Fannie Mae and Freddie Mac are large government-chartered corporations that own or guarantee over one-half of the home mortgages in the country. Fannie Mae and Freddie Mac have similar loss mitigation guidelines, divided between short-term options for temporary problems and long-term options for significant changes in your financial circumstances. When you ask for loss mitigation help for a Fannie or Freddie loan, your servicer must review your request by considering a series of specific options in a required order. If you do not qualify for the first on the list, your servicer must go on to the second, continuing until you qualify for some form of relief.

To request loss mitigation from either Fannie or Freddie, complete and submit Form 710—Mortgage Assistance Application to your servicer. Indicate you are experiencing hardship, either a loss of income or increase in expenses. You need not be in default, if default is “imminent” due to a change in your financial circumstances.

**Options for Temporary Hardships.** Under Fannie and Freddie guidelines, if your servicer considers your hardship to be temporary, it should offer you a repayment or forbearance plan. A temporary hardship might be a short-term drop in income (such as a loss of your job) or a one-time major expense. You may not agree with a servicer’s assessment that your hardship is only temporary, such as when your loss of income is long-term due to a divorce or medical condition. Press this point because, as described below, you have more options where a hardship is long-term.

Repayment plans are applicable when your temporary hardship has a forseeable short-term duration or is now over, but you are so far behind on your mortgage payments that you cannot get caught up right away. Fannie and Freddie will offer you a repayment plan where for up to a year you make each month your regular mortgage payments and a portion of your back-due payments. The repayment plan must be realistic, so that you can make the increased payments over the repayment plan period. In judging what you can afford, remember that your temporary financial difficulties will also have left you with other overdue obligations, such as utility bills or urgent needs for your children that have been postponed.

Forbearance plans, on the other hand, apply when you are currently experiencing a temporary hardship. A forbearance plan allows for reduced or suspended payments for up to six months, and even longer if you are unemployed. At the end of the forbearance period, the servicer must evaluate you for a long-term solution. What that option will be will depend on your financial circumstances at the time. It could be a repayment plan, a permanent reduction in payments, or an option involving your loss of ownership of the home.

**Home Retention Options for Long-Term Hardships—The Flex Modification.** The Flex Modification is Fannie and Freddie’s primary loss mitigation option for borrowers who want to keep their homes but are facing a long-term hardship (such as your disability, the death of your spouse, or divorce). Your servicer can offer you a “Flex Mod” in response to your loss mitigation application, or your servicer can offer this option unsolicited, based on its unilateral determination that you qualify.

*The Flex Mod Based on the Servicer’s Unilateral Evaluation.* Fannie and Freddie require that their servicers review all borrowers for eligibility for a Flex Mod when a borrower is between 90 and 105 days behind in payments (they can also do this review again later at their discretion). The servicer performs this evaluation based solely on information from its own records, including a property valuation, your current interest rate, the amount of your arrearage, and the unpaid balance that you owe. The servicer does not need income or any other information directly from you to decide on your eligibility. Instead, it applies a formula to the information it already has.

If the result shows you are eligible, the servicer will offer you a trial modification plan that will lower your payments. After you make three-to-four required monthly trial payments, you sign a permanent Flex Modification agreement and your loan is modified so that your mortgage payments are reduced.

*The Flex Mod Based on Your Loss Mitigation Application.* You can also apply directly to your servicer for a Flex Modification using the Form 710 application. To qualify, the servicer must find that your hardship is not temporary and that you are at least 60 days in default or meet the “imminent default” standard if you are less than 60 days behind. You can apply for a Flex Mod as long as a foreclosure sale has not yet occurred. If you submit your initial complete application at least 37 days before a scheduled foreclosure sale, the foreclosure must be delayed.

*The FlexModification Terms.* With one exception which will be discussed below, the terms of a Flex Mod is the same whether you receive a unilateral offer from your servicer or apply for the modification yourself. The Flex Mod formula favors borrowers with little or no equity in their homes, and particularly borrowers who are underwater (meaning they owe more on the mortgage than the home is worth). The formula can also provide a significant benefit for borrowers whose interest rate is well above the current market interest rate. The servicer must offer you the modification if the modification reduces your payments.
The flex modification involves four changes to your loan terms. First the servicer adds your current arrearage to your unpaid principal balance, so that you repay your arrearage gradually each month over the full term of the loan. Second, as long as your equity in the home is less than 20% of the home’s current market value, the servicer reduces your interest rate to a current national market rate. Third, the servicer extends the repayment term of your loan to forty years from the date of the modification, thus reducing your monthly payments.

And fourth, you are charged interest only on part of the principal balance, called principal forbearance; the remainder of your loan principal is a zero interest loan. The smaller the portion of your balance that is subject to interest charges, the lower your monthly payment. You still owe the part of the principal that has zero percent interest and you must repay it eventually; also, this portion of the loan is still secured by your home. First, the servicer sets aside the amount of your outstanding principal on the loan that exceeds your home’s current market value. For that part of your principal, you pay zero percent interest.

After modifying your loan using the four steps described above, the servicer determines if the resulting payment of interest and principal reduces your payments by at least 20%. If not, the servicer may further reduce the interest-bearing principal to an amount equal to only 80% of the property’s current market value, further reducing your monthly payment. Nevertheless, no more than 30% of your principal can be charged zero interest.

**The Special Flex Mod Terms for Borrowers Who Submit an Application.** In a Flex Modification calculation available only for those who initiate the application process before the loan is 90 days overdue, the servicer targets a new payment (for principal, interest, and escrow) that is not more than 40% of the borrower’s gross household income. This is over and above any reduction created by the Flex Mod evaluation described immediately above.

**Options That Involve Giving Up Your Home.** If your servicer finds you are not eligible for other Fannie or Freddie loan modification options, it must then evaluate you for options that involve giving up your home. You may also want to consider these scenarios even though you qualify for an option that instead reduces or delays your mortgage payments. The major benefit of these options is that you can obtain the lender’s agreement not to pursue you later for a “deficiency” debt. The deficiency is any amount still owed on the mortgage debt after a foreclosure sale.

No one likes to give up their home, but there are options which involve giving up your home that are better for you if a foreclosure is otherwise inevitable. This is a hard decision, as it involves emotional as well as family and financial considerations. But sometimes not saving your home is the wisest financial move you can make, particularly if your house is worth substantially less than the combined amount of your mortgages.

On the other hand, moving may involve leaving your neighborhood, result in your children having to change schools, or require you and your partner to make a difficult commute. You will have to consider the costs and benefits of renting as well.

Fannie and Freddie may propose a “short sale” that offers you benefits if your home is worth less than the mortgage balance. In this scenario, you would sell your home yourself to a third party, usually through a realtor. Fannie or Freddie accepts the sale proceeds to satisfy your mortgage, even if the proceeds are less than the amount owed. Realtors, particularly those who have experience dealing with a particular servicer, may be able to negotiate the best terms for you. As a last resort, the servicer will consider a “deed in lieu of foreclosure” transaction, where you voluntarily transfer title to your property to the servicer in exchange for a release from your liability on the mortgage debt.

Servicers are authorized to provide relocation assistance up to $3,000 in connection with these options. In the “deed in lieu” scenario, there is also a short-term lease option available which can ease the move from the home.

Short sales and deeds in lieu are almost always poor choices if your home is worth significantly more than your outstanding mortgage balances. If you have to lose your home, it is far better to sell it on your own because you get to keep the amount by which the sale price exceeds the total of first and second mortgages on the home. But you have to act quickly before the home is sold in foreclosure. If you ask, the servicer is likely to give you a short delay in a foreclosure to let you sell the home yourself, but only if you already have made substantial progress toward a sale, such as a signed “purchase and sale” agreement.

If you have favorable mortgage terms, it might be attractive for the buyer of your home to assume your mortgage, that is take over your mortgage payments. A mortgage is assumable if the original loan documents say it is or, in most states, if the documents are silent on the issue. Other mortgages contain a “due-on-sale” clause, preventing assumption in most situations. But even then lenders cannot block certain transfers from parent to child or from one spouse to another. Lenders also may
voluntarily agree to an assumption even when the mortgage contains a due-on-sale clause.

You should apply for a short sale or deed in lieu of foreclosure by completing and sending the servicer the same Form 710 loss mitigation application, which prevents a foreclosure sale while your request is being considered. For both short sales and deeds in lieu the documentation requirements are less strict the further behind in payments you are. If your financial documentation shows that you have the ability to contribute funds to reduce the amount owed, the servicer can require that you make some contribution to reduce the debt before a short sale or deed in lieu can be approved. Be sure to get the terms of a short sale or a deed in lieu in writing, including any release from liability that the servicer agrees to give you.

Second mortgages and other liens against your property may create barriers to a short sale or a deed in lieu, because the new owner will not have clear title. However, Fannie and Freddie guidelines allow the servicer to advance you funds to get rid of small junior liens if this facilitates the transfer of the property.

**Tax Consequences of Short Sales and Deeds in Lieu.** Many short sales and “deeds in lieu of foreclosure” cancel part of your debt, which has tax implications since forgiveness of debt can be treated as taxable income in the year the forgiveness took place. Nevertheless, you will typically not owe any additional taxes. There are several common situations where the IRS will not count the discharged debt as income. Because tax issues are complicated, get help from a qualified tax professional.

Some lenders will still send an IRS Form 1099-C both to you and to the IRS any time they agree to forgive your debt. Do not ignore this Form 1099-C, but instead file IRS Form 982 with the IRS, attaching an explanation, if applicable, why the discharged debt should not count as income. You also will have to file the longer Form 1040 tax return.

**Source:** National Consumer Law Center, Surviving Debt [50th NCLC Anniversary Edition], updated at www.nclc.org/library

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