Options for Leaving Your Home and Avoiding Foreclosure

While avoiding foreclosure through a loan modification or refinance is always preferable, it is not always possible. If you know you can no longer afford to stay in your home — and you're not eligible for a modification or refinance — it is best to leave the home before the foreclosure occurs.

By avoiding foreclosure, there will be less damage to your financial situation and credit history, which will benefit your family in both the short- and long term. In addition, going through foreclosure is emotionally difficult. Family members may feel scared, depressed, angry or embarrassed. If you can't stay in your home, consider the following options for exiting the home without foreclosure.

Avoiding foreclosure while exiting your home will be better for your credit rating, reduce damage to your overall financial situation, and minimize the emotional costs to you and your family.

Deed-In-Lieu (DIL) of Foreclosure. Deed-in-lieu (pronounced "lew") of foreclosure, or DIL, is when a borrower voluntarily turns the property deed over to the lender or servicer in exchange for a release from most or all of the mortgage obligations. If a lender accepts the deed-in-lieu of foreclosure, then the borrower does not owe any more on the home (or owes much less) and can walk away without any deficiency judgments or a foreclosure on his or her record.

You might consider a DIL if you are not eligible for a refinance or loan modification, and/or are not expecting your financial hardship to last a long time. DIL may also be a good option if you are behind on your mortgage payments, owe more on the home than it is worth, can't afford the home and can't sell the home. In order for a DIL to be considered, the title must be free and clear; no other liens on the home are allowed.

The benefits of a DIL are that it reduces or eliminates mortgage debt and allows your family to avoid the negative impact of foreclosure. To do this, you must work closely with the mortgage company. Call them and ask about the deed-in-lieu option. Before you call, do some research: know the value of the property and the amount still owed on the mortgage. Also, be ready to provide a full description of the reasons for your hardship; the lender will want a clear explanation. It is helpful to write a letter or create an outline describing your hardship and specifying the reasons for it.

To complete the DIL process, you will need to put your financial documents in order, including mortgage statements, other monthly debts and proof of income.

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The DIL process generally takes about 90 days. Once complete, families must move out, leaving the home in good condition. Some lenders provide relocation assistance to make the transition to a new home smoother. Be sure to seek tax advice if your case involves forgiven debt and ask if there are tax consequences for a DIL.

Leasing Back the Home. Some lenders allow homeowners to turn the home over to them through a deed-in-lieu of foreclosure, but continue to live in the home through a lease agreement. A lease option is important to consider; be sure to ask the company that holds the mortgage if this is an option. The process takes time to sort out — you must be persistent, stay clear about what you want, and prove that you can meet the terms of a lease agreement, including paying the monthly lease amount.

Short Sale. Another option for leaving your home without foreclosure is through a short sale. A short sale is when your lender or loan servicer agrees to let you sell the home for its current fair market value, even if that amount does not cover what's owed on the mortgage. The amount owed is then forgiven, so you don't owe any additional amount. A short sale lets you sell the property as a way of avoiding foreclosure. It also saves the lender from having to take possession of the home, which costs them money.

To be eligible for a short sale, your household must be unable to refinance or modify the loan, be facing long-term hardship, and owe more on the home that it is worth. This option is best for those who are behind on their mortgage payments and cannot afford to stay in the home, but are also unable to sell the home for a price that would cover what's owed on the loan.

The benefits of a short sale are that it eliminates or reduces the debt (depending on the lender), helps you to avoid the damage of foreclosure to your credit, and allows you to repair your credit sooner. Generally speaking, borrowers can be eligible for a new mortgage sooner — in some cases after two years — than if they go through foreclosure, which stays on your credit history for seven years.

The first step to leaving your home without a foreclosure is to call your lender. Ask about deed-in-lieu of foreclosure, short sale, lease-back options and HAFA. Keep a record of every conversation: the date, name of person you talked to and details of the conversation.

The short sale process is similar to selling a home: the homeowner works with a real estate agent to market and sell the property. The difference is that your lender or servicer is involved in setting the sales price, reviewing offers, agreeing to the terms of the sale once a buyer has been found, and working with the buyer's real estate agent and mortgage company to close the loan.

The first step to a short sale is getting the mortgage company to agree to it. To begin, get your financial information together, including mortgage statements and other debts, plus complete details on your household income. Be ready to clearly explain your hardship and why you need this option. It's a good idea to write it out in an outline or letter format. Then contact the mortgage company to discuss the possibility.

Once the mortgage company agrees, you will contact a real estate agent to help you proceed with the sales process. Some Realtors specialize in short sales; consider this when selecting an agent.

The short sale process can take up to 120 days (4 months). Some companies offer relocation assistance for this option; be sure to ask if relocation support is available.

Tax Implications. Forgiveness of debt in either a short sale or Deed-in-Lieu situation is not automatic. Lenders must issue a 1099-C tax form. Taxpayers have to file Form 982 with the long-form 1040 when they file their taxes, and explain that they qualify for an exception. The critical concern is that some types of debt that may have been included as part of a refinance or second mortgage (that were not house related) are excluded from this exception, meaning you may owe income tax on that portion of the debt, even if it was written as forgiven by the lender.

Home Affordable Foreclosure Alternatives (HAFA) Program. The Home Affordable Foreclosure Alternatives (HAFA) program is a federal program that helps families transition out of a home through either a deed-in-lieu or a short sale. Through HAFA, homeowners receive advice from HUD-approved housing counselors and real estate professionals. In addition, those who obtain a HAFA short sale are completely released from their mortgage debt after the home sells; the mortgage company works to find a sales price that is acceptable, and the borrower is not responsible for any of the remaining debt. HAFA also provides $3,000 in relocation assistance. The web link to the HAFA program is listed at the end of this fact sheet.

To be eligible, you must have lived in the home during the past 12 months, have a documented financial hardship, and not have purchased a new home within the past year. The mortgage amount must be less than $729,750 and the mortgage must have been obtained on or before January 1, 2009. You must also have not been convicted of a felony in the past 10 years.

General Preparations. If you decide that a deed-in-lieu of foreclosure, short sale or HAFA could work for you, you need to act quickly. To have a better chance at exiting the home without foreclosure, contact your lender immediately to discuss your situation and gather details about all possible options. Lenders want you to avoid foreclosure, but you need to take the first step. Get your financials in order and be sure to keep a contact log or detailed notes on each and every communication with the lender or real estate agent(s).

What's Next? Finding Affordable Housing. The final step in leaving the home without foreclosure is actually moving out and finding affordable housing. If you are not eligible for a lease-back option, then look for an affordable rental. The fact that you've avoided foreclosure will minimize damage to your credit score and increase your ability to find a good rental option.

Once you are settled in your new home, immediately begin to rebuild your credit. This will allow you to move toward homeownership again in a few years, or when you're ready. Consider joining a homebuyer club or financial fitness class at a local housing counseling agency. This can help to strengthen your budgeting, credit and financial skills so you're ready to purchase a home when the time comes.

Helpful Web Links
For more information on a deed-in-lieu of foreclosure:
http://knowyouroptions.com/avoid-foreclosure/options-to-leave-your-home/deed-in-lieu

For more information on short sales:
http://knowyouroptions.com/avoid-foreclosure/options-to-leave-your-home/short-sale

For more information on the HAFA program:
http://www.makinghomeaffordable.gov/programs/exit-gracefully/Pages/hafa.aspx

To find a local housing counseling agency:
http://portal.hud.gov/hudportal/HUD?src=/i_want_to/talk_to_a_housing_counselor
or call 1-800-569-4287

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