An Overview of Foreclosure

ARAG

While the rising number of foreclosures is an alarming national trend, the real hardship is for any individual or family who knows the threat of foreclosure firsthand. Unfortunately, many homeowners are already stretched financially – and job loss or extensive health issues could quickly put the safety of their home in jeopardy.

If you're currently facing foreclosure or feel you may be at risk, we're here to help. This guidebook covers the basics of what foreclosure is and provides options to prevent and defend against it.

We hope this guidebook will provide a valuable first step in finding clarity and relief for your legal concerns about foreclosure. If you have additional questions after reading this document, please share them with us at Service@ARAGgroup.com.

If you're not an ARAG® member, please feel free to review this information and contact us to learn how ARAG can offer you affordable legal resources and support.

Sincerely,

ARAG Customer Care Team

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Glossary

Deed. A document that indicates the title owner of a specific parcel of real estate, and is commonly used to transfer ownership of real estate.

Deed of Trust. A type of security interest used in some states that secures a note to real estate, where a third party acts as a trustee. A deed of trust is functionally the same as a mortgage.

Federal Housing Authority (FHA) Loan. A federally-insured mortgage loan.

Forbearance. When a lender agrees to postpone foreclosure in order to give the borrower time to catch up with past due payments.

Lien. A claim or interest on the real estate property stemming from an unpaid debt.

Lis Pendens. A notice filed in the land records showing that there is a suit pending in a court that concerns the title to land.

Loan Modification. A lender's agreement to change the terms of a mortgage agreement, either by decreasing the amount of monthly payments, lengthening the term of the loan and\or decreasing the amount of interest on the loan.

Mortgagee. The holder of the mortgage of the real estate (e.g., a lender, bank or creditor).

Mortgagor. The owner of the real estate subject to the mortgage (e.g., a borrower, homeowner, buyer or debtor).

Negative Equity. A situation that exists when the value of the real estate is less than the amount of debt.

Note. A promissory note showing the amount of money a borrower owes a lender. In a mortgage situation, the note is secured by the borrower granting the lender a security interest in real estate (e.g., a mortgage or a deed of trust).

Notice. A warning communication or period of warning required by law and/or by the security instrument (mortgage) or note.

Power of Sale. A clause in a mortgage or deed of trust that gives the mortgagee (or trustee) the right to sell the real estate at public auction without having to initiate any foreclosure proceeding in a court if the homeowner fails to make payments according to the terms of the mortgage or trust.

Sheriff's Deed. A deed issued by sheriff at a sheriff sale.

Sheriff Sale. A sale resulting from a court order authorizing the sheriff to conduct the sale in satisfaction of a judgment.

Short Sale. Process whereby a mortgagee agrees to allow a homeowner to sell the mortgaged real estate for less than the outstanding amount of the mortgage debt, contingent on the lenders approval of the buyers.

Writ. A form of written command in the name of a court or other legal authority to act.

Background

Simply stated, mortgage foreclosure is the legal process by which a lender tries to make up for losses if a borrower cannot make all the payments. While the lender could sue the borrower for all money due, the more common path for a lender is to foreclose on the mortgage it holds on the borrower's real estate.

The lender's goal is to encourage the borrower to either pay off the mortgage debt and charges, or face losing all ownership rights in the real estate covered by the mortgage. If debt is not repaid, then the lender will likely sell the real estate in order to regain losses from the loan.

Foreclosure Process

Most states have a step-by-step process by which a homeowner must be notified of the intent to foreclose and be given a series of dates or periods of time the homeowner has to defend against the foreclosure, redeem the real estate and appeal the process. The entire process can take anywhere from a few months to a year to complete.

Each state determines the legal process for foreclosing on mortgages on property within that state. An overview of the legal foreclosure process listed for each state can be seen at the following web resources:

- The U.S. Department of Housing and Urban Development has resources and links to state specific information: http://portal.hud.gov/hudportal/HUD?src=/topics/avoiding_foreclosure.
- The National Consumer Law Center is a non-profit legal information and advocacy organization. Its listing shows the available consumer protections in the specific state's mortgage foreclosure laws and rules. http://www.nclc.org/issues/state-foreclosure-laws.html

There are basically two types of foreclosure processes in the United States. Judicial foreclosure is permitted in all states and involves a lawsuit filed by the mortgage holder to secure a court order of foreclosure. Because it is a judicial process, there are required steps, timeframes for response and opportunities to be taken advantage of, if acted on.

Non-judicial foreclosures are permitted in over half the states. They do not involve the court if the mortgage or deed of trust has a power of sale clause which allows the mortgage holder to sell the mortgaged real estate after notices of default and of sale. Unlike judicial foreclosures, they can proceed very quickly.

Here are basic outlines of these two foreclosure processes:

Judicial Foreclosure Process

- The lender files a complaint and records the Lis Pendens. The complaint will state the type and amount of debt and why the default should give the lender the right to foreclose and take possession of the property.
- The homeowner is served notice of this complaint either via mail, process server, sheriff and\or publication.
- If the court determines that there is a default on a valid debt, it will issue a judgment for the total amount owed, including the fees of the foreclosure process.
- Once judgment is entered, a writ will be issued allowing the real estate to be sold.
- A public auction is held to sell the real estate. Once the sale is complete, a sheriff's deed will be issued to the new legal owner.

Non-Judicial Foreclosure Process

- First, the mortgage or deed of trust must contain a power of sale clause, which gives the third party trustee the right to sell the home if payments aren't made.
- The process starts when the mortgagee provides notice of the default and the amount of time the homeowner has to take care of that default by paying off any past due payments.
- Then the Notice of Trustee Sale is sent to the homeowner. It sets forth the auction date, time, location and in some states, the opening bid amount.
- Next, a Trustee Sale Auction is held and the real estate is sold either to the bank or a third party.
- Once the sale is complete, the new owner receives a trustee's deed.

Causes of Foreclosure

Mortgage Default. The most common reason a person's home is foreclosed is because of non-payment or default of the mortgage note. Unless your mortgage loan is in forbearance or some sort of non-collection status, not paying the mortgage payment triggers the acceleration clause, which allows the lender to request the entire balance of the mortgage loan be paid in full. This typically occurs after default.

Once the acceleration clause is triggered, the entire note becomes due. If the lender is unable to recover the entire balance due on the note from the foreclosure sale, they can sue the homeowner for the difference (also called a deficiency).

Tax liens filed against your home are another reason why a home may be foreclosed. The Internal Revenue Service (IRS), as well as state and local governments, can file and execute upon matured tax liens. The threat of their liens to a mortgagee's security is often a basis for foreclosure action.

Assessment liens imposed by planned community, condominium, or homeowners associations can also trigger foreclosure. In some states, homeowners associations may foreclose if the owners have not paid association dues or abided by established rules such as maintaining the character, standards or nature of the real estate within the subdivision. These liens may be a threat to the security interest in the home and may be a basis for a mortgagee's own foreclosure action.

Avoiding Foreclosure

If you're at risk of foreclosure because you're unable to make payments, you may have options to avoid defaulting on your mortgage.

- The homeowner can request loan forbearance from the bank. Loan forbearance is when the mortgagee extends the period within which the homeowner has to pay off back payments or defers payment for a certain grace period. Typically this will be for a short period of time such as six months to a year.

  A homeowner seeking forbearance should try to continue to make payments on the mortgage until the forbearance request is approved by the lender in writing.
- Loan modifications are used more often because of limited incomes and negative equity (the value of the real estate is less than the amount of debt). In a loan modification, the mortgagee will agree to change the existing terms of the mortgage loan, either by extending the repayment period, decreasing the homeowner's monthly payments, decreasing the rate of interest due on the note or reducing the mortgage loan principal to reflect the loss of the home's value.

  A homeowner seeking modifications should try to continue to make original payments on the mortgage until the loan modification is approved and confirmed in writing by the mortgagee. The mortgagee can still foreclose on a homeowner even if a loan modification application is pending.

Defenses Against Foreclosure

Foreclosure is rarely a simple matter. If you are in a potential foreclosure situation, it is generally best to involve an attorney early on so you fully understand the legal defenses that may be available to you. Common options to defend against foreclosure include the following:

Defense on the underlying action that triggered the foreclosure. If the homeowner can demonstrate that the action triggering foreclosure did not happen, then they will be able to avoid foreclosure as well. The mortgage company must be able to demonstrate that payments weren't made before being able to continue with foreclosure. All other creditors must show that they have the right to foreclose and the triggering event occurred allowing them to proceed.

Notice is another defense to the foreclosure process. The Due Process Clause of the United States Constitution requires the party who is going to lose an interest in real estate be provided with adequate notice. There are extensive notice requirements and steps a party needs to take before dispossessing a homeowner of their interest. If a party fails to provide the homeowner of notice of the debt and intent to foreclose, the debtor will be able to void the process and possibly get damages for failure to provide notice.

Unfair and Deceptive Trade Practices are when the homeowner alleges that the foreclosing party acted in such a way to render the mortgage agreement void. This defense is typically used against the bank/lender. Examples of this behavior include misrepresenting terms and conditions to the homeowner or not providing important disclosures to the borrowers before they took on the loan.

Unconscionability or unreasonable mortgage terms is another defense to foreclosure. Examples of this would be a bank issuing a home loan based on an appraisal that is more than 100% of the fair market value of the home or issuing a loan that violates federal or state law.

Active Duty Military
Mortgage lenders cannot foreclose, or seize real estate for a failure to pay a mortgage debt, while a service member is on active duty for a nine month grace period prior to December 31, 2012, unless they have the permission from the court. The normal grace period for service member protection will revert back to three months on January 1, 2013.

Foreclosure Alternatives

If you have not been able to prevent foreclosure, the foreclosure process has started, and you either cannot afford or are not inclined to use litigation to defend against the foreclosure, there are still options you may be able to use.

A short sale is where the lender agrees to allow the homeowner to sell the home for less than what is owed on the mortgage. The sale is contingent upon the lender approving the new buyer. The homeowner will still be liable for any of the remaining portion of the note, unless an agreement is reached for the mortgagee to waive any deficiency.

For example: Steve owes the bank $400,000 on his home. He can no longer afford to keep the home and has not been able to sell it for the amount he owes. Steve asks the bank's permission to sell the home for $300,000. The bank agrees on the condition that they can approve the buyer and that Steve will remain liable for the remaining $100,000 due on the note.

After the short sale is complete, the bank will do one of two things: The bank will issue Steve a 1099 form showing the $100,000 debt as forgiven debt and income to Steve. This will increase Steve's gross income for purposes of income taxes and increase his liability to the IRS and the state that year.

Another common practice is that the Bank will sue Steve for the balance or deficiency (again, unless there has been an agreement reached to waive any deficiency). A short sale can be just as detrimental to a homeowner's credit as foreclosure, often decreasing their credit score up to 200 points.

A **Deed in Lieu of Foreclosure** is a situation when the foreclosing party will accept the deed to the real estate from the homeowner instead of moving forward with the foreclosure process. Similar to the short sale, the bank will normally have a claim for deficiency balance (again, unless there has been an agreement reached to waive any deficiency).

Bankruptcy is one of the most common ways that a homeowner can ward off or stop foreclosure.

Essentially the filing of the bankruptcy petition creates a period in which creditors cannot collect on the debt for a minimum of thirty days after filing. This is called the automatic stay. This type of relief is available for bankruptcy filers depending on the type of bankruptcy they file.

Chapter 7 is a discharge bankruptcy where the homeowner can choose to surrender real estate and the debt without further liability. A bankruptcy filer can qualify for an FHA loan, two years after the chapter 7 discharge. The homeowner can choose to keep the real estate under the same terms of the original mortgage. This gives the homeowner an opportunity to catch up on any past due payments during the two to three month bankruptcy process. In addition, banks are more willing to negotiate loan modifications after a homeowner has filed for bankruptcy. In other cases where it is a third party filing the foreclosure proceedings, the underlying debt may be discharged thereby ending their right to foreclose.

Chapter 13 is a payment plan bankruptcy where the homeowner can modify the existing terms of their mortgage including interest, value of the loan, and payment schedule.

Taxable Income Arising from Foreclosure or Cancelled Loan
The tax implications of foreclosure are complex and not all losses can or should be included in the 1099 form. Consider consulting your tax advisor as well as IRS publication 4681, *Cancellations, Foreclosures, Repossessions and Abandonments for Individuals*.

Consequences of Foreclosure

There are a number of things that can happen after foreclosure.

For starters, **you could be sued for a deficiency**. The deficiency is when the amount the lien holder receives at auction is less than the loan balance. Most states allow a creditor to sue a debtor for this. This is a separate action from the foreclosure proceedings whether your state allows non-judicial or judicial foreclosure.

There could be **tax implications and liabilities**. Generally, a forgiven debt is income to a debtor. When a home is foreclosed the debtor receives a 1099(c) Form showing the amount of the debt forgiven. This forgiven debt must be reported on your taxes as income.

The Mortgage Forgiveness Debt Relief Act of 2007 generally allows taxpayers to exclude income from the discharge of debt on their principal residence up to two million dollars. A principal residence is a home where the debtor resides fulltime. It applies to debt forgiven between 2007 and 2012. The debt must have been used to buy, build or substantially improve the real estate. This program requires consent from a lender: consent is not automatic and may be freely withheld. In addition, when a home with a mortgage is lost in a foreclosure, the former owner can no longer claim mortgage interest or real estate tax paid as a deduction on his taxes.

Moreover, former owners who go through foreclosure may still find themselves **owing real estate taxes after the fact**. Real estate taxes are charged to the owner of record at the time the tax bills are issued.

Your credit will be affected. One major consequence of foreclosure is the impact on a homeowner’s credit. Foreclosure stays on your credit for seven years and has a very negative impact. It generally takes at least two years for credit scores to begin to improve after foreclosure.

It will be difficult to get another mortgage for a while. A homeowner must wait four years after a foreclosure before they qualify for an FHA loan. Since the requirements for conventional loans (based more on credit score and income) are far more stringent, it may take even longer to qualify for that type of loan after foreclosure.

Foreclosure Scams

There is nothing wrong with getting help if you are facing foreclosure, however be sure you are getting help from a reputable source. Here are some common "red flags" to avoid:

- **Paid "courses," "boot camps" or "seminars."** These companies or groups prey on financially distressed homeowners and sell them information that is in the public domain or, even worse, give them bad information.
- **Signing over title to a foreclosure recovery program.** This is a common scam. Not only will you lose your home, you will be sued by the bank for fraud. It is considered to be against the mortgage agreement to transfer your interest in real estate without strict consent of the bank to assign your interest.
- **"Sell the real estate to us and have us lease it to you, with you having the option to buy it back."** In order to buy the real estate back you will have to qualify and acquire a new loan that is far more than the loan you had with a higher interest rate.
- **"We have relationships with banks and can stop your foreclosure."** No matter how friendly someone is with bank officials nothing short of valid legal defense will stop or prevent the foreclosure process.
- **"Pay your mortgage through us."** The only way to insure that your mortgage payments are going to the bank is to make those payments to the bank or bankruptcy trustee (in the case where a homeowner files for bankruptcy). Another warning sign is if the foreclosure program or service requests payment up front, by cashier's check or wire transfer.

Government Sources for Help

Seeking knowledgeable mortgage help can often prevent the foreclosure process from occurring at all. When seeking legal assistance, search for attorneys who have experience with foreclosure defense and /or bankruptcy and are licensed in the state in which you reside and where the mortgaged real estate is located.

The U.S Department of Housing and Urban Development (HUD) also has officially approved counselors available for free or low cost, at both the national and state levels:
http://www.hud.gov/offices/hsg/sfh/hcc/hcs.cfm

Additional information on current government relief programs:
http://portal.hud.gov/hudportal/HUD?src=/topics/avoiding_foreclosure

The Federal Trade Commission also provides information on mortgage relief scams:
http://www.ftc.gov/bcp/edu/pubs/consumer/credit/cre42.shtm

Let us help you

If you need additional help or guidance, ARAG is here for you. Simply contact a Customer Care Specialist who can help you understand the benefits available to you. For more information:

Visit the Education Center at: ARAGLegalCenter.com, call 1-800-247-4184 or email Service@ARAGgroup.com

Preparing to Meet Your Attorney

If you decide to consult an attorney to help with your legal matters, we suggest you complete the following worksheet prior to meeting with the attorney. By preparing this information ahead of time, you have the opportunity to clearly think through your needs and the attorney will have necessary information to provide you with the highest level of legal service.

Start by thinking about your current situation, the communications you have received and any history you have about the matter. Summarize your legal needs in a few sentences. Use this as a starting point when you make your first phone call to an attorney.

List the names, dates and pertinent details about your legal matter so you will be ready to discuss it with your attorney either over the phone or during an in-office visit.

List and attach any documents or background information you think will be helpful in the first meeting with an attorney.

Resources for More Information

The following were used as resources in developing this guidebook and provide additional information.
U.S. Department of Housing and Urban Development (HUD):
http://portal.hud.gov/hudportal/HUD?src=/topics/avoiding_foreclosure

ARAGLegalCenter.com
800-247-4184

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