SLIDE 1 – Default (Cover Page)

SLIDE 2

Liens

A lien is a creditor's claim against personal or real property as security for a debt of the property owner. If the owner defaults, the lien gives the creditor the right to force the sale of the property to satisfy the debt.

For example, a homeowner borrows $5,000 to pay for a new roof. The lender funds the loan in exchange for the borrower's promissory note to repay the loan.

At the same time, the lender places a lien on the property for $5,000 as security for the debt. If the borrower defaults, the lien allows the lender to force the sale of the house to satisfy the debt.

SLIDE 3

The example illustrates that a lien is an encumbrance that restricts free and clear ownership by securing the liened property as collateral for a debt. If the owner sells the property, the lienholder is entitled to that portion of the sales proceeds needed to pay off the debt. In addition, a defaulting owner may lose ownership altogether if the creditor forecloses.

In addition to restricting the owner's bundle of rights, a recorded lien effectively reduces the owner's equity in the property to the extent of the lien amount.

SLIDE 4

Liens have the following legal features:

A lien does not convey ownership, with one exception

- A lienor generally has an equitable interest in the property, but not legal ownership. The exception is a mortgage lien on a property in a title-theory state. In these states, the mortgage transaction conveys legal title to the lender, who holds it until the mortgage obligations are satisfied. During the mortgage loan period, the borrower has equitable title to the property.
- A lien attaches to the property

SLIDE 5

Default

Default is the failure of the borrower to make payments on a loan or honor the terms of the loan agreement. Lenders, and the law, usually view borrowers delinquent 90 days or more as in default.

If a borrower is delinquent more than 120 days, the lender may begin foreclosure proceedings. Foreclosure is the legal process by which a lender acquires possession of a property securing a mortgage loan when the borrower defaults. This procedure allows the lender to sell the real estate to pay the defaulting borrower's debt.

SLIDE 6

Foreclosure

All liens can be enforced by the sale or other transfer of title of the secured property, whether by court action, operation of law, or through powers granted in the original loan agreement. The enforcement proceedings are referred to as foreclosure.

State law governs the foreclosure process. Broadly, a statutory or court-ordered sale enforces a general lien, including a judgment lien. A lawsuit or loan provision authorizing the sale or direct transfer of the attached property enforces a specific lien, such as a mortgage. Real estate tax liens are enforced through tax foreclosure sales, or tax sales.

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Mortgage Lien Foreclosure

Three types of foreclosure process enforce mortgage liens:

Judicial

Default

Acceleration

Foreclosure suit

Notice

Sale

Deficiency Judgement

Non-Judicial

Default

Acceleration

Notice

Sale

Deficiency Judgement

Strict

Default

Acceleration

Foreclosure suit

Title to lender

Deficiency Judgement

SLIDE 8

Judicial Foreclosure

Judicial foreclosure occurs in states that use a two-party mortgage document (borrower and lender) that does not contain a "power of sale" provision. Lacking this provision, a lender must file a foreclosure suit and undertake a court proceeding to enforce the lien.

- **Acceleration and filing** – If a borrower has failed to meet loan obligations in spite of proper notice and applicable grace periods, the lender can accelerate the loan, or declare that the loan balance and all other sums due on the loan are payable immediately.

SLIDE 9

If the borrower does not pay off the loan in full, the lender then files a foreclosure suit, naming the borrower as defendant. The suit asks the court to:

- Terminate the defendant's interests in the property

- Order the property sold publicly to the highest bidder

- Order the proceeds applied to the debt

SLIDE 10

Lis Pendens – In the foreclosure suit, a lis pendens gives public notice that the mortgaged property may soon have a judgment issued against it. This notice enables other lienholders to join in the suit against the defendant.

Writ of execution – If the defendant fails to meet the demands of the suit during a prescribed period, the court orders the termination of interests of any and all parties in the property, and orders the property to be sold. The court's writ of execution authorizes an official, such as the county sheriff, to seize and sell the foreclosed property.

SLIDE 11

Public sale and sale proceeds – After public notice of the sale, the property is auctioned to the highest bidder. The new owner receives title free and clear of all previous liens, whether the lienholders have been paid or not. Proceeds of the sale are applied to payment of liens according to priority.

After payment of real estate taxes, lienholders' claims and costs of the sale, any remaining funds go to the mortgagor (borrower).

SLIDE 12

Deficiency judgment – If the sale does not yield sufficient funds to cover the amounts owed, the mortgagee may ask the court for a deficiency judgment. This enables the lender to attach and foreclose a judgment lien on other real or personal property the borrower owns.

Right of redemption – The borrower's right of redemption, also called equity of redemption, is the right to *reclaim a property* that has been foreclosed by paying off amounts owed to creditors, including interest and costs.

Redemption is possible within a redemption period. Some states allow redemption during the foreclosure proceeding at any time "until the gavel drops" at the sale. Other states have statutory periods of up to a year following the sale for the owner of a foreclosed property to redeem the estate.

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Non-Judicial Foreclosure

When there is a "power of sale" provision in the mortgage or trust deed document, a non-judicial foreclosure can force the sale of the liened property *without a foreclosure suit*. The "power of sale" clause in effect enables the mortgagee to order a public sale without court decree.

Foreclosure process – On default, the foreclosing mortgagee records and delivers notice to the borrower and other lienholders. After the proper period, a "notice of sale" is published, the sale is conducted, and all liens are extinguished. The highest bidder then receives unencumbered title to the property.

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Deficiency suit – The lender does not obtain a deficiency judgment or lien in a non-judicial foreclosure action. The lender instead must file a new deficiency suit against the borrower.

Re-instatement and redemption – During the notice of default and notice of sale periods, the borrower may pay the lender and terminate the proceedings. Exact re-instatement periods vary from state to state. There is no redemption right in non-judicial foreclosure.

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Strict Foreclosure

Strict foreclosure is a court proceeding that gives the lender title directly, by court order, instead of giving cash proceeds from a public sale.

On default, the lender gives the borrower official notice. After a prescribed period, the lender files suit in court, whereupon the court establishes a period within which the defaulting party must repay the amounts owed. If the defaulter does not repay the funds, the court orders transfer of full, legal title to the lender.

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Deed in Lieu of Foreclosure

A defaulting borrower who faces foreclosure may avoid court actions and costs by voluntarily deeding the property to the mortgagee. This is accomplished with a deed in lieu of foreclosure, which transfers legal title to the lienholder. The transfer, however, does not terminate any existing liens on the property.

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Lien Priority

The following example illustrates how lien priority works in paying off secured debts.

By foreclosure sale the property netted $183,000.

Liens to be satisfied:

$25,000 – Second mortgage from 2001

$150,000 – Balance from 1997 First mortgage

$1,000 – Unpaid taxes from current year

$3,000 – Mechanic's lien from 1999

Lien distribution

1 . $1,000 Real estate taxes
2. $150,000 First mortgage
3. $3,000 Mechanics lien
4. $25,000 Second mortgage
5. $4,000 Balance to homeowner

Note the risky position of the second mortgage holder: the property had to sell for at least $179,000 for the lender to recover the $25,000.

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Foreclosure Effect on Title

State laws require the recording of all documents that affect rights and interests in real estate in the public real estate records of the county where the property is located. These title records, contain a history of every parcel of real estate in the county, including names of previous owners, liens, easements, and other encumbrances that have been recorded.

When properties are in default or going through the foreclosure process makes it difficult to transfer title.

Foreclosure is a lengthy and expensive process for the lender and other parties.

The title isn't clear until the foreclosure process is complete and all redemption periods have passed.

SLIDE 19

Short Sale

In order to avoid the lengthy and expensive foreclosure process, some lenders are open to a short sale of the property.

A short sale is an agreement between a mortgage borrower in distress and the lender, that allows the borrower to sell the house and remit the proceeds to the lender. The lender is willing to accept the sales price at market value for the property which is less than the current mortgage.

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Summary

SUMMARY	
Lien theory state	The buyer will hold the deed to the property for the term of the mortgage promising to make all payments to the lender – with title remaining with the buyers. Once all payments have been made, lender's lien is removed.

Section 12: Residential Mortgages

Slide 21

Summary

SUMMARY	
Promissory note	Legal instrument executed by borrower stating debt amount, loan term, method and timing of repayment, interest rate, promise to pay; may repeat other provisions from mortgage document or deed of trust; negotiable instrument assignable to a third party
Mortgage document and trust deed	The legal documents which pledge the property as collateral for the loan May include clauses covering payment of principal and interest, prepayment, late charges, escrow for taxes and insurance, liens, insurance requirements, occupancy and maintenance, lender's rights, private mortgage insurance, inspection, and other conditions of performance

Section 12: Residential Mortgages

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Summary

SUMMARY	
Anatomy of Mortgage Lending	
Mechanics of a loan transaction	Mortgage financing: using borrowed money secured by a mortgage to finance the purchase of real estate Instruments: note and mortgage or trust deed Mortgage mechanics: borrower gives lender note and mortgage; lender gives borrower funds and records a lien Trust deed mechanics: trust deed conveys title from the borrower/trustor to a third-party trustee who holds title on behalf of the lender/beneficiary until the debt is repaid

Section 12: Residential Mortgages

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Summary

SUMMARY	
Liens	Claims attaching to real and personal property as security for debt
Lien types	Voluntary and involuntary; general and specific; superior and junior
Lien priority	Rank ordering of claims established by lien classification and date of recording; determines who gets paid first if lienee defaults
Superior liens	Rank over junior liens; not ranked by recording date; real estate tax and assessment liens and inheritance taxes
Junior liens	Rank by recording date: judgment; mortgage, vendor's, utility, mechanic's, other tax liens; mechanic's lien priority "dates back" to when work or sale transpired

Slide 24

Summary

SUMMARY	
Financial components of a loan	Original principal: capital amount borrowed on which interest payments are calculated Loan balance: remaining unpaid principal at any point in the life of the loan Interest: charge for the use of money; rate fixed or variable Annual Percentage Rate (APR) includes interest and all other finance charges; lender must disclose on residential properties Point: one percent of the loan amount, charged by lender at origination to obtain required return Term: period of time for repayment of interest and principal Payment: periodic payment of interest and/or principal

Slide 25

Summary

SUMMARY	
Foreclosure	Enforcement of liens through liquidation or transfer of encumbered property
Mortgage lien foreclosure	Liquidation or transfer of collateral property by judicial, non-judicial, or strict foreclosure
Judicial foreclosure	Enforcement of liens through liquidation or transfer of encumbered property
Non-judicial foreclosure	"power of sale" granted to lender; no suit; no deficiency judgment; no redemption period after sale
Strict foreclosure	court orders legal transfer of title directly to lender without public sale
Deed in lieu of foreclosure	defaulted borrower deeds property to lender to avoid foreclosure