FORECLOSURE 101

I. Basic Non-Judicial/Foreclosure By Advertisement Process

A. Overview of Non-Judicial Foreclosure

- Foreclosure by power of sale, also known as non-judicial foreclosure, is authorized by many states if a power of sale clause is included in the mortgage or if a deed of trust with such a clause was used, instead of an actual mortgage.

- In some states, like California, nearly all so-called mortgages are actually deeds of trust. This process involves the sale of the property by the mortgage holder without court supervision (as elaborated upon below).

- This process is generally much faster and cheaper than foreclosure by judicial sale. As in judicial sale, the mortgage holder and other lien holders are respectively first and second claimants to the proceeds from the sale.

B. Procedure

- Procedure beings by giving the borrower a notice of default (NOD) and the mortgagee's intent to sell the immovable property in a form prescribed by state statute. This may be in addition to or concurrent with a Notice of Acceleration letter required by the underlying mortgage or deed of trust.

- The NOD in some states must also be recorded against the property.

- If the borrower fails to cure the default, or use other lawful means (such as filing for bankruptcy to temporarily stay the foreclosure) to stop the sale, the mortgagee or its representative are typically required to publish a notice of foreclosure with the sale date prior to the foreclosure sale.

- After the prescribed period of notice, a public auction similar to the sheriff's auction is held. Notably, the lender itself can bid for the property at the auction, and is the only bidder that can make a "credit bid" (a bid based on the outstanding debt itself) while all other bidders must be able to immediately present the auctioneer with cash or a cash equivalent like a cashier's check.

- The highest bidder at the auction becomes the owner of the property, free and clear of interest of the former owner, but possibly encumbered by liens superior to the foreclosed mortgage (e.g., a senior mortgage or unpaid property taxes).

- Some states provide for a period of redemption following the foreclosure sale in which the borrower has a period of time (anywhere from weeks to a year or more) to pay the winner of the foreclosure sale the amount of the winning bid plus allowed costs (interest, fees, taxes or association dues paid etc).

- If borrower redeems, the foreclosing mortgage is satisfied but borrower takes property back subject to any other liens.

- Further legal action, such as an eviction, may be necessary to obtain possession of the premises if the former occupant fails to voluntarily vacate.

II. <u>Starting the Foreclosure – Non-Judicial Process</u>

A. Required Documentation

- At a minimum, the following documents are required for a Foreclosure by Advertisement: 1) Mortgage/Deed of Trust; 2) Loan Payoff Information; 3) Borrower information (for Bankruptcy and SCRA searches); 4) Notice of Default and/or Acceleration if sent by Client.

- Other recorded documents such as deeds, assignments of mortgages/deeds, other recorded interests, etc. are pulled when the foreclosure attorney has a foreclosure title commitment prepared.

- Promissory note is somewhat less important in non-judicial states which do not require the note to be produced as part of the foreclosure process, but should be forwarded as a matter of course if loan becomes litigated.

B. Why Are These Documents Required?

- The mortgage and the related documents should be carefully reviewed prior to starting any foreclosure process.

- The mortgage and all assignments must be reviewed with particular attention given to the following clauses: (1) power of sale, (2) notice requirements, (3) acceleration, (4) property description, (5) promissory note, (6) proper execution by the parties (7) whether all necessary parties executed the documents and (8) proper recording.

- A mortgage without the power of sale clause cannot be foreclosed by advertisement and may only be foreclosed by judicial proceedings.

- A title search or commitment is necessary to determine whether any liens or other encumbrances have been recorded against the property or against the mortgagors, i.e., state or federal tax liens, mechanics liens or notices of lis pendens.

- If there are any notices of federal tax liens, but proper notice of the foreclosure proceedings was not given to the IRS, the foreclosure will not be valid against the IRS, and when the redemption period expires and the mortgagee becomes the title holder, its title will be subject to those liens.

- In order to commence foreclosure proceedings, there must be a default of one of the terms contained in the mortgage.

- The terms of the mortgage dictate whether a mortgagee can immediately commence foreclosure proceedings or if there are other requirements that may exist such as: (1) Requirement that the mortgagee submit a notice of default letter; (2) Requirement to allow mortgagor the opportunity to cure the default; (3) Requirement to accelerate the indebtedness.

- Many non-judicial states (if not all) require that an Assignment of Mortgage to be recorded prior to the foreclosure sale if the party foreclosing a mortgage by advertisement is not the original mortgagee.

III. <u>Effects of Bankruptcy on the Foreclosure</u>

A. Overview of Filing of Bankruptcy and Automatic Stay

- Bankruptcy Code § 362 imposes the automatic stay at the moment a bankruptcy petition is filed.

- The automatic stay generally prohibits the commencement, enforcement or appeal of actions and judgments, judicial or administrative, against a debtor for the collection of a claim that arose prior to the filing of the bankruptcy petition.

- The automatic stay also prohibits collection actions and proceedings directed toward property of the bankruptcy estate itself.

- A secured creditor may be allowed to take the applicable collateral if the creditor first obtains permission from the court. Permission is requested by a creditor by filing a motion for relief from the automatic stay. The court must either grant the motion or provide adequate protection to the secured creditor that the value of their collateral will not decrease during the stay.

- As the automatic stay is in effect the instance the Debtor's petition is filed, any action taken against the Debtor with respect to the property are generally treated as void and therefore have no legal effect (such as proceeding with a foreclosure sale)

- Damages are generally awarded for intentional violations of the automatic stay. There is a provision which limits damages to actual damages where a Creditor shows they were acting in good faith. There is no presumption of good faith if a Creditor ignores actual notice.

B. Automatic Stay and Abusive/Repeat Filers

- ONE PRIOR FILING-The automatic stay will terminate 30 days after the petition filing date if within one year prior to the filing, Debtor had a dismissed bankruptcy under Chapters 7, 11, or 13. § 362 (c) (3)

- TWO OR MORE PRIOR FILINGS-There is NO automatic stay if within one year prior to filing, Debtor had two or more dismissed bankruptcies under Chapter 11 or 13. §362(c)(4).

- The time tolls from the date of dismissal of the case, as opposed to the date the case was closed.

- A debtor must file a Motion to extend stay under §362(c)(3)(b). The motion must allege good faith in the new filing and facts sufficient to rebut any presumption of bad faith. The Motion must be filed and served so as to allow the court to enter an order granting the Motion within 30 days of the case filing.

- As for a motion to impose stay under §362(c)(4)(B), the debtor must file the Motion within 30 days of the case being filed, but the court is not required to rule on the Motion within that 30 day period to take effect.

C. Discharge Injunction

- A Debtor's discharge is a statutory injunction against the commencement or continuation of an action to collect, recover or offset a debt as a personal liability of the debtor.

- The discharge is one of the primary benefits afforded by relief under the Bankruptcy Code.

- The Creditor now has 28 days to object to a trustee's notice of plan completion of payments in a Chapter 13.

- A Debtors order of discharge sets forth that the mortgage obligation be current with no outstanding escrow.

- Commencing foreclosure proceedings following a debtor's discharge is only an action on the mortgage and not the promissory note (i.e. personal liability) so the discharge injunction is not violated.

D. Delays to the Foreclosure After Bankruptcy Filed

- Following the termination of a Bankruptcy (either through a Motion for Relief, Discharge or Dismissal of the Bankruptcy case), the foreclosing entity will usually need to "pick back up" where the foreclosure left off.

- Depending on whether the foreclosure is judicial or non-judicial, this may mean re-publishing the foreclosure notice, re-noticing the foreclosure sale, obtaining a judgment of foreclosure again or restarting the entire process.

- A Bankruptcy filed during a redemption period will extend the redemption period for 60 days in any jurisdiction with a redemption period.