

Foreclosure Update

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July 15, 2010

In the past...

- Foreclosures not as big of a problem for lenders
- Foreclosed property could usually be re-sold at a price that would fully pay off the debt and the lender's foreclosure costs
- This worked fine when foreclosures were at a level of 0.5% of all loans

But now...

- Substantial increase of foreclosures
 - At the end of 2009 the overall foreclosure level reached 5.98% - 10 times greater than traditional levels
 - Six states (CA, FL, MI, IL, AZ and TX) represented more than 60% of all foreclosures nationwide
 - 1st Q of 2010 has seen a 7% increase from the previous Q and a 16% increase from the 1Q of 2009

Source: Mortgage Banker's Association and RealtyTrac

Current State of Affairs

- ❑ In the first quarter of 2010, nearly 1 out of every 3 new home sales was a foreclosure property (approximately 31%)
- ❑ In a normal market, this is usually only about 1% to 2% of home sales.
- ❑ Lenders have been repossessing homes at record levels over the first half of 2010
- ❑ This will certainly lead to more distressed properties being on the market.

Source: Reuters

Non-Judicial Procedure

(in most cases)

- ❑ Because Texas is a lien state with non-judicial foreclosures, it is important that all of the proper steps are taken to have a valid foreclosure
 - And good title to be insured on a sale from the foreclosing lender
- ❑ For 4 years after foreclosure, owner can sue to set it aside (but no right of redemption)

Power of Sale

- ❑ Confirm that the foreclosed Deed of Trust (DT) contains “power of sale”
- ❑ This may be by specific language or by reference to state law providing for non-judicial foreclosure.
- ❑ Foreclosure must be conducted in compliance with the provisions of the DT and Texas Property Code §51.002

The non-judicial foreclosure must be conducted in compliance with the terms of the deed of trust

- A trustee's power to sell a mortgagor's property is derived solely from the deed of trust and the powers conferred on the trustee must be strictly followed.
- Therefore, if the deed of trust power of sale provisions establish requirements in addition to those set forth under Section 51.002 of the Property Code, these additional requirements must be complied with.
- The policy issuing agent may rely on an affidavit from the trustee or substitute trustee or the recitals contained in the trustee's or substitute trustee's deed which specifically verify that the terms and conditions of the deed of trust have been complied with.

Foreclosure Procedure

- Was a substitute trustee appointed?
 - Only the trustee or a properly appointed substitute trustee may foreclose.
 - Is the appointment in writing?
- Was the note accelerated?
- Was the owner notified as per law and the DT?
- Notices posted?
- Times and places noticed?

Who may foreclose?

- Confirm that the non-judicial foreclosure was conducted by the trustee or a properly appointed substitute trustee.
- Unless authorized by the deed of trust, the power of sale cannot be delegated to another.
- A foreclosure sale conducted by anyone other than the designated trustee or authorized substitute trustee is **void**.
- Any failure to comply with the provisions of the deed of trust pertaining to the appointment of a substitute trustee renders the appointment void.
- However, a trustee or substitute trustee may delegate the duties of signing and posting the notice because these acts are ministerial in character.
- The debtor must not be in bankruptcy – the automatic stay precludes the trustee from proceeding with the foreclosure

Appointment of Substitute Trustee

- Unless expressly required by the deed of trust, there is no requirement that the appointment of a substitute trustee be recorded.
- However, if the appointment of substitute trustee is not recorded, the policy issuing agent should require a copy of the appointment for review and recording.
- If the deed of trust requires that the appointment of substitute trustee be recorded, any notice of sale by the substitute trustee will have no force or effect until the appointment is recorded.
- If the appointment of substitute trustee is required to be recorded by the deed of trust and the appointment is made before the rendition of the 21-day notices required by Section 51.002(b) of the Property Code, the appointment must be recorded at least 21 days prior to the foreclosure sale in order to validate said sale.
- A mortgage servicer can administer a foreclosure for the mortgagee under and the mortgage servicer can appoint a substitute trustee. You may assume that the foreclosure is valid if it is a one to four family property and the mortgagor has abandoned the property.

Requirements of §51.002

- If the property is the debtor's residence, the holder of the debt must give the debtor
 - (i) written notice of default by certified mail and
 - (ii) at least 20 days to cure the default **before notice of sale can be given.**
- Notice of the sale must be given at least 21 days before the date of the sale by:
 - Posting at the courthouse door of each county in which the property is located, a written notice designating the county in which the property will be sold.
 - Filing in the office of the county clerk of each county in which the property is located, a copy of the posted notice.
 - Serving written notice of the sale by certified mail on each debtor who, according to the records of the holder of the debt is obligated to pay the debt.
- Service of notice is complete when the notice is deposited in the United States mail, postage prepaid, and addressed to the debtor at debtor's last known address as shown by the records of the holder of the debt.
- Service of notice is to be given by the holder of the debt. (Property Code Sec. 51.002(e)).

Notice...

- **Notice to Whom?**
 - Under §51.002 of the Property Code and current case law, only the debtor/debtors obligated to pay the debt must be served with written notice of the sale.
 - In addition to the maker(s) of a note, guarantors and anyone who has assumed the mortgage and so informs the mortgagee of said assumption must also be served with written notice of the sale.
- **Computation: 20-Day Notice**
 - The entire calendar day on which the 20-day notice to cure is given (regardless of the time of day at which the notice is given) is included in computing the 20-day cure period, and the entire calendar day on which the notice of foreclosure sale is given is excluded.
- **Computation: 21-Day Notice**
 - The day on which the 21-day notice of foreclosure sale is given (regardless of the time of day at which the notice is given) is included in computing the 21-day notice of foreclosure sale period, and the entire calendar day of the foreclosure sale is excluded.

The Foreclosure Sale; when and where

- ❑ The sale must be a public sale at auction held between 10:00 a.m. and 4:00 p.m. of the first Tuesday of the month.
- ❑ The sale must take place at the county courthouse where the property is located. *If the property is located in more than one county, the sale may be made in any county where the property is located.*
- ❑ The sale must take place in the area at the courthouse designated by the county commissioner's court. If no area is designated by the commissioner's court, the sale must take place in the area of the courthouse specified in the notice of sale.
- ❑ The notice of the sale must state the earliest time at which the sale will begin.
- ❑ The sale must begin at the time specified in the notice of sale or not later than 3 hours after that time.

Reliance on Recitals in Trustee's Deed and/or Affidavit

- ❑ Unless the policy issuing agent has actual knowledge of some problem with the sale, it may rely on recitals in the trustee's deed or in an affidavit from the trustee or substitute trustee which verifies the foreclosure sale was conducted in compliance with Sec. 51.002. The recitals should specifically outline the requirements of Section 51.002 which have been complied with and provide specific information rather than general representations.
- ❑ Since recitals contained in a trustee's or substitute trustee's deed constitute prima facie evidence that the terms of the deed of trust were fulfilled, the Company will accept the recitals in the trustee's or substitute trustee's deed in lieu of the affidavit noted above. However, the requirements for specifics in the affidavit also apply to the recitals in the trustee's or substitute trustee's deed.

Is the Debtor in possession?

- ❑ The policy issuing agent may rely upon an inspection by the policy issuing agent which verifies the debtor has vacated the property, or
- ❑ A non-possession recital in the trustee's or substitute trustee's affidavit, or
- ❑ A non-possession recital delineated in the trustee's or substitute trustee's deed (even though this is not really a sworn statement).

What about the Dead Debtor?

- Was the Debtor Alive at the time of the Foreclosure?
- Intestacy/Dependent Administration - A non-judicial foreclosure is allowed during the pendency of a dependent administration if:
 - The personal representative and lienholders are personally served,
 - The court authorizes the foreclosure, and
 - The claim of a lien has been allowed, approved and fixed.
- The court may establish a minimum price.
- A confirmation order after the sale is not required.
- Underwriting Standard: To insure out of such a non-judicial foreclosure sale:
 - Verify that all other requirements for a non-judicial foreclosure are satisfied,
 - Verify that the personal representative, any other owner, and all lienholders are personally served, and
 - Verify the bid complied with any court ordered minimum price.

Dead Debtor(s) continued...

- A dependent administration can be opened at any time within four years of the mortgagor's death
- If more than 4 years has elapsed since the death of the debtor with no administration having been filed, a non-judicial foreclosure can be pursued.
- If more than 4 years has passed since the death of the debtor and no dependent administration has been opened, then a foreclosure sale conducted during the 4 years will pass title via the recorded trustee's deed.

As it happens...(requests from mortgagee's counsel)

- If the debtor has been dead less than 4 years;
- No probate proceeding has been filed in the county where the property is located;
- No letters testamentary have been granted to a personal representative;
- The property is abandoned;
- There is limited equity; and
- The mortgagee has been paying taxes and insurance, then:
 - STG will agree to insure post foreclosure upon resale of the subject property, subject to the continuing vacancy of the property, no dependent administration pending, no contest of the non-judicial foreclosure by the heirs (no evidence of threatened legal action, etc.)

What about Testacy/Independent Administration?

- The power of sale in a deed of trust may be exercised after the death of the debtor if there is a pending independent administration. The policy issuing agent should review the notice of sale to confirm that the independent executor or executrix was notified.
- The policy issuing agent should require either a **recital** in the trustee's or substitute trustee's affidavit or deed which indicates the debtor was alive at the time of the non-judicial foreclosure or the facts of an intestacy or testacy situation that allow foreclosure. Such recitals should be supported by complete documentation.

What about Bankruptcy?

- Is/was a bankruptcy pending against the debtor at the time of the foreclosure?
- The filing of a bankruptcy petition by the debtor operates as an automatic stay against the commencement or continuation of a foreclosure proceeding.
- If the title search to a property reflects a recent foreclosure consummated after the filing of a bankruptcy petition by the debtor, the policy issuing agent should require a certified copy of an order from the bankruptcy court lifting the automatic stay. Said order must be obtained prior to the foreclosure and recorded.

What if there was no order lifting the stay?

- If a foreclosure has been initiated and completed subsequent to the filing of a bankruptcy petition by the debtor in violation of the automatic stay, it may be possible to validate the foreclosure.
- An order from the bankruptcy court which "annuls" the automatic stay has the effect of invalidating the stay thereby rendering the foreclosure sale valid.
- However, a subsequent bankruptcy order which merely "lifts" or "terminates" the stay is not sufficient to validate a foreclosure conducted in violation of the automatic stay. The subsequent bankruptcy order must contain specific language which "annuls" the stay in order to validate foreclosure.
- Therefore, you should require a certified copy of a bankruptcy order annulling the stay be recorded in order to insure a title arising out of a foreclosure which was otherwise conducted in violation of the automatic stay.

Abandonment of Debtor's Real Property

- The abandonment of property by the bankruptcy trustee does **not** terminate the automatic stay in regard to the abandoned property.
- Upon filing the bankruptcy, property owned by the debtor becomes property of the bankruptcy estate. The automatic stay applies to property of the bankruptcy estate *and* property of the debtor.
- Abandonment of the property by the trustee merely converts the property into property of the debtor so the automatic stay is still in existence against property of the debtor.
- Even if the property is abandoned by the bankruptcy trustee, require a court order lifting the automatic stay be obtained prior to a foreclosure.

Was the Debtor in the Military Service at the time of the Foreclosure?

- The Servicemembers Civil Relief Act (SCRA) (as amended 50 U.S.C.S. §533) provides special protections for servicemembers from a sale, foreclosure, or seizure of property.
- The sale, foreclosure or seizure of property for default on a debt originated before the servicemember's military service shall not be valid if made during, or within 9* months after, the period of the servicemember's military service, except:
 - Upon court order, or
 - Pursuant to a written agreement.
- *after December 31, 2010, this period will revert to 90 days

Texas version of the Servicemembers Civil Relief Act

- Texas has its own codification (§51.015 of the Texas Property Code) which requires a court order to foreclose any loan originated before a person was called to active duty that is secured by a "dwelling". This protection continues for nine months after active duty is terminated. So Texas law will maintain the 9 month period after the date on which the service period is concluded.
- In either case (Federal or State law): compliance with this requirement is generally satisfied by:
 - A recital in the trustee's or substitute trustee's affidavit or a recital in the trustee's or substitute trustee's deed which indicates the debtor was not in the military at the time of the non-judicial foreclosure.
 - A written agreement between the parties, or
 - A court order.

If there is no indication as to the debtor's military status:

□ The following link may be of some help

- <https://www.dmdc.osd.mil/appj/scra/scraHome.do>

Mechanic's Lien Issues

- Vendor's and purchase money liens have priority over subsequently recorded mechanic's liens unless the mechanic's lien is secured by "removables".
- Removables are defined as improvements that can be removed from the structure without material damage to either the item itself or the structure at the time of removal.

So what is a removable?

- Murky, gray area as the law has been all over the map when it comes to determining whether an item qualifies as a removable.
 - Usually carpet, doors, windows, cabinets, hearing and air-conditioning are considered removables
 - But not paint, wallpaper, rough plumbing, framing
- Also, very often the affidavits filed claiming mechanic's liens do not clearly specify the materials used and/or work done.
- If ML has been filed involving removables, the claimant may repossess the items from the property.

Home Equity Mortgage Foreclosures

- Require a court order allowing the foreclosure of the lien.
- Expedited judicial proceeding (Tex. Rules of Civ. Proc. 735 and 736) to establish default under the security instrument, as well as that notice to cure the default and accelerate the maturity of the debt under the security instrument has been given.
- This procedure does **not** constitute a judicial foreclosure.

Reverse mortgage – is a court order required?

- It depends:
- A court order is **not** required if the grounds for the foreclosure is due to a default:
 - When all the borrowers have died, or
 - The homestead property securing the loan is sold or otherwise transferred

Court Order Required

- In reverse mortgages only when default is due to:
 - All borrowers cease to occupy the property for a period of longer than 12 consecutive months without prior written approval from the lender;
 - Failure to repair and maintain, pay taxes and assessments, on or insure the homestead property;
 - Commits actual fraud in connection with the loan; or
 - Fails to maintain the priority of the lender's line on the homestead property

Foreclosure Alternatives

Home Affordable Foreclosure Alternative Program
"HAFA"

HAFA

- Part of the Home Affordable Modification Program "HAMP"
 - HAMP: a uniform loan modification process to provide eligible borrowers with sustainable monthly payments for their 1st lien mortgage loans.
- Primary Goal of HAFA: Reduce foreclosure inventory by making the short-sale process faster and easier

How does HAFA work?

- Pursuant to the servicer's policy, every potentially eligible borrower must be considered for HAFA before the borrower's loan is referred to foreclosure or the servicer allows a pending foreclosure sale to be conducted
- Servicers must consider possible HAMP eligible borrowers for HAFA within 30 calendar days of the date the borrower:
 - Does not qualify for a Trial Period Plan
 - Does not successfully complete a Trial Period Plan
 - Is delinquent on a HAMP modification (missing at least 2 consecutive payments); or
 - Requests a short sale or DIL

How does HAFA work? (continued)

- ❑ Borrowers must have been evaluated for a HAMP modification and/or meet the HAMP criteria if not previously evaluated
- ❑ Lender must get an independent valuation but does not have to price the property at the estimated market value or offer a discount
- ❑ Sales price must be established and revealed to the property owner
- ❑ If a buyer matches or exceeds the stated sale price the lender must agree to a sale within 10 days

Conditions of the Short Sale or Deed in Lieu (DIL)

- ❑ HAFA short sale (or deed in lieu), the servicer may not require a cash contribution or promissory note from the borrower
- ❑ Servicer must forfeit the ability to pursue a deficiency judgment against the borrower.

Review of Title

- ❑ Servicer must review readily available information provided by the borrower to determine if borrower can deliver "clear, marketable title" to a prospective purchaser (in Texas this would be "good and indefeasible title")
- ❑ Servicer *may* order a title search
- ❑ Borrower may not be charged for the title search but the cost may be added to the outstanding debt in accordance with the borrower's mortgage documents and applicable law in the event the short sale or DIL is not completed.

Seller Requirements

- ❑ Must be the borrower's principal residence
- ❑ Mortgage must be a 1st lien originated before January 2, 2009
- ❑ Mortgage must be delinquent or default must be reasonably foreseeable
- ❑ Unpaid principal balance < \$729,750
- ❑ Borrower's total monthly mortgage payment must > 31% of gross income

HAFAs Rules for Purchasers

- ❑ Must be arms-length transaction
- ❑ **Property may not be re-sold within 90 calendar days of closing**
 - Which brings up some questions about short sales....

Short Sales Issues

- ❑ Short sale instructions from lenders may contain unacceptable conditions that will render the transaction uninsurable
- ❑ Be sure to carefully read the sale approvals and instructions. If there are any provisions that would potentially void the sale, then do not proceed to close or insure. Some examples are:
 - "If the property was acquired by any means of fraud, Lender reserves the right to pursue any and all actions available to it to offset its losses. If it is determined that Seller(s) and/or Buyer(s) participated in any way to the fraud, this short sale will be void, and the Note and Security Instrument will remain in full force and effect."
 - "Lender requires full disclosure which includes all details of the transaction on both the Seller and Buyer side of the HUD1. If Lender finds full disclosure was not made at the time of the approval, the approval becomes null and void."
- ❑ If any such provision is present, do not sign or accept the instructions unless the instructions are revised to remove the objectionable provisions.

Short Sales Issues continued: Restrictions on Subsequent Sales

- The lender's closing instructions may contain provisions regarding subsequent sales, for example:
 - "There are to be no transfers of property within 30 days of the closing of this transaction. Escrow instructions must contain a clause that if such a transaction takes place then the title/escrow company must notify Lender."
- How does the a title company closing a short sale know whether the property will be transferred again within 30 days after the short sale.

Subsequent sale limitation continued..

- Obtain an affidavit from the buyer confirming that the property will not be sold within that timeframe.
- Insert the following exception in the Owner's Policy excepting to the terms of the payoff and any claim of reinstatement of the lien for failure to comply:
 - "The transaction vesting the Title as shown in Schedule A is subject to a condition prohibiting the transfer of the Title within ___ days after Date of Policy. This policy excepts any claim of reinstatement or refusal to release the ___ lien recorded _____ as a result of the failure to comply with said condition."
- See Bulletins SLS2010004 and SLS2010005 for more information and an example of the buyer's affidavit

Short Sales and Junior Liens

- All liens must remain exceptions unless released.
- Lender instructions may contain prohibitions or restrictions regarding payment to the second lienholder(s).
- Any payment to any lienholder, whether disbursed from proceeds at closing or POC, MUST be shown on the HUD-1.

Back to HAFA...

What effect on 2nd liens?

- Servicer *may* negotiate with subordinate lien holders on behalf of the borrower
- Servicer, on behalf of the investor, will authorize the settlement agent to allow a portion of the gross sale proceeds as payment to a subordinate lien holder in exchange for a release of lien and borrower liability
- Each lien holder may be paid no more than 6% of the unpaid principal balance of their loan up to \$6,000.
- Payments must be reflected on the HUD-1
- Prior to releasing funds to any subordinate lienholder, the servicer must obtain written commitment that it will release the borrower from all claims and liability in exchange for the agreed upon payoff amount

Borrower Fees

- Servicers may not charge borrower any administrative processing fees in connection with HAFA
- Servicer must pay all out-of-pocket expenses (e.g. notary fees, recording fees, release fees, **title costs**, property valuation fees, credit report fees, etc.)
- Servicer may add these costs to the outstanding debt in accordance with mortgage docs and applicable laws in the event the short sale or DIL is not completed
- Servicers may require borrower to waive reimbursement of any remaining escrow, buy down funds, or prepaid items, and assign any insurance proceeds to the investor, said funds will not be applied to reduce the total net proceeds from the sale

Financial Incentives

- Loan must be HAMP eligible in order to qualify for incentive compensation under HAFA
- Following successful short sale or DIL, borrower entitled to incentive payment of \$3,000 to assist with relocation expenses
 - Servicer must instruct the settlement agent to pay the borrower from the sales proceeds and this must be shown on the HUD-1
 - If borrower has not moved out of the property, the check must be mailed to the servicer within 5 business days of the borrower's vacancy and delivery of keys to servicer or servicer's agent
- \$1,500 for servicers to cover administrative and processing costs

Bankruptcy Issues

- Chapter 7 or 13 borrowers must be considered for HAFA if the borrower, borrower’s counsel, or bankruptcy trustee submits a request to the servicer
- With borrower’s permission, trustee may contact servicer to request a short sale or DIL under HAFA
- Servicers are not required to solicit borrowers
- Servicer and borrower (and their respective counsel) must work together to obtain any court order and/or trustee approvals required in accordance with local court rules and procedures
- Servicers should extend HAFA timeframes as necessary to accommodate delays in obtaining court approvals

Suspension of Foreclosure Sales

- Servicer may initiate or continue an existing foreclosure proceeding during the HAFA process but may **not** complete the sale:
 - While determining the borrowers eligibility and qualification for HAFA
 - While awaiting the timely return of a fully executed short sale agreement (SSA)
 - During the term of a fully executed SSA
 - Pending transfer of property ownership on an approved sales contract per the Request for Approval of Short Sale (RASS) or Alternative RASS
 - Pending transfer of property ownership via a DIL by the date specified in the SSA or DIL Agreement

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