying exercise only; do not expect this rate or payment! If the

payment at 5.00% is just too high, then you may not be an appropriate candidate for a modification. However, you can still request help with other services such as a deed in lieu of foreclosure, a short sale or postponing as long as possible a notice of trustee's sale in an effort to help you transition to more affordable housing.

Establishing a Hardship

Effective communication is the single most important aspect of describing hardship issues. Many modification requests fail because the homeowners can not tell their story in a simple way. It is easy to forget there is a real human being analyzing the hardship letter within the lender's or servicer's loss mitigation department who is responsible for determining the existence of a real hardship. With that said you must keep your hardship letter simple and get to the point quickly.

Loss mitigation departments are overwhelmed with foreclosures, short sales, and modification requests. They do not want to read a ten page letter regarding the loan officer who put them in the loan, why they bought the house, the memories they have had there and why they want to keep their home. When writing the hardship letter, keep the letter simple and to the point. In addition, handwrite the hardship letter. The fact is that people personally relate to handwriting more than a typewritten letter and this includes the lender's or servicer's loss

mitigators. What follows on the next pages are perfect examples of sample hardship letters, a financial worksheet, an income and expense worksheet, a sample loan modification request and a sample stacking order for you to use. Notice as well that on the loan modification request and on the sample stacking order for a loan modification you will need to include documentation of your home's value. You can obtain reliable documentation of your home's value from a local Realtor, Title Company or from an appraiser.

January 1, 2009

In Reference to:

Account Number: _____

Account Number: _____

Property Address: 1234 Any St. Hometown, USA 12345

Dear Sir or Madam,

This letter is a request for consideration for a loan modification. My husband and I have found ourselves struggling with our mortgage payments since a reduction in our hours and income.

My overtime was drastically cut which was a major reduction in my income, and my husband's hours were also cut. We were very dependent on my overtime and the reduction in hours was quite a burden on us. We have struggled to do all that we can in an effort to save our home.

Fortunately, my overtime hours have returned to normal and my husband did secure a second job. We are in a better position now, and would like to come to an arrangement that is suitable for all. We wish to work with you in an effort to modify our loan, and to help us keep our house. We love our home and don't want to lose it.

Thank you for considering our request.

Sincerely,

Borrower Signature

Co-Borrower Signature

FINANCIAL ANALYSIS WORKSHEET

BORROWER AND CO-BORROWER INFORMATION

| | |
|--|-----------------|
| Borrower Name: | |
| Co-Borrower Name: | |
| MORTGAGE INFORMATION | |
| 1st Lender Name | |
| Loan Number | |
| Type of Loan | |
| Balance | |
| Monthly Payment | |
| Interest Rate | |
| Months Delinquent | |
| Taxes Included? (YES) (NO) | If Yes, Amount: |
| Insurance Included? (YES) (NO) | If Yes, Amount: |
| PMI? (YES) (NO) | If Yes, Amount: |
| 2nd Lender Name | |
| Loan Number | |
| Type of Loan | |
| Balance | |
| Monthly Payment | |
| Interest | |
| MONTHLY INCOME INFORMATION | |
| Employer Name | |
| Borrower | |
| Co-Borrower | |
| Employer Phone | |
| Borrower | |
| Co-Borrower | |
| Years with Employer | |
| Borrower | |
| Co-Borrower | |
| Job Title | |
| Borrower | |
| Co-Borrower | |
| Pay Period (indicate weekly, bi-weekly etc.) | |
| Net Salary | |
| Commissions | |
| SSI Benefits | |
| Child/Spousal Support | |
| Rental Property Income (Net) | |
| Other | |
| Other | |
| Other | |

| MISCELLANEOUS MONTHLY EXPENSES | |
|---------------------------------|--|
| Union Dues | |
| HOA/POA | |
| Fuel (monthly) | |
| Auto Maintenance (Monthly) | |
| Food | |
| Childcare | |
| Child Support | |
| Spousal Support | |
| Clothing | |
| I.R.S. | |
| Auto Loan | |
| Other | |
| CONSUMER CREDIT INFORMATION | |
| Monthly Payments | |
| Visa | |
| Mastercard | |
| American Express | |
| Discover | |
| Other: | |
| Other: | |
| Other: | |
| Other: | |
| Other: | |
| Other: | |
| Other: | |
| Other: | |
| Other: | |
| Other: | |
| MONTHLY UTILITY INFORMATION | |
| Electricity | |
| Gas/Heat | |
| Water/Sewer | |
| Telephone | |
| Trash | |
| Cable/Internet | |
| Other: | |
| Other: | |
| MONTHLY INSURANCE INFORMATION | |
| Automobile | |
| Health/ Medical/ Dental | |
| Life | |
| Other: | |
| TOTAL EXPENSES AND TOTAL INCOME | |
| Total Expenses | |
| Total Income | |

| | | | |
|--------------------|--|-------|--|
| NOTES | | | |
| | | | |
| | | | |
| | | | |
| SIGNATURE AND DATE | | | |
| Borrower: | | Date: | |
| Co-Borrower | | Date: | |

June 10, 2009

Loss Mitigation Department / Legal Department

[INSERT BANK NAME]

[INSERT BANK ADDRESS LINE 1]

[INSERT BANK ADDRESS LINE 2]

REF: Borrowers: **[YOUR NAME(S)]**

Property: **[SUBJECT PROPERTY]**

Loan No: **[LOAN NUMBER]**

LOAN MODIFICATION REQUEST

Proposal: [PROPOSE NEW TERMS IN THIS SECTION] EXAMPLE:

- A Competitive interest rate of **2% FIXED, STEP LADDER PROGRAM. Max Rate after the fourth year at 5%, Amortized in 30 YEARS** thereafter, to capitalize past due amounts, legal fees, escrow deficiency, if any, etc.

Hardship: [SUMMARIZE HARDSHIP IN THIS SECTION] EXAMPLE:

- We are not looking to relinquish our responsibility, but rather, we are looking for a Loan Modification and / or Workout Plan equitable to our financial situation. With our already increased living expenses, and an Interest Rate that is set to adjust, the new payment will become unaffordable and difficult for us to maintain.

Market Value:

- Current Existing Balance: **\$ [YOUR CURRENT BALANCE]**
- **Current Fair Market / New Principal Balance:** **\$ [TODAY'S MARKET VALUE]**
- (Supporting Documents Included)
- **Principal Balance Reduction:** **\$ [REQUESTED REDUCTION AMOUNT]**

Request Details: [INPUT YOUR CURRENT AND PROPOSED DETAILS HERE] EXAMPLE:

| | |
|--------------------------------------|----------------------------|
| Current Interest Rate: | 6.00% |
| Requested Fixed Interest Rate | 2.00% |
| Current Loan Type: | Option Arm, ARM ect... |
| Requested Loan Type: | Step Ladder Program |
| Amortization Remaining: | 323 Months |
| Requested Amortization: | 30 Years |
| Previous Payment: | \$1000.00 |
| New Payment: | \$1075.00 |
| Late Fees / Penalties | FORGIVEN / WAIVED |
| Late Balance: | INCL IN NEW PRINCIPAL |
| BALANCE Requested Next Payment Date: | 2 Months |

Please find the following for you to proceed with the Loan Modification and / or Loan Restructuring Request:

- Mortgage Statement
- Market Value Documentation
- Hardship Letter
- Financial & Budget Worksheet:
- Income Documentation:
- Bank Statements

Thank you for your assistance in this matter.

Sincerely,

MOD STACKING ORDER

| | | |
|------------|---------------------------------------|-------------|
| Client(s): | Original Loan Amt (1 st): | MI/AE Name: |
| | Lender: | |
| Address: | Loan # | |
| Home #: | | |
| Work #: | Original Loan Amt (2nd): | |
| Cell #: | Lender: | |
| Email: | Loan # | |

| | | | |
|--|--|---|------------------|
| CSR <input checked="" type="checkbox"/> | MI/AE <input checked="" type="checkbox"/> | Left Side of Green File – Stack from the Top to Bottom | Comments: |
| <input type="checkbox"/> | <input type="checkbox"/> | Mortgage Statements (for each loan) | |
| <input type="checkbox"/> | <input type="checkbox"/> | Loan Modification Documentation (if available) | |
| <input type="checkbox"/> | <input type="checkbox"/> | Executed Fee Agreement for Services | |
| <input type="checkbox"/> | <input type="checkbox"/> | Proof of Payment for Service | |

| | | | |
|--|--|--|-----------------|
| CSR <input checked="" type="checkbox"/> | MI/AE <input checked="" type="checkbox"/> | Right Side of Green File – Stack from the Top to Bottom | Details: |
| <input type="checkbox"/> | <input type="checkbox"/> | Client Authorization | |
| <input type="checkbox"/> | <input type="checkbox"/> | Signed Hardship Letter & Documentation re: Hardship | |
| <input type="checkbox"/> | <input type="checkbox"/> | Completed Budget Worksheet – Signed | |
| <input type="checkbox"/> | <input type="checkbox"/> | Two (2) Months Recent Paystubs for Each Client | |
| <input type="checkbox"/> | <input type="checkbox"/> | 2007 W-2's for Each Client | |
| <input type="checkbox"/> | <input type="checkbox"/> | 07 & 08 Tax Returns - (Must have ALL Schedules if self-employed or have rental income) | |
| <input type="checkbox"/> | <input type="checkbox"/> | Two (2) Months Consecutive Bank Statements (All Pages) | |
| <input type="checkbox"/> | <input type="checkbox"/> | Any Correspondence (fax covers, letters, etc.) | |

Date File Submitted to Auditing: _____ **Date File placed on hold for missing docs:** _____

CSR: _____ **Date:** _____ **Manager:** _____ **Date:** _____

Reasons to Conduct a Forensic Loan Audit

Obtaining a Forensic Loan Document Audit is essential but not necessary in every Loan Modification. The findings of an audit can significantly improve your chances for a positive resolution. The following are common reasons to conduct a forensic loan audit:

1. General Loan Documentation Errors
2. Reverse Engineering
3. Real Estate Settlement Procedures Act (RESPA) Violations
4. Truth in Lending Act (TILA) Violations
5. Home Owner Equity Protection Act (HOEPA) Violations
6. Good Faith Estimate Compliance
7. Misleading Disclosures
8. Overstated Home Values
9. Overstated Income in the Loan Application
10. Lender and/or Broker Misrepresentations
11. Usury Violations
12. Excessive ARM Adjustments
13. Packing
14. Excessive Points & Fees
15. Predatory Lending
16. Forgery
17. Loan Flipping

Overall Process

Using the forensic mortgage loan document audit as basis for pressuring lenders, you will move lenders to take immediate action to stop an impending foreclosure and keep your home safe and place yourself in a better financial situation. This audit reveals various federal and state violations or errors in the original loan documents. Our internal auditing statistics show that four out of every five loans we have audited have significant violations.

In the beginning of the process you will need to send your lender a Qualified Written Request (QWR). The QWR is a formal demand that the lender must comply with under federal law to produce copies of your loan documents within a specified timeframe. Once you have collected all of the required documentation from your lender you can proceed to perform a forensic loan audit.

Once the audit has been completed and if violations are found a formal request for a loan modification is sent to the lender along with an abundance of highly

organized financial information that makes the best case possible as to why you (a) deserve a loan modification and (b) can afford the new payments. This is a long process that requires patience and negotiation skill.

Qualified Written Request

To perform the most comprehensive forensic loan audit you should compile all of the loan documents you maintain and get all of the loan documents your lender maintains. A Qualified Written Request (QWR) is a written demand to your servicing company. After receiving a QWR, the servicing company has twenty days to respond to the request and forward a copy of all loan documentation on file. The servicing companies also have to suspend all reporting activity to the major credit bureaus and then resolve the issue within sixty days. Federal RESPA laws require the servicing companies to comply and respond within this specified time frame. A QWR will be generated by you and submitted to the servicer for every file prior to the completion of the forensic loan document audit.

A sample QWR follows on the next page.

August 27, 2008

American Home Mortgage Services, Inc
Attention: **Correspondence Dept.**

Re: Loan Number: **1234511722**
 Name : **Johnathan Jones**
 Subject Address : **12345 Erehwon Street, Heartland, OH 12345**

To Whom It May Concern:

Please accept this letter as a “**Qualified Written Request**” under Section 6 of the Real Estate Settlement Procedures Act (RESPA) to obtain copies of ALL documents pertaining to the origination of the above mentioned Clients’ current mortgage on the referenced subject property. Please see below for a list of documents needed.

- Initial Loan Application and Final Loan Application
- Executed Notice of Right to Cancel (if refinance)
- Deed of Trust/All Riders
- Note and All Addendums/Riders
- Truth-in Lending Statements
- Itemization of Amount Financed
- Good Faith Estimates
- Estimated and Final Closing Statements (HUD)
- Appraisal
- Title Report
- Grant Deed(s)
- Copy of Loan Payment History – This must include all payments made, all fees incurred, any and all escrow account disbursements and how payments were applied

In addition to the above, please forward any and all disclosures, rate sheets etc. associated with the above transaction. Please note that all copies need to be clear and legible and all documents should be copied in their entirety.

In closing, We/I understand that under Section 6 of RESPA you are required to acknowledge our/my request within 20 business days and try to resolve any issues within 60 business days.

Please forward requested documentation as soon as possible and we look forward to working with you on a solution that benefits our mutual concerns.

Thank you for your time.

Sincerely,

The Forensic Loan Audit

A Forensic loan document audit is a comprehensive investigation of the documentation from your existing loan(s). Certified Financial Protection Group utilizes special state and federal mortgage loan post compliance software to calculate and identify violations that will transfer the findings into a detailed report.

The forensic loan document audit is a significant part of a loan modification request. We have found that over four out of five of the audits performed reveal major TILA (Truth in Lending Act), RESPA (Real Estate Settlement Procedures Act), Predatory Lending, and Real Estate/Mortgage Fraud violations.

In some cases, if you are simply overcharged by only \$35.00 on the final HUD-1, or if the annual percentage rate (APR) is only 0.125% higher than what was originally disclosed, there may be a violation of the Truth in Lending Act. This gives you the

leverage necessary when negotiating with the lender and more than enough incentive for the lenders to grant you a beneficial loan modification.

Chapter 3: Specific Strategies and Important Information to Consider During the Foreclosure Process

Which is Worse, Foreclosure or Bankruptcy?

The single most important question consumers ask themselves during the foreclosure process is whether it is better to lose their house to foreclosure or file for bankruptcy protection.

A foreclosure will remain on your credit report for 7 years, while a bankruptcy remains for 10 years. If you ever plan on getting any kind of loan, especially a mortgage, lenders are going to look at a foreclosure more seriously than they will a bankruptcy that doesn't include a house.

Even in the heyday of the subprime loan era you could obtain a loan one day out of bankruptcy. But a foreclosure was ALWAYS a black cloud and lenders usually wanted three to four years time to pass before considering a borrower for a loan.

No one will argue that the days of banks lending to anyone with a pulse is over.

What this translates to for the consumer is that you should expect to have to wait

at least four years from the time of bankruptcy discharge to obtain a mortgage with relatively favorable loan terms.

The main goal in trying to perform a loan workout with your lender is to avoid the catastrophic credit implications of a foreclosure or bankruptcy. But sometimes, even the best efforts to save your home and your credit fail.

Hoping for the best but preparing for the worst is the mindset anyone in the foreclosure process should maintain. There are no guarantees that even the hardest efforts to work with your lender will meet with success. If you are to be prepared for the worst, then it is important to consider the process of bankruptcy.

There are different ways to file for bankruptcy and not all of your debts have to be included. So even if faced with bankruptcy, you'll need advice from someone, either a good credit counselor or a bankruptcy attorney that can walk you through the choices you'll face.

While the bankruptcy process in the U.S. is governed by federal laws and handled by a system of federal bankruptcy courts, state laws regarding consumer debts and the disposition of property also come into play. There are also different types of bankruptcy filings. No matter which course you take, the filing stays on your credit record for 10 years. This makes it very difficult to get any type of loan during the bankruptcy process and even afterwards. If you can obtain a loan it will surely be more expensive than if you did not file for bankruptcy.

The two most common forms of personal bankruptcy are called Chapter 7 and Chapter 13. Under a Chapter 7 filing, you get to keep certain property (this is where state laws vary), but the rest is turned over to a court-appointed trustee that sells your eligible property or gives it to lenders to satisfy your debts. Under a Chapter 13 filing, you pay back your debts under a plan worked out by the court. The trustee collects payments, pays off your debts and makes sure you stick to the plan.

If you own a business, you may want to consider a Chapter 11 filing. This lets you stay in business, as long as the court and the people you owe money to approve of the plan to pay off your debts. If the court decides a trustee needs to be appointed, the trustee takes control of your business and its assets.

Not all debts can be wiped clean in bankruptcy. The list includes alimony and child support, taxes, court fines and most student loans. New debts, taken on after the discharge, aren't included. And if the judge finds out you've lied or committed fraud, your discharge can be denied.

You can also choose which debts you want to have discharged while you keep paying off others. You might want to work out a payment plan so you can keep your car, for example. To do this, you have to sign a "reaffirmation agreement," which says that you promise to pay off that debt. If you don't pay it back, the creditor can send it to a collection agency like any other debt.

If you've filed a Chapter 7 bankruptcy and gotten a discharge, you've got to wait 8 years before you can do it again. There are different limits on filing for Chapter 13, depending on whether you're trying to get debts discharged.

If you're having trouble making payments or even if you are behind by a month or two, contact an attorney and/or your lender before you get further behind. If you can, do this before you are 30 days late or before you receive the official "notice of default," indicating you're several months behind. This will insure you have time to get prepared before the formal foreclosure process begins.

First of all, you need to get ***honest with yourself*** about your situation. You need to take a good hard look in the mirror and decide if you can really afford your home and if you really want to save it. Either way, you are going to have to make a plan and you are going to have to act on that plan.

You may have to consider moving. Even if you do lose your house, you don't want a foreclosure on your record when you go looking for a smaller house or a place

to rent. One option is to ask the lender to hold off on foreclosing until you sell. If your mortgage balance is greater than your house is worth, you have the option of negotiating a short sale with your lender. You'll still owe money to the lender even after the house is sold. In some cases, lenders will let you off the hook for that amount rather than go through the expense of foreclosing. But you may not be completely off the hook: you may owe taxes on that amount. Consult an accountant for more information regarding the tax consequences of short sales.

You can also try something called a "deed in lieu of foreclosure" which basically means you turn over your house to the lender and walk away without owing anything. However, you'll need to work this out with the lender as well.

A good attorney who knows real estate and mortgage law can help you when you are facing foreclosure. If you cannot afford proper legal representation, then you should seek assistance from a legal aid or pro bono attorney. You can also seek a referral from your local BAR Association or get help from a legitimate credit counselor (from an accredited, non-profit agency).

A competent third party is a great choice for most people because they may be able to help smooth out the process and make sure that no laws have been broken by the lender when you received the loan.

If it is found that Truth in Lending Act, RESPA and other predatory lending law violations have occurred, then you may have legal recourse to sue your lender. A bankruptcy, then, would not be necessary and you can save your home and your credit from a foreclosure.

If you never seek proper legal advice, then you will never truly know what rights you have to properly defend yourself against your lender. Deciding whether foreclosure or bankruptcy is worse for you can be difficult to define. What makes this such a difficult question to answer is that no two loans are the same, no two consumer hardships are identical and hence what is best for you will not be the same for others. Getting advice from competent and trustworthy sources and educating yourself about the process of foreclosure and the options at your disposal is the best way to begin to make a sound decision.

www.NACBA.com National Association of Consumer Bankruptcy Attorneys -

NACBA is the only national organization dedicated to serving the needs of consumer bankruptcy attorneys and protecting the rights of consumer debtors in bankruptcy. Formed in 1992, NACBA now has more than 2500 members located in all 50 states and Puerto Rico.

NACBA has also played a critical role in many important court cases affecting the rights of consumer bankruptcy debtors by filing amicus briefs in U.S. Courts of Appeal and the Supreme Court, with many of those case decisions influenced by NACBA's participation. In addition, NACBA provides the most comprehensive educational programs in the country for consumer bankruptcy attorneys with its annual convention seminars.

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Principle Reductions: Wipe Out Your 2nd Mortgage with Bankruptcy

Millions of American homeowners are now upside-down on their home mortgage and they are looking for a way out. In some areas like the Inland Empire of California, local homeowners have seen values drop 30-50% and many are making a “business” decision to walk away without ever exploring ways to save their home. If you have decided to walk away from your home and think you have no other option but to bail on your upside-down house, you may want to read this.

Wouldn't it be much easier to save your home if you only had a first mortgage and no other payments? What if you could effectively wipe out \$50,000, \$100,000 or \$200,000 of what you owe on your mortgage? Also, if the market turns around, think of all the equity you could build back up years from now?

For homeowners who have taken out a second mortgage on their home, facing financial difficulties can be particularly challenging. In most cases, a second mortgage reduces your home equity to a very small margin leaving you vulnerable

to the whims of your lenders. In cases where real estate values have declined, as we are seeing in most markets today, there are strategies that you can use to protect yourself from excessive debt. Current bankruptcy law allows judges to approve the loan modifications of the terms of certain debts, namely auto and student loans and second-home mortgages. In the case of second mortgages, if the value of the property falls below the loan amount, debtors potentially could reduce the balance of the loan to equal the current value of the property.

Stripping the Lien, Cram Down or Strip Down

When a judge removes the second mortgage during bankruptcy proceedings it is referred to as “stripping” the lien, a “cram down” or “strip down.” This can happen if the loan is secured by other collateral that is part of the bankruptcy filing or if the home is not your principal residence or even if the payment structure on the second mortgage falls heavily during the bankruptcy filing period itself.

Here is a Lien Stripping Example:

- Home is worth \$200,000.
- The first mortgage is \$200,000.
- A second mortgage (or in certain states, a deed of trust) for \$100,000.
- Lenders are only secured up to the value of the property. In this case the first lender is secured by the property value.
- The second lender has nothing securing their lien. They are unsecured because the property has no value left over from the first lien. In a Chapter 13 bankruptcy, you can lien strip the second lender.
- The second lien is treated as an unsecured creditor.
- Most likely the second lender will not be able to collect on the mortgage after the bankruptcy discharge and the homeowners (debtors) still get to keep the house.
- The homeowner would not even have to pay the lien when they sell the house.

Additional liens on your home beyond your initial mortgage, whether you have taken a second mortgage or just another related lien, could be negated in the case of a Chapter 13 personal bankruptcy filing.

Liens can be stripped off of the debtor's assets in Chapter 11 or Chapter 13 when there is not enough equity in the asset, after deducting senior liens from the property's current market value, to secure the unsecured in whole or in part, where the lien exceeds the value of the debtor's property. Section 506 of the Bankruptcy Code acknowledges that a lien is only a secured claim to the extent there is value in the asset to which it attaches. To the extent that the claim exceeds the value of the collateral, that portion of the claim is unsecured. In Chapter 11 or Chapter 13, even voluntary liens, such as mortgages and security interests, can be stripped down to the value of the collateral, with the exception of voluntary liens secured only by the debtor's residence. Moreover, Congress is currently considering changes to bankruptcy law allowing the modification of home mortgages.

Despite the general rule, two exceptions may apply so as to allow lien stripping of a mortgage on a personal residence: loans based on a home plus other collateral. Lien stripping is prevented only when the lien is secured "solely" by a personal residence. Court decisions have made it clear that when the debtor has given other collateral (in addition to the personal residence; e.g., office equipment) as

security for the mortgage, lien stripping will be allowed. Thus, if you will be taking out a second mortgage or refinancing your home, you should consider offering additional collateral, such as furniture, as security for the loan. This can be done under the guise of seeking better terms from the lender, such as a lower interest rate.

Many (but not all) bankruptcy courts follow a rule that makes a second mortgage totally unsecured if the first mortgage balance equals or exceeds the value of the personal residence. This exception will not apply in the case of a refinancing of a mortgage, since in a refinancing the new mortgage pays off the first mortgage. The exception is predicated on there being two distinct mortgages (a first and a second mortgage). For this reason, if you have the option of financing your business through a second mortgage or refinancing your first mortgage, the second mortgage may be the better choice, especially where the amount of the first mortgage is close to the value of the home.

In addition, remember that the general rule applies only to a lien secured solely by a personal residence. Thus, lien stripping will be not allowed for a mortgage on a building used in a business.

While there is no assurance of what the courts will decide, depending on the terms of the original loans as well as the details of your filing, there are options for home owners with multiple liens on their home. This is because most additionally mortgages are unsecured, especially in the modern context of depressed home values. While inflated home appraisals may have allowed you to take out an additional mortgage, it's possible that your original home loan is now upside-down. When the real estate market was much more active, lenders often sidestepped the 20% down payment rule by allowing the borrower to get private mortgage insurance. As a further side step this rule of thumb, many borrowers took out a second mortgage to cover the 20% payment which led to the additional lien on the home. Given current market conditions, many buyers ended up with net negative financing, or negative equity, before they even made their first payment (and often did not have to provide any collateral).

Within Chapter 13 Bankruptcy law, section 11 USC 1322, can potentially allow you to forego your second mortgage, under certain circumstances. If your second lien on the whole is unsecured, then when the value of your home drops below the first mortgage deed of trust, the second becomes wholly under secured. This second loan can be negated through a Chapter 13 filing.

The lien stripping program is available for individuals desiring to reorganize their debt using Federal Laws under Title 11 of the United States Code. The mortgage removal program can only be used in the context of reorganization, often referred to as Chapter 13(see below).

If you own a home with more than one mortgage, you may be able to completely remove or “avoid” the second and subsequent junior mortgages from your home and county records, thus leaving only the first original mortgage!

To qualify for this defense, the court will generally require objective evidence that the home is appraised for less than the value of the initial mortgage, which can be

obtained through a county property appraisal or through a third party certified appraisal that is accepted by the court. In an environment where home prices in most markets have fallen at least 30%, many borrowers may qualify.

Tax liens can also be stripped off in reorganization proceedings (Chapters 11 and 13) to the extent that the lien does not attach to equity in property. Tax liens can't be avoided in Chapter 7 on the grounds that they impair exemptions; if the tax is dischargeable in the Chapter 7 filing, the bankruptcy court can determine the amount of the lien that is secured at the time of the filing. Payment of that sum entitles the debtor to the release of the lien.

Ultimately, working with a qualified tax and real estate attorney or experienced real estate bankruptcy lawyer will help you present your case to the Federal Bankruptcy Court, so it's important to get qualified legal advice in advance regarding any filings.

The comments and material in this ebook are NOT to be taken as legal advice and we highly recommend that anyone facing foreclosure should seek the counsel of an attorney and/or an accountant. ALWAYS obtain a second and third opinion on your particular situation from a trusted source. We will not be held liable for any material, comments, posts, threads, emails or any communication made subsequent to downloading this free ebook. The comments made and the materials available in this ebook are for informational purposes only and not for the purpose of providing legal advice. You should contact your attorney to obtain advice with respect to any particular issue or problem. The opinions expressed in and throughout this ebook are the opinions of the individual author and may not reflect the opinions of our employers, other ventures or any individual attorney. No advice or information, whether oral or written, obtained by you or through or from this ebook shall create any kind of promise or business relationship. The views and opinions in this ebook are likely to change over time.

A Deed in Lieu of Foreclosure as a Cure for Your Mortgage Woes

For home borrowers ("mortgagors") facing foreclosure, a deed in lieu of foreclosure provides an alternative solution to the standard default process. In particular, the deed grants the lender, the "mortgagee," full rights to the property title to satisfy the conditions of the loan. Such agreements are a common form of mortgage contract settlements. In general, a deed is a right granted by a legal contract based upon mutual agreement; therefore, a deed-in-lieu must be based upon voluntary agreement in good faith.

In cases where a borrower lacks sufficient assets for a deficiency judgment, the lender will often pursue a deed settlement independent of court proceedings. Under certain conditions, a deed in lieu of foreclosure can offer several advantages to the borrower and lender alike. If agreed to by both parties, the lender is then able to assume ownership of the property, creating a more efficient process by limiting court costs and waiting periods involved in standard foreclosure processes. Standard foreclosure procedures can take years to process in court and are further complicated by personal bankruptcy declarations, which

are relatively common in such cases. For a borrower facing foreclosure, the deed agreement can relinquish him or her from underlying debt, thus removing the foreclosure record from a credit record and reducing the need for a declaration of personal bankruptcy. Lenders also benefit in terms of improved settlement efficiency, which greatly reduces the time, cost and potential complications that would otherwise be involved in a repossession procedure.

In order for the agreement to be reached, the appraised market value of the property must be less than the outstanding debt from the original agreement, and the property must not be subject to any third party creditor claims or liens. Deeds-in-lieu are often initiated either by personal financial difficulties on the part of the borrower or changes in the macroeconomic environment that shift interest rates and/or underlying home values. Mortgage contracts that rely upon a relatively high monthly payment based upon a variable interest rate (with a limited, initial down payment) are particularly vulnerable to shifts in the economic environment; an interest rate change of just a few percentage points could double a borrower's monthly payment, under certain circumstances. The recent

housing market challenges have reflected a coalescence of these factors, which have made deeds-in-lieu a common instrument for borrowers facing foreclosure.

Technically, to proceed with a deed in lieu both parties must agree to and sign both an Agreement in Lieu of Foreclosure, which outlines the terms of the deed, as well as the deed itself, which transfers legal ownership of the property. In certain situations, a borrower may pay to reduce the debt to ensure they maintain their credit rating. Once the agreements are reached, the lender then classifies the original loan as paid and issues a waiver to deficiency judgment, which would normally go into effect in case sale of the property results in an amount less than the debt. A third party escrow service then executes the agreement, thus releasing both parties from their original contract.

The IRS on Shorts Sales, Foreclosures and Debt Forgiveness

The Mortgage Forgiveness Debt Relief Act of 2007 generally allows taxpayers to exclude income from the discharge of debt on their principal residence. Debt reduced through mortgage restructuring, as well as mortgage debt forgiven in connection with a foreclosure, qualifies for this relief.

This provision applies to debt forgiven in 2007, 2008 or 2009. Up to \$2 million of forgiven debt is eligible for this exclusion (\$1 million if married filing separately).

The exclusion doesn't apply if the discharge is due to services performed for the lender or any other reason not directly related to a decline in the home's value or the taxpayer's financial condition.

The amount excluded reduces the taxpayer's cost basis in the home. More information on claiming this exclusion will be available soon.

The questions and answers, below, are based on the law prior to the passage of the Mortgage Forgiveness Debt Relief Act of 2007.

1. What is Cancellation of Debt?

If you borrow money from a commercial lender and the lender later cancels or forgives the debt, you may have to include the cancelled amount in income for tax purposes, depending on the circumstances. When you borrowed the money you were not required to include the loan proceeds in income because you had an obligation to repay the lender. When that obligation is subsequently forgiven, the amount you received as loan proceeds is reportable as income because you no longer have an obligation to repay the lender. The lender is usually required to report the amount of the canceled debt to you and the IRS on a Form 1099-C, Cancellation of Debt.

Here's a very simple example. You borrow \$10,000 and default on the loan after paying back \$2,000. If the lender is unable to collect the remaining debt from you, there is a cancellation of debt of \$8,000, which generally is taxable income to you.

2. Is Cancellation of Debt Income Always Taxable?

Not always. There are some exceptions. The most common situations when cancellation of debt income is not taxable involve:

Bankruptcy: Debts discharged through bankruptcy are not considered taxable income.

Insolvency: If you are insolvent when the debt is cancelled, some or all of the cancelled debt may not be taxable to you. You are insolvent when your total debts are more than the fair market value of your total assets. Insolvency can be

fairly complex to determine and the assistance of a tax professional is recommended if you believe you qualify for this exception.

Certain farm debts: If you incurred the debt directly in operation of a farm, more than half your income from the prior three years was from farming, and the loan was owed to a person or agency regularly engaged in lending, your cancelled debt is generally not considered taxable income. The rules applicable to farmers are complex and the assistance of a tax professional is recommended if you believe you qualify for this exception.

Non-recourse loans: A non-recourse loan is a loan for which the lender's only remedy in case of default is to repossess the property being financed or used as collateral. That is, the lender cannot pursue you personally in case of default.

Forgiveness of a non-recourse loan resulting from a foreclosure does not result in cancellation of debt income. However, this may result in other tax consequences, as discussed in Question 3 below.

3. I Lost My Home to Foreclosure. Are There Tax Consequences?

There are two possible consequences you must consider:

Taxable cancellation of debt income (Note: As stated above, cancellation of debt income is not taxable in the case of non-recourse loans).

A reportable gain can occur from the disposition of the home because foreclosures are treated like sales for tax purposes. Often some or all of the gain from the sale of a personal residence qualifies for exclusion from income.

Use the following steps to compute the income to be reported from a foreclosure:

Step 1 - Figuring Cancellation of Debt Income (Note: For non-recourse loans, skip this section. You have no income from cancellation of debt).

1. Enter the total amount of the debt immediately prior to the foreclosure _____.
2. Enter the fair market value of the property from Form 1099-C, box 7 _____.
3. Subtract line 2 from line 1. If less than zero, enter zero _____.

The amount on line 3 will generally equal the amount shown in box 2 of Form 1099-C. This amount is taxable unless you meet one of the exceptions in question

2. Enter it on line 21, Other Income, of your Form 1040.

Step 2 – Figuring Gain from Foreclosure

4. Enter the fair market value of the property foreclosed on. For non-recourse loans, enter the amount of the debt immediately prior to the foreclosure _____.

5. Enter your adjusted basis in the property (Usually your purchase price plus the cost of any major improvements) _____.

6. Subtract line 5 from line 4. If less than zero, enter zero.

The amount on line 6 is your gain from the foreclosure of your home. If you have owned and used the home as your principal residence for periods totaling at least two years during the five year period ending on the date of the foreclosure, you may exclude up to \$250,000 (up to \$500,000 for married couples filing a joint return) from income. If you do not qualify for this exclusion, or your gain exceeds \$250,000 (\$500,000 for married couples filing a joint return), report the taxable amount on Schedule D, Capital Gains and Losses.

4. I Lost Money on the Foreclosure of My Home. Can I Claim a Loss on My Tax Return?

No. Losses from the sale or foreclosure of personal property are not deductible.

5. Can You Provide Examples?

A borrower bought a home in August 2005 and lived in it until it was taken through foreclosure in September 2007. The original purchase price was \$170,000, the home is worth \$200,000 at foreclosure, and the mortgage debt canceled at foreclosure is \$220,000. At the time of the foreclosure, the borrower is insolvent, with liabilities (mortgage, credit cards, car loans and other debts) totaling \$250,000 and assets totaling \$230,000.

The borrower figures income from the foreclosure as follows:

Use the following steps to compute the income to be reported from a foreclosure:

Step 1 - Figuring Cancellation of Debt Income (Note: For non-recourse loans, skip this section. You have no income from cancellation of debt).

1. Enter the total amount of the debt immediately prior to the foreclosure ___\$220,000__.

2. Enter the fair market value of the property from Form 1099-C, box 7 ___\$200,000__.

3. Subtract line 2 from line 1. If less than zero, enter zero ___\$20,000___.

The amount on line 3 will generally equal the amount shown in box 2 of Form 1099-C. This amount is taxable unless you meet one of the exceptions in question

2. Enter it on line 21, Other Income, of your Form 1040.

Step 2 – Figuring Gain from Foreclosure

4. Enter the fair market value of the property foreclosed. For non-recourse loans, enter the amount of the debt immediately prior to the foreclosure ___\$200,000___.

5. Enter your adjusted basis in the property. (Usually your purchase price plus the cost of any major improvements) ___\$170,000___.

6. Subtract line 5 from line 4. If less than zero, enter zero ___\$30,000___.

The amount on line 6 is your gain from the foreclosure of your home. If you have owned and used the home as your principal residence for periods totaling at least two years during the five year period ending on the date of the foreclosure, you may exclude up to \$250,000 (up to \$500,000 for married couples filing a joint

return) from income. If you do not qualify for this exclusion, or your gain exceeds \$250,000 (\$500,000 for married couples filing a joint return), report the taxable amount on Schedule D, Capital Gains and Losses.

In this situation, the borrower has a tax-free home-sale gain of \$30,000 (\$200,000 minus \$170,000), because they owned and lived in their home as a principal residence for at least two years. Ordinarily, the borrower would also have taxable debt-forgiveness income of \$20,000 (\$220,000 minus \$200,000). But since the borrower's liabilities exceed assets by \$20,000 (\$250,000 minus \$230,000) there is no tax on the canceled debt.

Other examples can be found in IRS Publication 544, Sales and Other Dispositions of Assets, under the section "Foreclosures and Repossessions."

6. I Don't Agree With the Information on the Form 1099-C. What Should I Do?

Contact the lender. The lender should issue a corrected form if the information is determined to be incorrect. Retain all records related to the purchase of your home and all related debt.

7. I Received a Notice from the IRS on This. What Should I Do?

The IRS urges borrowers with questions to call the phone number shown on the notice. The IRS also urges borrowers who wind up owing additional tax and are unable to pay it in full to use the installment agreement form, normally included with the notice, to request a payment agreement with the agency.

IRS LINKS:

If you are having difficulty resolving a tax problem (such as one involving an IRS bill, letter or notice) through normal IRS channels, the Taxpayer Advocate Service

may be able to help. For more information, you can also call the TAS toll-free case intake line at 1-877-777-4778, TTY/TDD 1-800-829-4059.

In some cases, you may qualify for free or low-cost assistance from a Low Income Taxpayer Clinic (LITC). LITCs are independent organizations that represent low income taxpayers in tax disputes with the IRS. Find information on LITCs in your area.

Related Items:

- Publication 523, Selling Your Home
- Publication 544, Sales and Other Dispositions of Assets
- Publication 908, Bankruptcy Tax Guide
- Form 1040, U.S. Individual Income Tax Return
- Form 1040, Schedule D, Capital Gains and Losses
- Form 1099-C, Cancellation of Debt

- Form 9465, Installment Agreement Request

Chapter 4: If You Need Professional Help

Not everyone will want to perform a loan modification on their own. If you feel stuck, frustrated or just need help you can always call on us for assistance. We have included in this ebook an intake packet for our retail loan modification service. If you are interested in pursuing a loan modification and want professional help, just fill out the information in the application and call a representative of Certified Financial Protection Group and they will get you started on the path towards securing your home.