

FORECLOSURES IN CALIFORNIA

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In California, there is only one remedy to collect a debt secured by a mortgage or deed of trust on real property. That remedy is foreclosure. The party holding a note secured by real property cannot waive the security and sue independently on the note. For this reason it is important to understand some of the basics of the foreclosure process.

There are two basic ways to proceed with foreclosure: judicial and non-judicial. In a judicial foreclosure a lawsuit is filed and the real property will ultimately be sold at a foreclosure sale, usually conducted by a receiver. The creditor has the right to seek a deficiency judgment for the difference between the amount of the debt and the fair value of the property.

The deficiency is not measured by the amount actually received at the foreclosure sale. If a deficiency judgment is sought, the property is sold subject to a right of redemption. That is, the property may be reacquired by the borrower within the redemption period (usually one year following the foreclosure sale) by paying the price paid at the foreclosure sale, plus interest, taxes, insurance, and similar items accrued during the redemption period.

Because of the time and expense involved in a judicial foreclosure, as well as the fair value limitations on the amount of a deficiency judgment, the vast majority of all foreclosures proceed non-judicially, as they do in California.

Non-judicial foreclosure sales, usually called trustee's sales, are regulated by statute. The statutory procedures must be strictly followed. The foreclosure is initiated by a Notice of Default being filed. This notice states what the borrower must do to cure the default and it explains the lender's right to force the sale of the property to satisfy the debt. Among other things, the notice must contain a full and accurate statement of the nature of the breach. Failure to give an adequate notice may invalidate the foreclosure.

The Notice of Default explains in detail, the borrower's reinstatement rights. A borrower has the right to bring his account current and avoid foreclosure by paying the past due amounts, plus certain permitted expenses. The amounts must be paid five business days prior to the date of the foreclosure sale. The borrower does not have to pay the full accelerated amount if he timely cures the default. After the time for reinstatement has passed, the borrower can stop foreclosure only by paying the entire amount of the debt, plus permitted costs and expenses.

Costs and expenses are limited by statute. Even if the note or deed of trust provides for the recovery of costs and attorneys' fees, the fees and costs incurred in foreclosing are subject to the statutory limit.

Notice of the time and place of sale is a prerequisite to a sale under a power of sale. The notice must be given at least 20 days before the sale and at least three months after the Notice of Default is filed. The existence of junior liens is determined as of the date the Notice of Default is filed. For example, if a junior lien, including a mechanics lien, is recorded after the Notice of Default, the new junior lien is not entitled to any notice. Anyone taking lien on real property must check the record to avoid being sold out without notice. The one exception to this rule is federal tax liens that may attach to the property up until the Notice of Trustee Sale is filed.

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The Notice of Trustee Sale is posted in a public place and also on the property. If the property is a single family residence, it must be posted on the front door. The sale is by public auction to the highest bidder. The sale is conducted by the trustee. The trustee owes a fiduciary to the borrower to conduct the sale openly and fairly. A prospective bidder has been allowed to sue a trustee who fraudulently conducted a secret sham sale, and there are criminal penalties for collusive bidding or accepting consideration not to bid or to fix or restrain bidding at the auction.

The trustee's sale may be postponed upon the request of the beneficiary (the note holder). Formerly, the borrower was entitled to one postponement, but the statute was amended in 1992 so that now the borrower has no right to a postponement of the sale. The beneficiary may postpone the sale three times. If a sale is postponed three times, the scheduling of a further sale requires a new notice of sale. Not counted against the three-postponement limitation are postponements requested by the borrower or ordered by the court.

At the sale, the note holder is entitled to credit bid the full amount of his debt, though unless there are other bidders it is seldom wise to make a full credit bid. Acceptance of the highest bid completes the sale, and the bidder must deposit payment on demand. Failure to deposit the payment subjects the bidder to liability for damages sustained by the trustee and, if the failure is willful, potential criminal penalties. The successful bidder takes the property free of all liens junior to the foreclosed liens, but subject to any senior encumbrances.

A bankruptcy filing by a borrower can disrupt the foreclosure process. Immediately upon filing of a bankruptcy petition the automatic stay comes into effect and any foreclosure proceeding must stop. It is not uncommon for a bankruptcy filing to precede the scheduled trustee's sale by hours (or sometimes minutes). So long as the bankruptcy proceeding is pending, the foreclosure cannot proceed unless the bankruptcy court permits it. Even in cases where the borrower has no equity in the property being foreclosed, the bankruptcy court must give relief from the automatic stay so that the foreclosure can go forward.

Since foreclosure is the only remedy available to collect a debt secured by real property, a familiarity with the foreclosure process is essential to a note holder. Properly initiating and pursuing foreclosure will prevent challenges by a borrower seeking to delay the inevitable.