



## ***The Foreclosure Process***

The foreclosure process can be triggered by a number of different defaults by the borrower. Typically, the borrower fails to make monthly installment payments or fails to make balloon payments which are due prior to total repayment of the note. Other violations may involve a sale of the Property by the borrower to a third party, which results in violation of a "due on sale" clause in the Deed of Trust.

Many times a borrower is also in violation of "covenants" within the Deed of Trust. These can include, for instance, the obligation to maintain fire insurance on the premises and the obligation to pay real estate taxes before they become delinquent. Less frequently, the owner of the Property may allow buildings to deteriorate, committing what is known as "waste" of the premises. Any one of the foregoing can constitute an "event of default" in violation of the Promissory Note or the Deed of Trust, allowing foreclosure.

### ***Judicial vs. Non-judicial Foreclosure***

A judicial foreclosure requires at least one year, as it was created to protect farmers from losing a crop on agricultural land. As you will read below, there is a difference between a judicial and non-judicial foreclosure regarding whether the lender has a claim against the borrower for a shortfall between the amount due and the net proceeds of the foreclosure action, called a *deficiency*. In most instances, the non-judicial foreclosure process is quicker and cheaper. The first thing to keep in mind is that a non-judicial foreclosure sale cannot take place on the courthouse steps until 190 days from the date a default first occurs. Even though there are other time requirements which will be discussed below (which appear to be shorter), the overriding requirement is that the actual sale cannot take place until the 190th day after the date the debtor first commits or suffers an "event of default." This time frame applies only to the non-judicial foreclosure of a Deed of Trust.

In certain situations it may be appropriate to file a court action called a "Judicial" or "Mortgage" foreclosure instead of proceeding with the less expensive and less cumbersome non-judicial proceeding. If the borrower is damaging the property (committing waste) or is in some other way destroying the market value of the property, fast action must be taken through judicial proceedings, although the sale process takes longer and is more cumbersome.

If the lender is concerned that the value of the property may be less than the amount of the debt, they should consider the foreclosure by judicial means, as that process will allow them to recover any *deficiency* on the sale of the property directly from the debtor. Basically, this allows them to proceed with personal recourse against the debtor individually, instead of just relying on the value of the property as the basis for recovering the amount due on the loan.

### ***Notice of Default***

If the defaults under the Promissory Note are simply a failure to pay installment payments or taxes, the lender may wait 70 days before starting a non-judicial foreclosure. Typically, if they wait until there are two months of default in payment and then contact the attorney to commence the foreclosure, they will have waited sufficient time to meet the time frame requirements of the statute.

The first step in the foreclosure process is the issuance of a "Notice of Default." This notice is sent only to the debtor who owes the money and any person who may have requested special Notice of Default or foreclosure by recording such a request with the county Auditor or providing notice to the lender. Generally, the Notice of Default should not be sent to any subordinate lien creditors such as second mortgage companies, judgment debtors, etc. The Notice of Default tells the borrower the specific violations of the Promissory Note or the Deed of Trust which have been committed. The borrower may be told that they have failed to pay several years of property taxes, failed to maintain fire insurance, failed pay installment payments or committed a violation of the "due on sale" clause. The debtor is given the opportunity to cure the defaults for a period of 30 days from issuance of the notice.

### ***Notice of Trustee's Sale and Notice of Foreclosure***

Thirty days following giving notice of default to the debtor, if the debtor has not cured the defaults, a Notice of Foreclosure and Notice of Trustee's Sale are issued by the Trustee. Prior to the issuance of these notices, the attorney will require that the lender sign an Appointment of Successor Trustee" which, when recorded, designates the attorney as the substitute Trustee under the Deed of Trust. This gives the attorney the ability to act directly in the foreclosure process. The Notice of Trustee's Sale and Notice of Foreclosure are sent to the debtor, as well as anyone shown on the title as having an interest in the property which is subordinate to or arises out of the debtor's interest in the property. This notice would go to anyone who is owed money by the debtor who has a judgment of record, any second mortgage lender, mechanic's lien claimants, public utilities having liens against the property such as sewer and garbage liens, etc. The notice will state that the property will be sold on a date at least 90 days from the date the notice is mailed. This sale takes place on the courthouse steps in the county where the property is located. The property is sold to the highest bidder. The debtor has until 11 days before the sale date to bring the defaults current by paying the back payments, late charges, taxes, insurance, foreclosure costs, etc. to the lender. After the 11th day before the sale expires, then the debtor must pay to the lender the entire balance owed under the Promissory Note. This includes ***all the principal and interest***, together with other fees, costs, etc. Approximately one month prior to conduct of the trustee's sale, a notice must be published twice in the newspaper. The cost of publishing the notice is part of the expenses recoverable from the debtor.

### ***Trustee's Sale***

If the debtor has not cured the defaults or paid the debt in full prior to the sale date, the Trustee or agent will go to the courthouse and orally auction the property on the courthouse steps to the highest bidder. Many times no bidder appears at the sale because purchase of the property is not economically feasible. Sometimes there is sufficient value to make it worthwhile for a third party to bid. This does not mean that the lender will not recover all that they are owed. Typically, people that bid at foreclosure sales are looking to make a substantial profit on their investment. They must recover their cost of sale and the cost of any improvements that have to be made to the property, etc. The lender is usually in a position to recover their money without incurring the expenses that a third party would. If a third party bids at the sale, the lender is repaid first. If the bid is in excess of the amount owed to the lender, then the excess proceeds will be paid into the registry of the Superior Court for disbursement to subordinate claimants or the property owner, depending on the priority of claims to the money. This is not the concern of the lender. Following conduct of the sale, the trustee will issue a deed to the successful bidder and the property will be titled in the name of the bidder. Twenty days following the sale the successful bidder is entitled to possession of the property and can remove the occupants through the landlord/tenant process known as an "unlawful detainer." This is an expense separate and apart from conducting the foreclosure process. People who lose property in the foreclosure process will usually, but not always, vacate the premises voluntarily.

### ***Payment of Fees and Costs of Foreclosure***

While the debtor is ultimately responsible to pay the fees and costs of foreclosure, the lender is responsible to advance these fees and costs to the attorney with the expectation that these fees and costs will be recovered from the debtor. The attorney handling the foreclosure will order a title report in order to determine the status of taxes and verify the parties in title to the property. In the event the debtor does not cure the defaults and the property goes to foreclosure sale, the lender will recover these funds at the foreclosure sale or a subsequent private sale, if the lender is the successful bidder at the sale. If the lender is the successful bidder at sale, they will receive a Deed to the property. They may then sell the property to recover their investment.

### ***What if the Borrower Declares Bankruptcy?***

Just as there is nothing sure in life except death and taxes, there is no guarantee that a lender will be able to complete a foreclosure in the event of default by a debtor. The debtor has the ability to file bankruptcy under Chapter 7, 11, 12, or 13 of the Bankruptcy Code. A Chapter 7 is a full liquidation of the assets of the debtor and complete discharge of their obligations. Typically, this takes about 4-1/2 months to complete. The foreclosure process is stopped by an order which prevents all creditors from collecting debts during the bankruptcy. This order is called the Automatic Stay in bankruptcy. The only way to proceed then is to get relief from the court-ordered automatic stay. Many times it is not cost effective to get relief from the Stay and, instead, one just waits out the time frame until the bankruptcy is over. If the debtor files a

Chapter 11 or 12, it may be appropriate to obtain relief from the automatic stay if the property is not necessary to the debtor's reorganization of their business or farming operation. **Keep in mind that if the collateral is properly secured, the lender ultimately will be paid: it just takes longer to complete the process.** Consult an experienced bankruptcy or real estate attorney knowledgeable in these matters for advice. Unfortunately, if you are the creditor in a Chapter 11 bankruptcy, you may wait a substantial period of time before recovering your investment. This can also be true in a Chapter 13 which is a small creditor "orderly payment of debt" program. Some bankruptcy attorneys tend to be slow and "do-it-yourself" bankruptcies are even slower. Investigation into the borrower's background through use of credit reports, financial statements and personal references before making a loan or buy a "contract" are the keys to avoiding a debtor's bankruptcy.

### ***What if the Homeowner's Insurance is cancelled?***

One of the most overlooked defaults concerning residential and commercial property is that of homeowner's insurance. Many times, when the debtor is in financial trouble, they fail to keep their homeowner's insurance in force. The consequence, of course, is that the collateral is no longer insured. If it burns down, the lender is left only with the land to recoup their investment. It is imperative that the lender make sure that the debtor keeps the property insured and that they arrange to receive notice from the debtor's insurance company of any cancellation of homeowner's insurance. Usually one can obtain a 30-day notice prior to cancellation so that there is an opportunity to make sure the homeowner's insurance premium is paid. The Deed of Trust or Real Estate Contract should have a provision requiring the borrower to list the lender on the insurance as an "Insured Mortgagee." The lender can recover the funds advanced for payment of homeowner's insurance, usually with interest, as part of the foreclosure process. Just be sure to keep the borrower's building insured to protect the collateral.

### ***What if the Debt is Larger than the Property Value?***

If the property is worth less than the amount of the loan, this is referred to as a *deficiency*. If the lender has been careful in lending money based on the value of the property, the loan to value ratio (LTV) will be sufficient to protect from any downturn in the real estate market. Even after careful analysis, sometimes property values drop and a property will be worth less than the amount owed to the lender. If there are any questions about this issue, it is wise to obtain a real estate broker's opinion or full appraisal of the property before commencing a non-judicial foreclosure. If the amount of the debt and the market value of the property are close, it may still be wise to complete the nonjudicial foreclosure since the speed and low cost will allow the lender to cut its losses and move on. On the other hand, if the deficiency is so great it may be wise to seek a judicial mortgage foreclosure so that the property can be sold and the debtor can be held liable for any short-fall following sale of the property.

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