December 13, 2011

Is a Deed in Lieu of Foreclosure for You?

Foreclosures are rampant these days due to the economic recession. If you have defaulted on your mortgage and foreclosure seems inevitable, is there any option left? Yes, there is. You can file for a Deed in Lieu of Foreclosure (DILF). A DILF means you voluntarily surrender your property back to the lender and vacate the premises. This will save you the hassle of going through the foreclosure process and might be less detrimental to your credit score.

A DILF is usually initiated by the borrower. The lender may or may not agree to the DILF. A lender may reject a DILF proposal because accepting it might entail giving up on certain rights under a foreclosure like mortgage insurance claims. On the other hand, going ahead with the foreclosure would inevitably incur foreclosure expenses and may run the risk of property damage in the process of foreclosure. So these factors might cause the lender to agree to a DILF.

In any case, before agreeing to a DILF, the lender will ask the borrower to arrange and pay for an appraisal of the property and perform a title search. The search is to see if any other interested party has placed a lien on the property. In some situations, the lender may set aside the DILF if it discovers later that there were other liens against the property because the lender may not be interested in a DILF if the property lacks equity.

For the borrower, there are also pros and cons in a DILF. The pros are that you will not have to endure the embarrassment of a foreclosure. It is also usually a quick and straightforward process that does not entail lots of negotiation, unlike a short sale or loan modification. You could be over and done with your mortgage through a DILF in a matter of weeks.

On the other hand, although in theory your credit score should not be as adversely affected in a DILF as in a foreclosure, there is no guarantee. This is because when a DILF is granted, the borrower has already defaulted on the mortgage, which causes some credit damage. But unlike a foreclosure, a DILF should not affect your credit score that badly because the mortgage debt is resolved much faster with less missed payments.

The other con is that under a DILF, you the borrower would forfeit all your rights to the property, including whatever surplus there may be in the sale of it. In a foreclosure situation, if the property is sold at a price that is much higher than the amount of loan outstanding, the borrower may receive a portion of the sale price, something you would not enjoy if you go the route of a DILF.

Finally, a DILF would also require that the borrower pay the deficiency balance on the property, or the difference between the loan balance on the property and what the lender sold the property for. The lender has the right to waive the deficiency balance requirement and may choose to do so. But then you the borrower would have to pay taxes on the deficiency forgiveness.