LAF Equal justice starts here.

HELOCs and Foreclosure

The Basics

LAF

What is a HELOC?

- Home equity line of credit
- Revolving credit that is secured by the borrower’s property.
- Lender allows the borrower to draw from the funds whenever he chooses.
- High limits with low-interest rates.

HELOC

- Line of credit
- Repayment period and/or balloon payment
- Possibly interest only payments, or negative amortization
- Lower up front costs
- Flexibility of funds available
- Promissory note

Home Equity Loan

- Fixed amount
- Fixed interest rate
- Fully amortized
- Higher up front costs
- Promissory note

Subordinance and Recourse

- Normally **Subordinate** to primary home loans. This means that the HELOC lender has claim to any money generated by a foreclosure, only after the primary mortgage lender recoups their full loss.
- Almost all HELOCs are considered "**recourse** loans." The borrower is personally responsible for paying recourse loans in full, regardless of their property's value. If the lender doesn't recoup the full cost of the HELOC during foreclosure, they can sue the borrower for the remaining money owed.

Draw Period

- Span of 5-10 years during which the borrower can withdraw money whenever he chooses.
- Borrower will be given a checkbook or a special credit card to use for withdrawals.
- Like a credit card, when money is taken out, the borrower will receive a monthly bill and must make a minimum payment (sometimes interest-only). When no money is withdrawn, the borrower will not be charged.

Reset

- Many HELOCS have the option for a lower payment term for the first ten to twenty years.
- Reset, in most instances to fully amortizing loans.
- Usual result is a substantial increase in the monthly payment amount.
- Reset is based upon the terms of the original contractual agreement for the HELOC.

Repayment period

- Period after reset is called the repayment period
- During the 10-20 year "repayment period" the borrower cannot make any more withdrawals from the line.
- To determine the monthly bill, the total amount withdrawn is divided by months allotted for the repayment phase.

HELOC Freeze

- Lenders reserve the right to reduce the credit line should the home value decline.

Short Sale and Foreclosure

- Deed in lieu of foreclosure
- Straight-Up Short Sale
- Short Sale with Incentive to HELOC Lender
- Primary Lender Forces Foreclosure
- HELOC Lender Forces Foreclosure
- HELOC Lender purchases first mortgage and forecloses

Deed in Lieu of Foreclosure

- Lender agrees to accept a deed to the property instead of foreclosing in order to obtain title.
- Deficiency amount is the difference between the fair market value of the property and the total debt
- In Illinois, a lender may not obtain a deficiency judgment following a deed in lieu of foreclosure unless the borrower agrees to remain liable by signing such an agreement at the same time as the deed in lieu of foreclosure

Straight-Up Short Sale

- Primary lender and the HELOC lender must agree.
- As a part of the short sale agreement, borrower may be required to pay a certain amount to both lenders in order for account to be considered closed. This may be addition to the money recouped by the sale.
- Credit report will note that the account was settled but that the full amount was not paid.
- May still result in deficiency unless agreement indicates otherwise.

Short Sale with Incentive to HELOC Lender

- It can be difficult to get a HELOC lender to agree to a short sale;
- If the primary lender wants to push a short sale, it may offer the HELOC lender an incentive to sign off on the sale.
- May still result in deficiency.

Primary Lender Forces Foreclosure

- If property is foreclosed upon, primary lender will be paid everything it is owed with the money it takes from the sale.
- Since the HELOC loan is subordinate to the first mortgage, the HELOC lender will be paid with any remaining money.
- If the HELOC lender is not paid the full amount owed on the line, the HELOC becomes an unsecured debt and the HELOC lender can pursue judgment.

HELOC Lender Forces Foreclosure

- Some borrowers stop paying their HELOC while continuing to pay their primary mortgage. In this case, the HELOC lender may decide to force foreclosure.
- Primary mortgage lender may receive the lion's share of the foreclosure money.
- Unless there is a lot of equity in the home, HELOC lenders often choose to wait it out rather than forcing foreclosure themselves.

HELOC Lender Purchases Primary Loan

- If borrower stops paying HELOC while still making primary mortgage payments, the HELOC lender may try to purchase first mortgage in order to initiate foreclosure proceedings.
- As the holder of both the first and second loans, the lender will be able to recoup the maximum amount possible.

If borrower cannot afford second mortgage and wants to save the home - options:

1. Refinance with lender
2. Shop for a new HELOC.
3. Get a new first mortgage and payoff HELOC.

4. Look into modification

HELOC Modifications

- 2 government programs for second mortgages – 2MP and FHA2LP
- Proprietary Modifications
- Illinois Hardest Hit

Second Lien Modification Program (2MP)

- First mortgage was permanently modified under HAMP and second mortgage is on the same property, borrower may be eligible for a modification or principal reduction on the second mortgage as well, through MHA's Second Lien Modification Program (2MP). ONLY AFTER MODIFICATION OF FIRST MORTGAGE
- Resources for 2MP https://www.makinghomeaffordable.gov/steps/pages/step-2-program-2mp.aspx

  and

  https://www.hmpadmin.com/portal/programs/second_lien.jsp

FHA Second Lien Program (FHA2LP)

- If first mortgage servicer agrees to participate in FHA Short Refinance, borrower may be eligible to have second mortgage on the same home reduced or eliminated through the FHA Second Lien Program (FHA2LP).
- Must be negative equity and also only for borrowers that are current on mortgage.
- All servicers of eligible second lien Non-GSE Mortgages may participate in FHA2LP. A servicer need not service the related first lien or participate in HAMP in order to participate in FHA2LP.
- Refinance into an FHA-insured loan where the unpaid principal balance (UPB) of the original first lien mortgage is written down by at least 10 percent and the amount of all mortgage debt, after the FHA refinance, does not exceed 115 percent of the current value of the property. Lender will be required to reduce the amount owed on first mortgage to no more than 97.75% of your home's current value.
- ONLY AFTER MODIFICATION OF FIRST MORTGAGE.
- Resources: https://www.hmpadmin.com/portal/programs/fha2lp.jsp

Other modifications

- Proprietary modifications – Some lenders offer proprietary modifications of second mortgages without modification of first mortgage. The terms of those modifications are set by the lender but may be HAMP-like. Example, Bank of America.
- Illinois Hardest Hit may also be applicable.

Bankruptcy

- If there is no equity in home, a Ch. 13 bankruptcy (reorganization bankruptcy) is a possibility to "strip off" the HELOC.
- A bankruptcy attorney must be consulted.

HELOCS can be sold to debt collectors

- If payment is not made, the loan may go into default and be sold to a collection company to recover. Home equity lenders and second mortgage holders frequently choose to pursue a standard lawsuit to obtain a money judgment rather than proceeding with foreclosure action.
- If the creditor does not foreclose, rather sues and obtains a judgment, the creditor may be able to garnish wages, levy bank accounts, or attempt to seize other property.

Questions?

If you have any questions about, HELOCS and foreclosure, or the materials – please contact amargalit@lafchicago.org