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The trick to getting a mortgage fixed

Foreclosure prevention is a messy business - more art than science. Here, an inside look at why some people get a loan workout and others don't.

By Les Christie, CNNMoney.com staff writer
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NEW YORK (CNNMoney.com) -- More than 3,000 times daily, struggling homeowners call the foreclosure Help Hotline for advice on how to save their homes.

And so begins the complicated and time-consuming foreclosure prevention process. Working together are mortgage servicers - the companies that manage the loans - and the borrowers, with foreclosure prevention counselors often acting as go-betweens.

"The common objective is to fix the loan," said Alan Goldberg, vice president with the home owner assistance division of Genworth Financial, a mortgage insurer that has collaborated with servicers in completing more than 2,800 workouts in the first quarter of 2008.

But what's best for a borrower isn't always best for the lenders, who weigh the cost of every workout against the cost of foreclosure. Whether or not a homeowner gets help boils down to the numbers.

If keeping an at-risk borrower in their home is going to cost the lender more than a foreclosure will, that homeowner is usually out of luck. The good news is that foreclosures are expensive - at least \$50,000 according to the Center for Responsible Lending.

A frank discussion The first step in the workout process is to document the borrower's financial situation.

Servicers request details about a borrower's income, as well as what the family spends on food, clothing, car payments, credit card debt, and student loans, according to Cleveland-based foreclosure prevention counselor Mark Seifert. Homeowners have to submit copies of pay stubs, bank statements, and utility bills to back up their claims.

"Servicers are also asking for things like hardship letters stating what the emergency was that caused them to miss payments," Seifert said.

To stay in their home, borrowers almost always have to cut back on other expenses. "We'll tell someone they have to get rid of that \$600 SUV payment if they want a workout," said Wesley

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Justice, a vice president for loss management for AIG United Guaranty, a mortgage insurer.

Counselors often suggest homeowners cancel extras like cell phones and cable television, and stop eating out.

After a new, tighter budget is been established, the workout team comes up with a number: the dollar amount left after all reasonable expenses have been deducted from income, with about \$200 set aside for emergencies.

"[Borrowers] need to have the ability to pay all their expenses and have a little left over," said the director of loss mitigation for one servicer. (The servicers we contacted chose not to be quoted directly.)

So if a homeowner has \$3,000 in monthly income, \$1,400 in household expenses and puts aside \$200, that leaves \$1,400 for a housing payment.

The magic number That's the number the servicer uses to determine whether a borrower can get a workout and keep their home.

Not everyone can afford to stay in their home, even with a change to the terms of their mortgage.

Sometimes, whether it's because a borrower is just in too deep or because a household's income sees a steep drop due to a job loss, there just isn't any reasonable solution.

"I could give someone a 0% interest rate and they still wouldn't be able to afford the loan," said Goldberg. Those borrowers are urged to sell or do a deed-in-lieu of foreclosure, in which the lender takes possession of the property.

The counselor or servicer compares a borrower's monthly housing allowance with a range of available solutions, looking for the option that will cost the lender as little as possible.

"You wouldn't just jump to giving away the farm," said the director of loss mitigation. "You give them [borrowers] what they need, no more."

Ideally lenders want to just put borrowers on a repayment plan, which allows them to make up missed payments, without altering the terms of the loan or reducing the revenue that these loan generate for investors.

These plans generally work best to get homeowners back on track after unexpected expenses, like medical bills, derail their finances. Repayment plans can also help people who are living beyond their means but could afford their home if they pare unnecessary expenses.

A new loan Other workouts, for borrowers with bigger problems, involve restructuring the terms of the loan. These mortgage modifications require sacrifices by investors, since some the loan's value has to be written down. Investors accept this if the alternative, foreclosure, would be even more costly.

One option is to extend the length of the loan, from say 30 years to 40 years, which would knock about \$100 a month off the payment on a \$200,000 mortgage.

Other at-risk borrowers may be able to afford payments at the teaser interest rate on their adjustable rate mortgages (ARMs), but not at the higher, reset rates. A \$200,000 loan at 6% might cost \$1,200 a month, but if that rate resets to 8% the payments climb to \$1,570.

For them, a rate freeze keeping the payment at \$1,200 may be the answer.

"We do the five-year freezes," said the director of loss mitigation, "but most of our modifications are two-year freezes. If there's still a problem, we promise to do another two years after that."

Some homeowners may need their principal reduced as well, say from \$200,000 to \$160,000, to make payments affordable. That's an expensive fix and offered only as a last resort.

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In these cases, some servicers are hoping to recover their principal by stipulating that they will be entitled to collect the difference between the old mortgage balance and the new, lower balance if home prices recover and the home is sold.

"This is catching on quickly," said the director of loss mitigation.

Another big factor in whether someone gets a workout is where they live. If the home is in an area where housing markets are in free-fall, like Las Vegas, servicers will try harder to keep borrowers in their home, since it would be very hard to sell the property. In better markets, however, a house will sell fairly quickly at a good price, the math may favor foreclosure.

One thing is for sure: If a borrower is fortunate to get an offer for a workout, the servicer isn't going to negotiate beyond that, says the director of loss mitigation. By that point, workouts have already gone up the line for approvals from the mitigation specialists to department managers and directors to sign off on.

"The workout we're prepared to give is pretty much it," she said.

If that's not enough, then the homeowner may be out of luck and, soon, out of the house. ■

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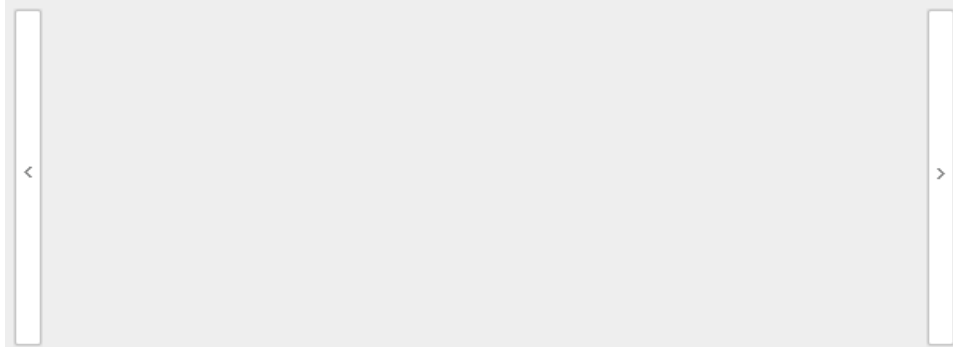
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