

**California Real Estate Finance**  
**Chapter 13**  
**Defaults and Foreclosures**

**Chapter Purpose**

With the large amount of mortgage debt in this country, it is inevitable that some borrowers will find it difficult to make their payments on time, while others may not make their payments at all.

This chapter describes the reasons for default as well as their consequences. It acquaints the student with the techniques of foreclosure and discusses the borrower's liability in the event of foreclosure.

**Suggestions to the Instructor**

A field trip to a public auction of foreclosed property would make the material in this chapter come alive. Special attention should be paid to the foreclosure processes of the FHA and DVA, since the incidences of default are relatively high for these loans.

**Learning Objectives**

Upon completion of this chapter, the student should be able to:

1. identify the circumstances that constitute a default under a real estate loan;
2. describe the remedies that can be applied to offset a foreclosure, including a voluntary conveyance of deed;
3. discuss a borrower's redemption rights under the three financing forms;
4. define the different methods of foreclosure;
5. understand the possibilities of an income tax impact in a foreclosure where the mortgage balance exceeds the property's adjusted book basis.

**Presentation Outline**

- I. Defaults
  - A. Delinquencies
    1. Principal and interest
      - a. grace period
      - b. late payment charge
      - c. workouts
    2. Property taxes

3. Other liens
    - a. federal or state income taxes
    - b. mechanic or materialmen's liens
  4. Hazard insurance premiums
- B. Poor property maintenance
- II. Adjustments
- A. The Soldiers and Sailors Civil Relief Act of 1940
    1. Protects military personnel from foreclosure in times of combat
    2. Limits creditors from foreclosing without a court order
    3. Court may suspend enforcement of civil obligations if borrower affected by military service
  - B. The Housing Act of 1964
    1. Lenders must provide relief if default is beyond borrowers' control
    2. Applies to FHA and DVA loans
  - C. Avoiding a foreclosure
    1. Borrower attempts to solve short-term problems with help of the lender
    2. Borrower tries to sell property to recover some equity
    3. Borrower gives property away to someone who can make the payments
  - D. Moratoriums and recasting
    1. Waive the principal portion of the payment
    2. Waive the interest portion of the payment
    3. Full payment waivers
    4. Refinance to reduce payments (recast)
  - E. Voluntary conveyance of deed
    1. Deed in lieu of foreclosure
    2. Only when all other alternatives have been exhausted
- III. Foreclosures
- A. To foreclose
    1. To shut out, bar or deprive one of the right to redeem a mortgage, deed of trust or land contract
    2. To protect the lender in case of an incurable default
  - B. Redemption rights
    1. Equitable redemption
    2. Strict forfeiture
    3. Statutory redemption
  - C. Power-of-sale foreclosure
    1. The right to sell without court appearance
    2. Borrowers' redemption period limited to time before auction sale
    3. Deeds of trust
      - a. beneficiary notifies trustee of trustor's delinquency
      - b. trustee begins foreclosure process
      - c. requires about three months
      - d. if trustor does not bring payments current before sale, property sold to highest bidder

- e. sale proceeds distributed
  - (1) to trustee for expenses
  - (2) to beneficiary
  - (3) to junior lienholders in order of priority
  - (4) to borrower if any surplus
- D. Judicial foreclosure and sale
  - 1. Conventional mortgages
    - a. lis pendens
    - b. judgment decree
    - c. public auction
    - d. lender acquires property
  - 2. Conventional guaranteed mortgages
    - a. lender bids loan balance at auction
    - b. insuring agency will reimburse lender full bid price if property can readily be sold
    - c. insuring agency will pay lender only the amount of principal insured if property difficult to resell
    - d. equitable redemption
      - (1) brings payments current any time before judgment
      - (2) stops judicial foreclosure process
    - e. statutory redemption
      - (1) within three months if sale satisfied entire debt
      - (2) within one year if sale insufficient to cover entire debt
- E. FHA-insured loans
  - 1. file notice of default with local FHA office within 60 days of default
    - a. includes reasons for default
    - b. describes efforts made to reinstate loan
  - 2. borrowers counseled to avoid foreclosure
  - 3. lender bids loan balance at auction
  - 4. FHA fully compensates lender
    - a. in cash, or
    - b. in government debentures
  - 5. FHA resells property
    - a. as is, or
    - b. repaired and refurbished
- F. DVA-guaranteed loans
  - 1. lender bids balance of loan at auction
  - 2. DVA compensates lender only for amount insured
  - 3. lender resells property
- G. Junior loans
  - 1. lender bids balance of junior loans
  - 2. secure ownership of property subject to balance of senior loan
- H. Tax Impacts
  - 1. Normally no tax consequences
  - 2. Tax impacts when adjusted book basis is *less* than the balance of the loan
- I. Auctions