American Nightmare

Most immigrants and naturalized citizens who sought greener pastures in America looked forward to achieving the American Dream of attaining success through hard work. Years of toiling and buckets of sweat generated prosperity to diligent laborers. Many enjoyed the rewards of homeownership during the boom of the latter part of nineties through the early part of this decade.

Today, most homeowners suffer from what I call "The American Nightmare." It is no longer news that Americans are feeling the effects of the housing slump. Some homeowners may have taken the plunge into homeownership despite their inability to afford the mortgage payments. Others may have been steered towards subprime rates that resulted in a negatively amortizing mortgage. And some individuals, despite their best intentions, cannot keep up with the payments and are imprisoned in a home which has a market value that is significantly less than the amount of their loan. Regardless of which situation you identify with, don't feel that there is no hope. There are many alternatives to foreclosure.

It is important that I begin with a primer on the foreclosure process before I discuss the various solutions available to homeowners threatened with the loss of their property. In California, lenders may foreclose on deeds of trusts or mortgages in default either through a judicial or non-judicial foreclosure process. In a judicial foreclosure, the lender must file a Complaint to allege the default and to seek a judicial decree allowing the lender to foreclose. The defaulting borrower is given the opportunity to file a response to challenge the allegations in the Complaint. The judicial foreclosure is rarely used because it is a lengthy and more expensive process for the lender.

In a non-judicial foreclosure, the lender simply exercises its rights under a "power of sale" clause in the mortgage or deed of trust. The lender is not required to file a Complaint and may simply conduct a trustee sale, but it must follow strict guidelines under the California statutes. The process begins when the lender records a Notice of Default in the County Recorder's Office which notifies the borrower of its default. The borrower is given a 90-day redemption period to cure the default.

If the default is not cured during that time, the lender will record a Notice of Trustee Sale. The sale or auction must be scheduled at least 20 days after the Notice of Trustee Sale is recorded. If the default is not cured, the sale is conducted and the property is awarded to the highest bidder.

This article will briefly describe the tools available to the homeowner to either delay, postpone or stop the foreclosure process. Even before a Notice of Default is recorded, a homeowner in default has a good estimate of how much of the mortgage payments are past due. During this time, the homeowner may avoid recordation of the Notice of Default through "reinstatement" by paying the past due amount including any late fees. Reinstatement is also available even after a Notice of Default is recorded. However, at that time, the homeowner will have to pay the fees incurred by the lender to hire a foreclosure attorney for starting the foreclosure process, along with the past due amount, late fees and other penalties.

A homeowner may also negotiate with the lender to enter into a forbearance agreement. This will allow the homeowner who is currently experiencing a short-term financial crisis to stop paying or reduce the mortgage payments for short period, usually up to six months. If a homeowner's financial picture looks grimmer, a loan modification may also be negotiated. Lenders may agree to reduce the interest rates for a certain period or for the life of the loan. In rare situations, lenders may even reduce the principal to come close the market value of the property.

Sometimes, the homeowner will come to grip with reality that the property is either not worth keeping or not affordable to maintain. Borrowers are advised not to simply walk away and hand the keys to the lender. In today's market, if the lender forecloses on the property it is almost certain that the trustee sale proceeds will not be enough to cover the mortgage balance. The sale may generate a taxable event in which homeowners may be responsible for the deficiency and have to report it as taxable income.

Alternatives to walking away include a deed in lieu of foreclosure (property is voluntarily given to the lender who agrees to cancel the whole debt) and a short-sale (lender allows the sale of property at a price that is not enough to cover the loan balance). Using these alternatives, the borrower may negotiate with the lender to waive the deficiency to avoid having to report any cancelled debt or shortage as taxable income.

Future articles will discuss each alternative to foreclosure in detail. There will also be opportunities to discuss defenses to foreclosures in upcoming issues.