

What is a Foreclosure?

A legal process by which a property, pledged as collateral for a debt, is sold to satisfy the debt. If the borrower defaults, the lender can initiate legal proceedings against the borrower, and force the sale of the property to satisfy the loan.

Primary Causes of Foreclosure

The most common causes are: divorce, illness, death, unemployment, and high-risk loans. Sometimes an owner will stop making payments because of gambling or drug related addictions. Some owners will abandon their property for no apparent reason.

Divorce. Divorces often lead to one spouse refusing to contribute to mortgage payments. The remaining spouse may be unable or unwilling to make the payments. In some cases, both spouses abandon the property.

Illness. A major illness can impact a family's ability to make payments. Such a family will sacrifice available funds, including mortgage payments, to cover medical bills.

Death. This represents a permanent loss of income. In some cases, there is insufficient income from life insurance, savings, pensions, or social security.

Unemployment. Job loss from federal budget cutting, military streamlining, and corporate downsizing continues to be the most prevalent cause of foreclosure. It increases during a slow economy and gets worse during a recession.

High Risk Loans. Loans with high interest rates, high loan fees (points), and/or huge balloon payments can impact an owner's ability to pay. Many owners accept such loans without having a plan to pay them off when due.

Mortgage: Security instrument by which the buyer pledges a property as collateral for the loan. It includes terms and conditions of ownership and the lender's rights in a default. **Deed of Trust:** Similar to a mortgage except for the rights it offers the lender during foreclosure. It is sometimes called a trust deed or trust. **Property Tax Lien:** This is created when an owner fails to pay property taxes. **IRS Lien:** This is created when an owner fails to pay IRS taxes. It is a general lien that affects all of the owner's property. **Mechanic's Lien:** A contractor can establish this claim when he is not paid for work performed on an owner's property. **Judgment:** This is the result of a claim filed against an owner for a personal debt, and is a lien against all of the owner's real and personal property.

Additional details and money making techniques can be found in **The Complete Guide** eBook series and **The Foreclosure Food Chain** eBooklet series available from www.foreclose.com.

Foreclosure Phases

A foreclosure property can pass through one or more of the following phases: pre-foreclosure, auction, Real Estate Owned (REO), and government repossession.

Pre-Foreclosure. This phase begins when the property owner defaults on the mortgage payments and ends just prior to the foreclosure auction. It can last from a few weeks to several months. You must work directly with the owner if you want to buy such properties. Remember that all of the existing debt remains on the property, so you must do a careful evaluation when purchasing properties in this phase.

Auction. An auction is held at the local courthouse, in front of the property, or at an auctioneer's office. It begins when the ad is read and ends when the property is sold. The lender sets the opening. Bidders compete for the property until the high bidder emerges. A bidder can be an investor, owner-occupant, or foreclosing lender. This phase occurs very quickly and can take as little as three minutes.

Real Estate Owned (REO). If a property is not sold at the auction to an investor or owner-occupant, the lender gets the property back. Lenders want to sell these properties quickly and list them via their REO or special assets department. Oftentimes they advertise the REOs via realtors. You can negotiate contract offers with the lender or realtor.

Government Repossessions. REOs with government-sponsored loans (e.g., VA, FHA, or related agencies) typically end up in this phase. The agencies make restitution with the lenders and take control of the properties. They then advertise the properties via local realtors and/or newspapers. You must submit your contract offers via realtors.

Priority of Liens

There are several types of debts or liens associated with real property. A lien is a claim against a property as collateral for the debt. The most common liens are: mortgages, deeds of trust, mechanic's liens, property taxes, IRS taxes, and judgments. A property can have multiple liens, with each lien having a specific priority. The priority of a lien generally takes effect at the time it is recorded in the public records. Whenever a property is sold, the liens must be satisfied in the order of their priority.

The following table highlights the lien priority of a sample property. The table shows the priority of each lien based on the date it was filed. The exception is the property tax lien, which takes precedence regardless of when it was filed. In some states, the mechanic's lien takes priority over all the other liens except for the property tax lien.

Pri	Type	Date Filed	Comment
1 st	Property Tax Lien	Does not matter	Always top priority regardless of filing date
2 nd	First Trust	March 1991	First trust (mortgage) filed on the property
3 rd	Second Trust	May 1995	Second trust filed years later
4 th	Mechanic's Lien	October 1995	2 nd priority in some states
5 th	IRS Lien	July 2000	Attaches to <u>all</u> properties for a given owner
6 th	Third Trust	November 2000	Filed after the Mechanic's and IRS liens
7 th	Judgement	April 2001	Also attaches to <u>all</u> of the owner's properties

Foreclosure Procedures

The foreclosure process varies somewhat from state to state, and often from county to county. Generally, states or counties that use mortgages conduct judicial foreclosures. Those that use deeds of trust conduct non-judicial foreclosures. Some states conduct strict foreclosures, while a few employ other types of forced sales. You should examine your loan documents to see if mortgages or deeds of trust are used in your area. You can also check with a local foreclosure attorney or the county's land record office to verify which procedure is used.

Non-Judicial Foreclosure

Foreclosures based on deeds of trust are known as non-judicial foreclosures. This is because deeds of trust contain the power of sale clause that enables the trustee to initiate foreclosure, without having to go to court. This is the basic difference between the non-judicial process and the judicial process.

If for some reason the trustee is not available, the beneficiary (lender) can appoint a substitute trustee to initiate the foreclosure. The substitute trustee or simply the trustee is required to issue a notice of default and notify the trustor (borrower) accordingly. The trustee then proceeds with the notice of sale and begins the advertising. The trustee conducts the sale in the same manner.

Strict Foreclosure

The process used by a few states to conduct a foreclosure without a forced sale is called a strict foreclosure. Once the notices have been filed and the owner has been notified, the court can establish a time period during which the default must be cured. If the default is not cured within the time period, the court transfers the title to the lender, without a sale.

Other Forced Sales

A forced sale can also be conducted for nonpayment of property taxes. If an owner does not pay his taxes, the local tax authority may place a property tax lien on the property. If the owner does not satisfy the lien, the tax authority can conduct a forced sale and use the proceeds to pay off the taxes owed. By the same token, the IRS may conduct a forced sale to satisfy a federal tax lien on the property.

Judicial Foreclosure

Default. An owner who misses a mortgage payment is said to be in **default**. The lender sends a letter asking for prompt payment of the mortgage and late fee. The lender sends a more urgent letter when the second payment is missed. The lender may also contact the owner by phone to resolve the issue, and usually allows 15 to 30 days for the owner to bring the back payments or **arrears** current. If the owner does not pay the arrears within the deadline, and eventually misses the third payment, the lender will then foreclose. Lenders typically foreclose after three months of default on conventional loans and after six months on VA and FHA loans. Lenders, as a rule, do not accept partial payments. They feel that accepting partial payments merely prolongs the process and increases the cost of foreclosure.

Court Action. Once the lender has exhausted its attempts to resolve the default with the owner, it contacts an attorney to pursue court action. The attorney then contacts the owner to try to resolve the default. If the owner is unable to cure (pay off) the default, the attorney files a lis pendens (action pending) with the court. The lis pendens indicates public notice of the default and solicits the court's approval to initiate foreclosure. This court action could take up to 30 days, depending on the local jurisdiction.

Notification. Once the attorney gets a positive ruling from the court, he files a Notice of Default with the county clerk's office. The notice is sent to the owner by certified mail and also to any junior lien holders who may have requested notice. It specifies the amount of the default and the date by which the amount is due. The notice essentially grants the owner a reinstatement period of about 30 days, during which he can pay the amount without incurring further penalty.

Advertising. The attorney's next step, assuming the owner does not cure the default, is to publish a **Notice of Sale**. Attorneys advertise the notice in a local newspaper, affix it to the property, and/or post it in some "conspicuous place" (e.g., near the courthouse). They also publish the auction schedule as often as dictated in the mortgage document, or according to a specific timeline, such as once a week for three weeks.

Sale. A foreclosure property is sold at auction if the owner does not cure the default and thereby reinstate the mortgage. The attorney conducts the sale either at the courthouse steps, in front of the property, or at the attorney's office. In some areas, the attorney hires an auctioneer to conduct the sale. The attorney opens the bid at an amount authorized by the lender. This usually includes the mortgage balance, the arrears, foreclosure costs, and attorney fees. The attorney then encourages bids from interested parties, including investors and home buyers looking for a good deal. Lenders generally require a deposit to be paid in cash or certified funds and a settlement within 10 to 30 days. The deposit is either a specific dollar amount or a percentage of the mortgage balance or high bid (usually 10%).

The sale is conducted very quickly, usually in less than five minutes. Once the property is sold to the high bidder, the attorney collects the deposit and issues a **certificate of sale**. When the high bidder goes to settlement within the specified time, he is given a **deed** to the property which transfers title from the previous owner. The proceeds from the sale are applied to the debts associated with the property in order of their priority. If there is no high bidder, the property reverts back to the lender.

Note that some jurisdictions offer a **reinstatement** period during which the owner has the right to buy back the property that was sold at the auction. The terms and conditions vary in each jurisdiction, so you should check with the local foreclosure attorneys for details.

Eviction. An owner loses his rights to the property once it is sold at the auction. In almost all cases, the owner leaves voluntarily. Sometimes, the new owner (high bidder) will have to negotiate a departure date, usually within a few days, with the foreclosed owner. In the few cases where the foreclosed owner still won't cooperate, the new owner can contact the local sheriff's office to initiate the eviction procedure. The sheriff begins by contacting the occupants and serving them a notice to vacate, generally within 30 days. If they do not vacate the property within the specified period, the sheriff then schedules the eviction date, contacts his eviction crew, and proceeds with the eviction.