LOAN DEFAULT AND FORECLOSURE:
A BRIEF GUIDE FOR CALIFORNIA HOMEOWNERS

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This guide is designed to help homeowners understand the options available to them in foreclosure. It describes the foreclosure process, the documents homeowners may expect to receive in foreclosure and highlights some of the important options and considerations home-owners must be aware of when their home is threatened by foreclosure.

Actions You Can Take to Save Your Home If You Are Behind or Not Able to Pay Your Mortgage

It is important to know that your mortgage company would always prefer to keep you in your home rather than foreclose. They are in the business of providing mortgages, not owning or selling homes. It is in your best interests to talk to a counselor, a lawyer, or contact your mortgage company directly so you can keep your home.

Talk to a housing counselor.

Look for a **HUD certified counselor.** The Department of Housing and Urban Development has trained and certified loan counselors who will assist you **free of charge** and can negotiate with the mortgage company's representative or "servicer" on your behalf. Servicers are often permitted by the agreements governing loans to renegotiate your loan terms, a process known as "work-out" or "loss mitigation." This process may reduce your monthly payments, give you a few months without loan payments, delay payment of arrears or make it possible to otherwise change the payments on your home loan.

The Department of Housing and Urban Development's Web site, www.hud.gov/foreclosure, has a nationwide directory of counseling agencies, or you can call them at (800) 569-4287. **Services are free.** Advice is also available at the **Homeowner's Hope Hotline** at (888) 995-HOPE.

Contact a lawyer.

If you were misled or not fully informed by a broker or mortgage company about the terms of the loan, you might be able to "rescind" (cancel) the loan. You may also be entitled to damages. If you cannot afford a lawyer, call your local **Bar Association or Legal Aid** office and ask them to refer you to a lawyer.

Contact information for local **Legal Aid Societies** can be found at www.dca.ca.gov/publications/guide/legal_index.shtml.

Call your mortgage company.

Ask for the "loss-mitigation" or "work-out" department and try to modify the loan terms. Be smart about modifying your loan. Many properties are worth less than the mortgages they secure; is it in your best interests to keep a property that is worth less than your mortgage? Be realistic about whether you can make the "modified" payments. Keep in mind that most modification documents contain a "waiver". That means when you sign the modification documents you give up any legal rights you may have and you give up the right to take your mortgage company to court. **Before you sign anything, take the papers to a lawyer or counselor to be sure you fully understand what you are signing.** It is a legal document and you will be bound by the terms in the modification agreement.

How Mortgages in California are Foreclosed

Foreclosures vary from state to state. The following information will help you to understand the California foreclosure process.

California is known as a Title Theory state where the mortgage company (i.e. bank) holds the title to the property while you live on the land and continue to make mortgage payments. The document that secures the title is usually called a "deed of trust" but may also be referred to as a mortgage. California has a complicated set of rules concerning foreclosures. The entire foreclosure process is described below.

How are mortgages in California foreclosed?

In general, foreclosure means that when you miss a payment or two, the bank sends an official notice that you are in the foreclosure process. Then you have a period of time to cure the deficiency. If you cannot do that, the mortgage company pursues foreclosure through either judicial or non-judicial means. An auction is then held and the property is sold to the highest bidder.

The primary method of foreclosure in California involves what is known as **non-judicial foreclosure**. This type of foreclosure does **not** involve court action. When the deed of trust/mortgage is initially signed, it will usually contain a provision called a power of sale clause. This allows the trustee (usually a title company) to sell the property to satisfy the defaulted loan. The trustee acts as a representative of the mortgage company to sell the property, which typically occurs in the form of an auction.

California has a requirement known as the one-action rule. If a foreclosure is completed by non-judicial means (outside of court), then the mortgage company cannot pursue a second action against you if the auction proceeds do not meet the amount due on the property.

If a foreclosure is **judicial**, the house may be sold and a separate judgment may be obtained against you for the remaining balance due on the loan (up to the full amount of the loan plus foreclosure costs) if the auction proceeds do not meet the balance due on the property.

Most loans are foreclosed using non-judicial foreclosure, but a mortgage company has the option of using judicial foreclosure. Since this process takes longer than non-judicial foreclosure, it is rarely used. In California non-judicial remedies have stringent notice requirements and the mortgage documents are required to contain the power of sale language in order to use this type of foreclosure method.

Key Points in the Foreclosure Process

Missing one or more mortgage payments means you are in default.

If you miss one or two payments, a mortgage company will usually contact you to demand payment and may offer to modify the loan. *This is a good time to consult a counselor or lawyer and ask them to negotiate with the mortgage company.*

Receiving a Notice of Default.

If you do nothing in response to the mortgage company's attempts to contact you, or you cannot come to an agreement with them, the mortgage company generally sends a further notice advising that they are declaring a "default" of the loan obligations. The official notice is called the **Notice of Default** and is filed with the County Recorder's Office by the trustee (usually a title company). A copy must be mailed to you. The Notice of Default must spell out the specific breach of contract. If you want to know whether a Notice of Default has been filed against your property, consult with the County Recorder in the County where the property is located. All interested parties must be served and notified of the foreclosure.

The filing of the Notice of default begins the **Reinstatement Waiting Period**, which is **90 days**. This is the time period that you get to cure the debt by paying off all overdue payments (i.e. bringing the mortgage current).

Selling the property - Notice of Trustee's Sale.

After the 90 day Reinstatement Waiting Period is up, the Trustee has the obligation to do a final check to see if the deficiency has been cleared. After this check, a **Notice of Sale** of the property can be issued and you must be served with this notice. The Notice of Sale must be published once per week for a period of at least 20 days. The Trustee is also obligated to post in a conspicuous place on the property and in at least one off-property place, a sign notifying the public of the upcoming sale. After the 20 day Publication Period is up, the auction for sale of the home can be held.

As stated earlier, the Trustee does not have to go to court to have the right to sell the property. The sale is an auction and the property is sold to the highest bidder. If anyone other than the beneficiary (mortgage company) purchases the property, they must have cash in hand.

The laws that govern California foreclosures are found in California Civil Code, Section 2924. To view these statutes on the Web, you can visit: http://www.leginfo.ca.gov.

If the property is foreclosed through the court system in a judicial foreclosure, there is a right of redemption period after foreclosure. However, foreclosures that are non-judicial have **no** period of redemption in California. Most foreclosures in California are non-judicial, so more often than not, **once the sale of the defaulted property is complete, the sale is final.**

California Foreclosure Timeline

Day 1-Day 90	Day 91-Day 110	Day 111 or more
Redemption Period	**Publication Period**	**Trustee's Sale**
Lasts 90 days from the recordation of the Notice of Default	Lasts 20 days from the end of Redemption	Held 21 days after first publication

After the property is sold at the Foreclosure Sale.

Whoever owns your home cannot just change the locks to the home. The new owner must serve you with a 3-day written notice to quit, and then must take you through the formal eviction process in order to get possession of the property. That process takes about 30-45 days.

If someone knocks on your door and tells you to get out, do not panic. No one has the right to simply tell you to leave without going through the formal eviction process. If you feel threatened or unsafe, do not answer your door, or call the police. The new owner must follow the formal legal process and evict you in order to have you leave.

Alternative Options to Foreclosure

Contact your existing mortgage company

As stated earlier, the first thing you may want to do is contact your existing mortgage company. Some mortgage companies are willing to work with those who have fallen behind on their payments and have defaulted on their loans.

Forbearance

Like a payment plan, forbearance is an agreement between you and the mortgage company that reinstates the delinquent loan through the payment of a lump sum or a schedule of payments over a period of time. If you are behind on your payment by $2,000, for example, the mortgage company may allow you to pay the money back through installment payments over six months. The mortgage company may decide, on the other hand, to allow you to pay a reduced monthly payment until you have an opportunity to get back on your feet and pay any remaining arrearages in one lump sum. Generally, these agreements will not exceed more than 12 months, but before you sign anything, consult with a lawyer or counselor.

Deed in Lieu of Foreclosure

A deed in lieu of foreclosure is an alternative where you voluntarily give up the property title to the mortgage company. Generally, this is a last ditch effort to avoid the negative consequences of foreclosure. Here, you tell your mortgage company that they do not need to bother with the formalities of a foreclosure proceeding because you will simply turn over your title to the property rather than lose it. This is sometimes known as a "friendly foreclosure" because it is a mutual agreement between you and the mortgage company and is not forced upon you by use of the power of sale.

The advantage of the deed in lieu of foreclosure is that it lessens the damage to your credit history. Although it is not nearly as good as paying off the note on time, it is better than a foreclosure. The mortgage company will still report the surrender to credit rating agencies, which will significantly lower your credit rating, but you can point to the surrender to indicate to future lenders that you acted responsibly upon realizing that you would be obliged to default on your note.

Short Sale

When the mortgage company agrees to do a short sale in real estate, it means they are accepting less than the total amount due. Not all mortgage companies will accept short sales or discounted payoffs, especially if it would make more financial sense to foreclose; moreover, not all sellers nor all properties qualify for short sales. A short sale means your mortgage company is accepting a discounted payoff to release an existing mortgage. Just because a property is listed with short sale terms does not mean the mortgage company will accept your offer, even if you accept it.

Be aware that you need not be in default -- to have stopped making mortgage payments -- before a mortgage company will consider a short sale. A mortgage company may consider a short sale if you are current on your payments, but the value on your home has fallen. You may have over-encumbered (owe more than the home is worth), so a discounted price might bring the price in line with market value, but will not bring the loan to a price below market value. A short sale negatively affects your credit, but it is not as bad as foreclosure.

Can a Bankruptcy Help Save My Home?

Talk to a lawyer or counselor about the benefits and drawbacks of filing for bankruptcy. Filing bankruptcy should be considered with great care. It stays on your record for up to 10 years and can have significant negative impact on your life for this duration.

The filing of bankruptcy triggers an automatic stay which stops all creditors from any action to collect their claim while the bankruptcy is pending. This will temporarily stop foreclosure in most cases. Nevertheless, a foreclosure may still continue in limited situations such as when multiple bankruptcy cases have been filed in a row or if the property was transferred to your name immediately prior to filing.

The biggest mistake that people make is waiting until a few days prior to the foreclosure sale date to look into bankruptcy as an option. The best time to consult with a bankruptcy attorney is either before or early on during the Notice of Default period.

The most typical Chapter to file to stop a foreclosure is a **Chapter 13**, because you can propose a plan of repayment that catches up on the past due amounts you owe to your mortgage or other lenders against your home, over a 36 to 60 month period.

You can file for bankruptcy on your own or with a lawyer. The first option is cheaper, but some individuals are making errors in the process and not getting approved, then they often have to wait several months before they can reapply.

Hiring a lawyer can help ensure an accurate filing, but charges for filing a bankruptcy can be steep. If you are considering bankruptcy and using a lawyer to file, ask the lawyer what you may expect as the outcome if you file for bankruptcy and then ask the lawyer to put his fees in writing. Depending on your unique situation, a bankruptcy might just end up being a costly delay of the inevitable loss of your home.

What are the Tax Implications of Default and Foreclosure?

Until 2007, homeowners who lost their homes in foreclosure or modified their loans were often shocked to learn that they owed taxes on the home they had lost. In 2007, the federal government passed the Mortgage Forgiveness Debt Relief Act of 2007 which generally allows taxpayers to exclude income from the discharge of debt on their principal residence. Debt reduced through mortgage restructuring, as well as mortgage debt forgiven in connection with a foreclosure, qualifies for this relief.

This provision applies to debt forgiven in 2007, 2008 or 2009. Up to $2 million of forgiven debt is eligible for this exclusion ($1 million if married filing separately). The exclusion does not apply if the discharge is due to services performed for the mortgage company or any other reason not directly related to a decline in the home's value or the taxpayer's financial condition.

Keep in mind that the Debt Forgiveness Act of 2007 pertains to federal income taxes only. The State of California has a mortgage debt forgiveness program too, but it differs from the federal law. **Please consult a tax professional for advice on federal or state tax law**.

If you are having difficulty resolving a tax problem (such as one involving an IRS bill, letter or notice) through normal IRS channels, the Taxpayer Advocate Service may be able to help. For more information, you can also call the TAS toll-free case intake line at 1-877-777-4778, TTY/TDD 1-800-829-4059.

In some cases, you may qualify for free or low-cost assistance from a Low Income Taxpayer Clinic (LITC). LITCs are independent organizations that represent low income taxpayers in tax disputes with the IRS. Find information on a LITC in your area at http://www.irs.gov/advocate/content/0,,id=151026,00.html.

Look out for Mortgage Foreclosure Rescue Scams

Foreclosure rescue fraud is sweeping the country and can end up costing you the home you are desperately trying to save from foreclosure.

Some of the fastest growing frauds sweeping the nation are foreclosure rescue scams. These scams involve thieves who steal people's homes and equity after promising to help save their homes from foreclosure.

Public notices of foreclosure proceedings usually trigger mail, phone, and even door-to-door solicitations.

You should steer clear of any company that initiates such contact, demands a fee before providing services, or advises cutting contact with the mortgage company, which can delay legitimate options for preventing foreclosure proceedings.

Foreclosure rescue scams usually fall into one of the following four categories:

1) Phantom help

In this scam, the supposed rescuer charges very high fees for basic phone calls and paperwork that you can easily do yourself without any assistance. Or, the rescuer will make promises to represent you, but will not follow through. This is really a "too little too late" scam as in the helpless homeowner receives too little (or no) help that is too late to stop the foreclosure from taking place.

2) Bailout

Here the scammer claims to assist you by promising you can stay in the house as a renter and buy the house back once things have been "fixed" if you transfer the title of the house to the scammer. The way the scammers get the house varies, but each method ends with you not being able to buy the house back and the supposed rescuers get most, if not all, of the equity.

3) Bait and switch

The bait and switch with foreclosure scams involves signing away the ownership of your home. The scammers will tell you that they are signing documents for a new loan that will solve your problems. In reality, you may be signing **forged documents** that will give the crooks ownership of your home. To make matters worse, you will still be liable for the mortgage even though you no longer own the home.

4) Bankruptcy Foreclosure

The scammer may promise to negotiate with your mortgage company or to get refinancing on your behalf **if you pay a fee up front**. Instead of contacting your mortgage company or refinancing your loan, the scammer instead pockets the fee and files a bankruptcy case in your name, and sometimes without your knowledge. A bankruptcy filing often stops a home foreclosure, but only temporarily. The bankruptcy process is also complicated, expensive and unforgiving. For example, if you fail to attend your first meeting with the creditors, the bankruptcy judge will dismiss the case and the foreclosure will continue. If this happens, you could lose the money you paid to the scammer and *still* lose your home on top of it. Too make matters worse, a bankruptcy stays on your credit report for ten years and can make it very difficult to get a job, get life insurance, buy a car, rent an apartment or buy a home.

Red Flags – If you're looking for someone to help prevent a foreclosure, be sure to avoid any businesses that…

- *Guarantees* to stop the foreclosure process, no matter what your circumstances.
- Tells you not to contact your mortgage company, lawyer or credit or housing counselor.
- Collects a fee before providing you with any services.
- Accepts payment only by cashier's check or wire transfer.
- Encourages you to lease your home so you can buy it back over time.
- Tells you to make your mortgage payments directly to them instead of your mortgage company.
- Tells you to transfer your property deed or title to them.
- Offers to buy your house for cash at a fixed price that is not set by the housing market.
- Offers to fill out paperwork for you.
- Pressures you to sign paperwork you have not had a chance to read or that you do not understand.

Foreclosure is difficult enough without scams being involved in the process. Follow these do's and don'ts.

- **Do not** bury your head in the sand. The problem will not go away, and will only get worse if you ignore it.

- **Do** make sure that you are in foreclosure. If you are behind in payments, you will receive what is called a **deficiency notice**. These letters notify you of your delinquency and give you a chance to resolve the debt. If you receive a Notice of Trustee's Sale, or similar document, you are in foreclosure.

- **Do** speak with your mortgage company. Try to work with your mortgage company to restructure the payments or refinance the loan.

- **Do** learn the laws regarding foreclosure for your state. It is important to know how much time you have to resolve the issue.

- **Do** contact a counseling agency. This is often too big of an issue for a person to handle on his or her own. Make sure that the counselor is certified by the Department of Housing and Urban Development (HUD). Their website is www.hud.gov.

  Be careful when choosing a counselor and pay attention to the certification requirement recommended above. **You should not have to pay for legitimate housing counseling.**

- **Do** contact an attorney. You can find one through the National Association of Consumer Advocates (www.naca.net) or by contacting your local Bar Association. Homeowners in the Bay Area can contact www.sfbar.org/lawyerreferrals/index.aspx or call Community Legal Services in East Palo Alto at (650) 326-6440. Assistance is also available in Spanish.

- **Do not** sign a contract under duress. Always request to take time to review any documents on your own and at your own pace. Do not sign a document that you do not understand.

- **Do not** enter into oral agreements. Get in any offers in **writing** and tell whoever is making the offer that you and/or your representative will review any and all offers.

- **Do not** make payments to any party other than your mortgage company.

- **Do not** sign a home-sale contract where you are not released from your existing mortgage.

- **Do not** sign a quit claim deed without being specifically instructed by your attorney or representative to do so. Do not agree to any deal that allows you to rent the property and then buy it back at a later date.

- **Do not** accept an offer from somebody who wants to make good on your missed payments and take the house off your hands in exchange for documents that assign them the surplus from the foreclosure sale. Think about it, if you owe $200,000 on your mortgage, plus arrears of $10,000, and your house is worth $250,000, you stand to make money on a sale.

Frequently Asked Questions

Q: What happens after I miss a loan payment?

Generally, the first thing a mortgage company will do is telephone you or write to offer you help. They may telephone or write and demand that you pay the loan arrears and penalties. Keep in mind that these calls and letters are designed to collect money for loan payments and the mortgage company or his agent will use collection tactics. STAY CALM. If you are limited English proficient, ask for an agent that speaks your language. The Fair Debt Collection Practices Act imposes rules on debt collectors; they may only telephone you between the hours of 8 a.m. and 9 p.m. local time, the caller may not make repeated calls to annoy you and *may not use profane language or threaten you. If you want to stop the calls, you may write to the mortgage company and invoke your right to get notices only in writing***.** *If you think the caller has violated these rule, consult a lawyer.*

Q: Am I exposed to a Deficiency Judgment on my mortgage after foreclosure of the first mortgage?

As noted above, California allows a mortgage company to choose to proceed with a judicial or non-judicial foreclosure. If the mortgage company uses non-judicial foreclosure (does not take you to court) the mortgage company gives up the right to collect any additional money from the homeowner even if the money obtained in the foreclosure sale does not cover the full amount of the underlying loan.

In a Judicial foreclosure the mortgage company takes the homeowner to court and can get the property and a money judgment up to the full amount of the debt plus costs.

Q: Am I exposed to a deficiency Judgment after foreclosure on the second mortgage?

If the second or junior mortgage is a "purchase money" mortgage (one that you got to purchase the property originally) the second mortgage is extinguished. ALL purchase money mortgages, whether first or second loans, are extinguished in a foreclosure.

If you have refinanced your home after the original purchase mortgage and have a second or junior mortgage, the mortgage company on the second mortgage can go to court and seek a judgment for the amount of the second mortgage. This means that if you have a junior or second mortgage and go through foreclosure of the first mortgage, you may still be liable for the full amount of the junior mortgage.

Q: What is my exposure to taxation if I reform my loan or go through foreclosure?

Because tax issues are complicated and vary so much depending on the circumstances, it is best to ***seek guidance from a tax professional***. *The Debt Forgiveness Act of 2007 does provide some relief to taxpayers in foreclosure. Please keep in mind that while the federal Internal Revenue Service has provided tax relief to homeowners in foreclosure, the State of California has not done so at the time this Guide was printed. You may be liable to the State of California for income taxes..*

If you owe property taxes on your home and the property is foreclosed. You do not have to pay the property tax.

Q: Can I go to jail for failing to pay my mortgage?

NO! But, in some circumstances described in this Guide, the lender or someone whom the lender has given the claim to may get a judgment against you and collect money by attaching property or bank accounts in your name and may garnish or attach your wages, collecting a percentage of your wages for each pay period.

Q: Will a default, short sale, or foreclosure damage my credit and if so, to what extent?

Yes. All of these will severely damage your credit but, the damage can be mitigated and you can rebuild your credit. It is hard to do this on your own and free assistance is available through Consumer Credit Counselors of California. If you are experiencing money troubles, call 800.777.7526 or email info@cccssf.org.

Q: After my house has been sold in foreclosure, how much time do I have to move?

This question is difficult to answer because there are many variables. However, a new owner cannot force you to move out by threatening you or telling you to leave the property. The new owner must go to court and seek a judgment of possession – that means the Court, in a written document, must say that you have to move out. If you get any papers telling you to move, don't panic. In most cases you will have six weeks or more to move out. Tenants in properties that have been foreclosed have special rights and should consult a lawyer if they are asked to move or served with legal papers.

Q: Whom should I contact if I think I've been taken advantage of by a foreclosure rescue scammer?

- *Contact a housing counselor*
- *Contact a private attorney or your local Legal Aid office (See information on Page1)*
- *Contact your local Better Business Bureau*
- *Contact the Federal Trade Commission at 1-877-FTC-HELP*

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