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SENIOR LEGAL GUIDE

What to do if you are facing foreclosure

This guide is meant for California seniors who have contacted the Senior Legal Hotline (SLH) because they have fallen behind on their mortgage payments or can foresee doing so in the near future. Know that you are not alone; millions of seniors nationwide face similar dilemmas. Use this guide to help you understand what may lie ahead and to make decisions in a way that makes sense for your individual situation.

First, some important basic facts about foreclosure in California:

1. Foreclosure time line

Missed first mortgage payment

- 60-90 days (could be more or less)

Notice of default

- 90-day waiting period (minimum required by law; can be more)

Notice of trustee's sale

- 20-day waiting period (minimum required by law; can be more, and can be postponed, then rescheduled without notice)

Right to reinstate

- Up to five days before sale

Trustee's sale of the property

- Property sold at auction
- No post-sale right of redemption, so sale is almost always final

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Let's say your mortgage payment is due today, and you aren't able to pay it.

After you miss two or three payments – no set rule, could be less or more – you may receive a **notice of default** from your lender. It becomes official when it is filed in the **Recorder's Office** in the county where your property is located. You should get a copy in the mail, too.

At this point, you can still save your home, but if you do not make arrangements with your lender within 90 days, you'll probably receive a **notice of trustee's sale**. Also filed in the county Recorder's Office, it sets a date and time when your house will be sold at auction – but no sooner than 14 days from the date of recording. The notice must be posted on your property and mailed to you at least 20 days before the sale, and it must be published in a local newspaper of record.

You have up to five days before the sale to **reinstate the loan** by paying the past-due balance to bring it current, plus late fees/costs (set by state law), or by making other arrangements with your lender.

Up to the moment of sale, you can save the house only by paying the full amount of the loan, reaching some other agreement with the lender or filing for **bankruptcy**. Bankruptcy can freeze the foreclosure process temporarily but it alone will not prevent foreclosure. (See also below, page 5.) Once the sale occurs, it is almost impossible to reverse.

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2. Non-judicial foreclosures and the 'one-action rule'

- California is a **non-judicial** foreclosure state. Though a lender could opt to foreclose on your property by going to court, virtually all homeowner foreclosures in California happen without a judge.
- The **one-action rule** means that a lender can choose only one or the other foreclosure path: judicial or non-judicial; and if it forecloses without going to court, it cannot then take further legal action against the borrower to collect a **deficiency** amount – any portion of the mortgage debt that exceeds the foreclosure sale price.

Whatever the goal, don't wait until it's too late

If you are having trouble with your mortgage, it is best to **contact your lender**, or more accurately, the **servicer** of your mortgage, as soon as possible to discuss your options. A servicer collects payments on the owner's behalf. Sometimes they are the same, but often they are not.

Even if you decide not to keep your house or it really is not possible to do so, it's worth looking into options that could improve your future financial situation and credit record.

If you do want to keep the house, don't be discouraged if at first you don't succeed in negotiations. With the ever-changing nature of home retention programs amid the current crisis, there's a possibility that if you try again later (even after being denied a modification previously) you could succeed the next time around. This is especially true if the nature or extent of your hardship has changed.

If you find yourself behind on your mortgage or fear that you may soon fall behind, here are some options to consider, depending first on whether or not you want to keep your home.

If you want to stay in your home

Repayment plans, forbearance, modifications and refinancing

As a first step, contact your loan servicer. You can usually find the phone number on your monthly billing statement. Be prepared with a plan of action. Some options you may want to discuss include:

- **Repayment Plan:** An agreement whereby you start making your regular monthly payment on time again, catching up on the past-due amount with small extra payments each month. This option is best suited for someone who has fallen behind (or will soon fall behind) due to a temporary hardship, such as medical expenses or loss of income.
- **Forbearance:** If you are having an extreme but temporary hardship, the servicer may allow you to stop making payments, or make lower ones, for a short time, then catch up under a repayment plan.
- **Loan Modification:** Unlike a repayment plan, where none of the permanent loan terms change, in a modification the servicer may reduce the interest rate, extend the length of the loan, reduce the principal balance (least common) – or a combination of these – to make the loan more affordable. This option is best if you are behind or expect to fall behind due to hardship of a more permanent nature, such as long-term loss of household income or increased mortgage payments due to your loan's adjustable rate or other terms that you may or may not have understood when you got the loan.
- **Refinance:** A refinance is a whole new loan, with the same or a different lender.
  - *When negotiating any of the above options, be aware that if you have a* ***subordinate loan*** *secured by the same property (second mortgage, home equity loan) or* ***other liens due to judgments, tax debts, etc.****, it can complicate matters. Exactly how it plays out depends on many factors, such as the type of lien, its terms and the inclinations of the servicers and owners of the debts. Before you enter negotiations, make sure you are aware of all liens on the property (the official record can be obtained at your county recorder's office) and share that information with servicers.*

Documentation required when applying for mortgage help

Make sure to ask the servicer representative you speak with for a list of the documents you'll need to submit. To give you an idea of what to expect, the following items are generally required when considering you for a repayment plan, forbearance, modification or refinance:

- **Financial worksheet**: a list of all your monthly income sources and amounts, expenses and sometimes, assets and liabilities.
- **Verification** will be needed for every source of income. Examples include a copy of a Social Security award letter, an IRS W-2 form and if employed, recent pay stubs.
- **Bank statements**: Usually for the last several months.
- **Tax returns**: Usually your two most recent federal tax returns. Frequently servicers require you to submit IRS form 4506, which gives them permission to obtain your tax records from the IRS.
- **Hardship letter**: For a repayment plan or modification, you will usually need to explain why you fell behind on your mortgage or think you will fall behind soon. Examples of hardship include increased expenses, loss of income for a reason you can explain, such as disability that results in increased medical expenses or loss of work. A sample hardship letter can be found on the last page of this guide.
    - *Although it is good to have these items ready before contacting your servicer, requirements vary among them. Ask the representative you speak to for a list of the documents needed.*

The Making Home Affordable Program

In 2009 the Obama Adminstration established the **Making Home Affordable (MHA)** program to help homeowners avoid foreclosure. The program has two components: the **Home Affordable Modification Program (HAMP)** and the **Home Affordable Refinance Program (HARP)**.

Can MHA help me? Three questions:

1. **Is my servicer participating in the program?**

- All mortgages owned or guaranteed by Fannie Mae or Freddie Mac are eligible for either HAMP or HARP. Also, many servicers voluntarily signed up for the MHA program. You can find a list of all participants at http://makinghomeaffordable.gov/contact_servicer.html.
- *If your servicer it is not participating, ask what programs of its own are available. It may offer something similar.*

2. **Is my loan eligible for either HAMP or HARP?**

- **To be eligible for the modification program (HAMP):**
    - Your mortgage must be a first lien loan made before January 1, 2009.
    - Your mortgage cannot have been modified previously under HAMP.
    - You must either be behind on your mortgage payments or in danger of falling behind.
    - Your home cannot be vacant or condemned.
    - The property must be your primary residence.
    - Your current monthly mortgage payment plus taxes, insurance and any homeowner association fees, must take up more than 31 percent of your gross monthly income.
    - Your current mortgage balance must be less than $729,750 for a single-family or other one-unit home, less than $934,200 for a two-unit property, $1,129,250 for three units, $1,403,400 for four.
- **To be eligible for the refinance program (HARP):**
    - Your mortgage must be a first lien, conventional loan owned or guaranteed by Fannie Mae or Freddie Mac. You can look up your loan at http://loanlookup.fanniemae.com/loanlookup/ for

Fannie Mae; or https://ww3.freddiemac.com/corporate/ for Freddie Mac.
- You cannot have been more than 30 days late on your mortgage payments in the last 12 months.
- Your mortgage balance can be no more that 25 percent higher than the current value of your home.

3. Can I afford it?

- Eligibility of the loan is not enough. Under **HAMP**, servicers are required to see whether **modification** can reduce your monthly payment (including taxes, insurance and HOA fees) to an amount equal to 31 percent of your gross monthly income. They must do this by considering the following steps: 1) reduce interest rates to as low as 2 percent (temporarily – they then rise gradually up to current market rates); 2) extend the length of the mortgage up to 40 years; and 3) defer some of the principal balance on the mortgage until a specified later date. There are limits on how much principal the servicer is required to defer, however, and servicers are not required to write off any principal balance.
- **HARP** allows eligible homeowners to **refinance** an existing mortgage into a 30-year fixed-rate loan at the current market rate, which can be found on line at www.freddiemac.com, under the heading "Primary Mortgage Market Survey." You may be able to obtain a HARP refinance even if you owe up to 25 percent more than the current value of the home, but no more. There is no set limit on how much of your income must go to payments under the new loan, but the whole point is to improve your situation in a way that makes it likely you'll be able to keep up.

How to apply for HAMP or HARP – and what happens next?

To apply for HAMP, HARP or both programs, contact your mortgage servicer.

- If you are approved for **HAMP**, typically the servicer will place you in a **trial modification** for three months, with reduced payments that are supposed to be a close approximation of what your continued modified payments will be. Ideally, after you have completed the trial period plan successfully, you will be offered a permanent loan modification. However, oftentimes the servicer is overloaded and does not have the permanent offer ready. Here are some helpful tips in dealing with the servicer:
  - Be sure to make all trial plan payments on time while waiting for the permanent modification offer.
  - Your case should have an assigned negotiator. Know who it is and try to deal with this person or his/her supervisor.
  - Carefully document all conversations and correspondence with the servicer.
  - If a sale date was set in the past and your trial plan or negotiations have led to a postponement of this sale date, ask the servicer for written verification of the new sale date – but know that if a notice of sale has been previously recorded in the county Recorder's Office, then there is no further legal requirement for the servicer to re-record or re-notify you in writing that a sales date is set.
- For **HARP**, either the refinance will be approved, or not; before you sign, make sure you understand the terms, and can afford them. Get expert advice if you're not sure.

Challenging foreclosure in court

Because most foreclosures in California are **non-judicial**, with no court filing necessary, any legal challenge to the validity of the loan or the foreclosure process must be initiated by the debtor. There are several potential arguments – failure to make disclosures or obtain signatures according to truth in lending law, fraud or misrepresentation, failure to provide a contract in the borrower's language, etc. If the borrower was over 65 or a "dependent adult," a lender's violations could also constitute financial elder abuse.

Pursuing such a case successfully demands expert knowledge of the law, rules of court and procedures. With your home at stake, you should obtain a knowledgeable, reliable attorney to represent you. Senior Legal Hotline can help determine whether the facts of your case may merit a lawsuit, and if so, how to go about finding an attorney. If you think you may have been victimized by illegal actions, don't delay; for most matters, time limits apply.

Reverse mortgages

Reverse mortgages were originally designed for lower income homeowners over 62 with substantial equity in their homes that could be used to help pay other expenses, thus making it possible to remain in the home. Repayment of a reverse mortgage is postponed until one of three events occurs: you sell or transfer the home, you move out, or you die. Additionally, failure to maintain the prop-erty or pay taxes can trigger repayment. The loan balance increases as interest and other fees are added each month.

Historically, it was not uncommon to obtain a reverse mortgage to pay off an existing loan, even under the threat of foreclosure, as long as there was sufficient equity. But nowadays, many homeowners suddenly have little – or even negative – equity, due to falling home values.

In such situations, a senior who can't make the payments and therefore faces foreclosure could propose a **short payoff**, in which the servicer accepts the amount obtained in a reverse mortgage as payment in full. Because the formula used to determine how much you can borrow under a reverse mortgage involves your age, your home's current value and interest rates, you can still be approved for a reverse mortgage even though you may have little or no equity in the home. A servicer may conclude it is in its best interest to receive an immediate cash infusion in the form of reverse mortgage proceeds, even if that requires it to accept a write-off of the remaining balance.

***Reverse mortgages** are complex, involve high up-front costs and are generally advised only if a borrower is determined and likely to remain in the home for a long time. They may affect a borrower's finances and limit future choices in ways that normal home loans do not. Anyone considering a reverse mortgage should obtain expert, unbiased counseling early on, from Senior Legal Hotline or another HUD-approved agency. AARP is a good source of on-line information. See* www.aarp.org/revmort.

If you have lost your home in foreclosure, you may even be able to repurchase the property with a reverse mortgage, if you have funds to cover part of the price.

Bankruptcy

A bankruptcy court filing puts an immediate freeze (called an **automatic stay**) on any legal action involving the filer's property, including foreclosure or eviction. But the delay may be very short-lived, as the servicer can file a **motion to lift the stay**. If there is no equity in your property and you are behind on payments without the ability to bring your arrearages current, it is very likely that a judge will grant the motion. Your bankruptcy case may continue, but your home can be sold.

To extend the stay, you must propose a plan under **Chapter 13** of the Bankruptcy Code to resolve your debt problems – and convince the court that it is realistic. Typically, such a plan involves using your income to pay some or all of your debts over several years, with regular payments to the court beginning immediately. When stopping a foreclosure is the goal, a plan could involve any of the options discussed in this guide, or others, depending on your circumstances. Because the bankruptcy court can eliminate ("**discharge**") unsecured debt such as credit cards and other loans, it can also discharge (**"strip"**) a second, home equity loan if the debt secured by the first loan is greater than the home's fair market value.

Timing is critical when filing for Chapter 13, since the basis for what you can afford to pay during the plan is determined by your average income during the six months prior to filing. If you expect to lose income in the near future, or recently lost income, waiting until that loss is reflected in the six-month look-back period will increase your chances of a successful bankruptcy plan.

If laws were broken in the making of a home loan or in a foreclosure process, you may be able to file an **adversary complaint** within the bankruptcy case. You must still prove your case, as explained above, but in some instances the bankruptcy court may be a better place to pursue a judgment.

- *As with any lawsuit involving complex laws, rules and procedures, it is extremely difficult to stop a foreclosure in bankruptcy court without representation by an expert attorney. In a Chapter 13 case, payment of attorney fees may be structured into the bankruptcy plan, avoiding the need for a large payment up front. Call the California State Bar Association's Referral Services Directory at (866) 442-2529 (toll free in California) for a referral service in your county to help you find a competent attorney. An initial consultation may help you determine if bankruptcy is right for you.*

If you do not want to keep your home, or if modification or refinance are not feasible

Sale of the house

If the amount owed on your loan is less than current market value, it's usually best is to sell the home. You can then use the proceeds to help to get started in your new situation, whether that means purchasing a less costly home or renting.

Short sales and deeds in lieu of foreclosure

A **short sale** occurs when you sell your house for less than you owe on your mortgage. In today's economy, where many home values have dropped, short sales are common. A **deed in lieu of foreclosure** is an agreement with the servicer whereby you hand over the keys to the property in exchange for the servicer's agreement to cancel the note and deed of trust on the mortgage.

Both of these options require servicer approval. Short sales and deeds in lieu must be carefully negotiated and can take many months to finalize. Once you have an agreement in writing from the servicer, make sure you will be released from any unpaid debt before signing. Also, understand that until title is actually transferred to a new buyer or the bank, you are most likely liable for utility bills, maintenance and any damage to the property.

There are a few potential benefits of pursuing a short sale or deed in lieu arrangement. First, if you are not far along in the foreclosure process, either one may reduce damage to your credit score. Also, during active negotiations with the servicer the foreclosure should be postponed and you may be able to remain quite a bit longer in the home. As with modifications, however, the existence of a second (or more) lien holder will complicate matters. Unless all secured lenders agree to a short sale or deed in lieu, the borrower will not be relieved of all liability.

Walking away

Some people just want out and decide to walk away from the property, allowing it to go to foreclosure. But if you lose the house to a primary lender, the owner of a subordinate loan may try to collect any unpaid debt from you, even sue you in an attempt to recover. Its success will depend mostly on your financial situation. Also, keep in mind that until the property is actually sold in foreclosure and title transfers, you are liable for upkeep, utility bills and any damage to the property.

Tax consequences

'Debt forgiveness'

Even though a non-judicial foreclosing lender cannot sue for excess debt thanks to the **one-action rule** (see page 2), a foreclosure, short sale, deed in lieu or modification that involves principal reduction can leave the former borrower with a tax bill for **forgiven debt**, which may be treated by the IRS as ordinary, taxable income. Many become aware of this only when they receive a form 1099-C from the servicer (or former servicer), indicating that the "income" was reported to the IRS. But there are several ways that such federal tax liability can be avoided:

- ***Non-recourse loan:*** If the loan was for the purchase of a principal residence, or if the seller financed the purchase of any property, the loan is considered "non-recourse" under California law. This means that if there is forgiven debt resulting from a foreclosure, short sale, deed in lieu or modification, there can be no collection of the difference – and the IRS therefore does not consider the forgiven portion to be taxable. If you have a non-recourse loan, you should not receive a 1099-C from the servicer.

> ***Important: State tax law differs from the federal rules described here in several important respects, and both are subject to change. Anyone facing possible tax liability for forgiven debt should consult a CPA or other tax professional.***

- ***Federal tax relief:*** Debt canceled or forgiven by a lender between 2007 and 2012 may be exempt under the **"qualified principal residence exclusion"** provision of the Mortgage Debt Relief Act of 2007. This applies to a loan with a balance of less than $2 million ($1 million if married, filing separately) used to buy, build or substantially improve (repairs don't count) a principal residence – or to refinance debt used for these purposes. Amounts obtained from a cash-out refinance or to pay off bills or other liens on the property are not eligible for the exclusion. You will be taxed on this portion of the forgiven debt.
- ***Insolvency exclusion**:* This exclusion applies if your liabilities exceed your assets at the time of foreclosure, short sale or deed in lieu. If your liabilities exceed your assets, i.e. you are insolvent, but this excess in liability is less than the amount of the forgiven debt, only the amount of excess would be excluded. The remaining amount of the forgiven debt would be considered taxable income. The taxpayer has the burden of proving insolvency. Therefore, you may have to include appraisals with your tax return valuing your assets right before the time of foreclosure, short sale, or deed in lieu.
- ***Bankruptcy:*** By the same logic, the insolvency exclusion also applies to any **debts discharged in bankruptcy**. Moreover, some assets – retirement accounts, for instance, that are counted in an insolvency calculation outside of bankruptcy are not counted in bankruptcy. This can make filing advantageous for tax purposes; and the timing can also matter. Consult a bankruptcy expert if you think this may affect you.

Capital gains tax

Since a foreclosure, short sale or deed in lieu are all treated by the IRS as a sale of the property, there may also be a **capital gain** to report, even if the taxpayer is insolvent, if the current value exceeds the property's **basis,** its original purchase price plus improvements. The gain may or may not be taxable, depending on other rules – most typically, the exclusion of up to $250,000 ($500,000 for a married couple) of gain on a principal residence occupied for two of the previous five years.

A loan modification involving principal reduction will cause a downward adjustment of the property's basis, potentially affecting the capital gains calculation when the property is eventually sold.

More resources

U.S. Department of Housing and Urban Development (HUD): Call 800 569-4287, or visit www.hud.gov, where you can access a list of additional approved housing counseling agencies in your area that can assist you with mortgage-related issues.

U.S. Treasury Department: See www.makinghomeaffordable.gov for the latest programs and eligibility requirements for government-assisted modifications and refinances.

U.S. Internal Revenue Service: See www.irs.gov for information and assistance with tax issues, including contact information for the Taxpayer Advocate, an independent division within the IRS that helps taxpayers resolve their tax issues. For details on taxability of forgiven debt, see IRS publication 4681.

Law Help California: See www.lawhelpcalifornia.org for access to self-help information and how to contact nonprofit legal aid and other organizations for free or low-cost legal help. It has a special section on foreclosures.

Tax help

- AARP's Tax-Aide program for help with income tax preparation during tax season, call 888 227-7669 or visit https://locator.aarp.org/vmis/sites/tax_aide_locator_adv.jsp.
- California's tax board also sponsors free assistance programs. Call 800 906-9887 or visit http://www.ftb.ca.gov/individuals/vita/sites.asp.

California Department of Justice: Call 800 952-5225 or visit http://ag.ca.gov/loanmod/ to report fraudulent loan modification companies and other foreclosure rescue scams.

Sample hardship letter

Jane Borrower
1234 Main Street
Anytown, XX, 12345

Date

XYZ Mortgage Company

5678 Foreclosure Street

Anycity, XX, 56789

RE: Loan Number: ______________________________

Property Address: _______________________________

To Whom It May Concern:

I* am writing to explain the unfortunate circumstances that caused me to become delinquent on my loan. I have done everything I can to make ends meet, and I would like you to consider modifying my loan so that I can stay in the home I've been living in for the last ____ years.

The main reasons why I fell behind on my mortgage payments are______________________________

__________(*Make this part as long as needed; see discussion above on common hardships*)______________

____

If approved for a loan modification that I can afford, I am confident that I can resume payments on time and in full. I hope you will work with me and I thank you in advance for your cooperation and attention to this matter.

Sincerely,

(Signature)

Printed Name

** If there is more than one borrower, replace "I" with "we" in the letter, and have both sign.*

If you are over 60 in California, you can get free advice by phone from the Senior Legal Hotline regarding your questions about this issue. Hours are Mon.-Fri. 9 to 12 and 1 to 4, and until 7 p.m. on Thursdays. You can also submit your question by e-mail from www.seniorlegalhotline.org.