FEDERAL HOUSING FINANCE AGENCY
FHFA OIG
OFFICE OF INSPECTOR GENERAL

AN OVERVIEW OF THE HOME FORECLOSURE PROCESS

An Overview of the Home Foreclosure Process

Foreclosure:
The legal process used by a lender to secure possession of a mortgaged property.

Among the most prominent features of the current housing crisis has been an unprecedented jump in the incidence of mortgage delinquencies and **foreclosures**. Public policy and financial market observers have attributed delinquency and foreclosure increases to a wide range of causes and have offered varying policy prescriptions for what remains a continuing problem. Allegations of improper or deficient practices on the part of mortgage originators and servicers have also been a major source of controversy over the past few years. By identifying and describing the procedures and requirements that characterize an appropriately executed foreclosure process, FHFA-OIG seeks to provide useful context and understanding for policymakers and members of the public.

Most home purchases in the United States are financed through loans provided by banks or other lenders. Lenders, as part of the legal process that provides cash financing to borrowers, typically require a secured interest or mortgage on the property financed. Borrowers agree to accept the secured interest on their properties and to repay the loans provided over time. The foreclosure process typically commences only after a borrower has stopped repaying the loan (meaning that the loan has gone into default); the lender therefore uses the foreclosure process to recover the proceeds of the loan through the sale of the property. Foreclosure involves specific rights and obligations with respect to both the homeowner/borrower and the lender (or its representatives) through each step of the process.

Before turning to default and the foreclosure process, however, this overview reviews the legal process supporting mortgage loans. It next turns to default, the gateway to foreclosure, before discussing the foreclosure process and loss mitigation options. This discussion will also identify sources of information regarding federal programs designed to assist homeowners who may be involved in, or at risk of, foreclosure proceedings.

FUNDAMENTALS OF THE MORTGAGE

A mortgage is a loan secured by real estate collateral, specifically the borrower's house or apartment.[a] While the term "mortgage" is used colloquially to refer to both the loan and the security, there are actually two separate legal documents: a note and a security instrument.

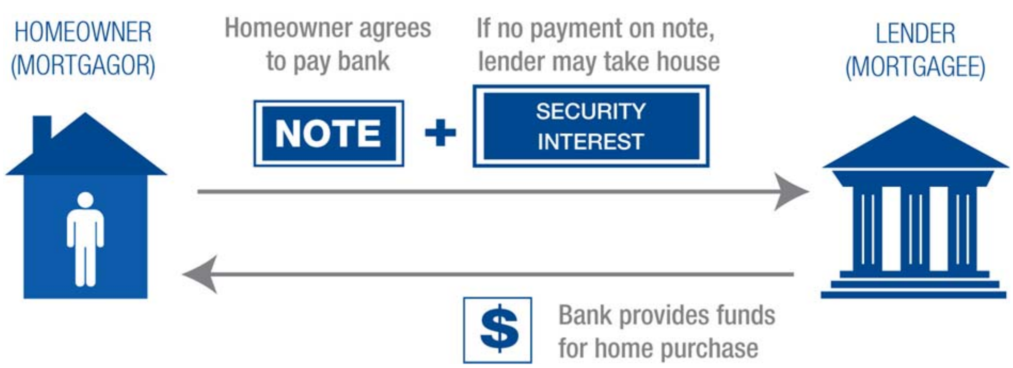
[a] Although real estate investors may also finance their purchases of commercial properties, such as office buildings and rental apartment complexes, through mortgage debt, this discussion will center specifically on residential mortgages.

Securitization:
A process whereby a financial institution assembles pools of income-producing assets (such as loans) and then sells an interest in the cash flows as securities to investors. See page 20, Figure 1.

The Note

The note represents the promise or agreement of the homeowner (mortgagor) to repay the loan to the lender or noteholder and specifies the terms of repayment, such as the interest rate and schedule of payments. Most mortgage notes are freely transferable from the original lender to others. Lenders, in fact, sell most loans to third parties, either directly or through the **securitization** process in which groups of mortgages are pooled together and sold as a security to investors. The Enterprises are the most prominent participants in the purchases and sale of mortgages; they accounted for approximately 70% of the nation's issuances of MBS in 2010. Rather than lend directly to homeowners, they purchase mortgages from the original lenders and other buyers. The mortgage note specifies that the borrower must repay the noteholder, which may differ from the original lender if the loan is sold.

Figure 9. Mortgage



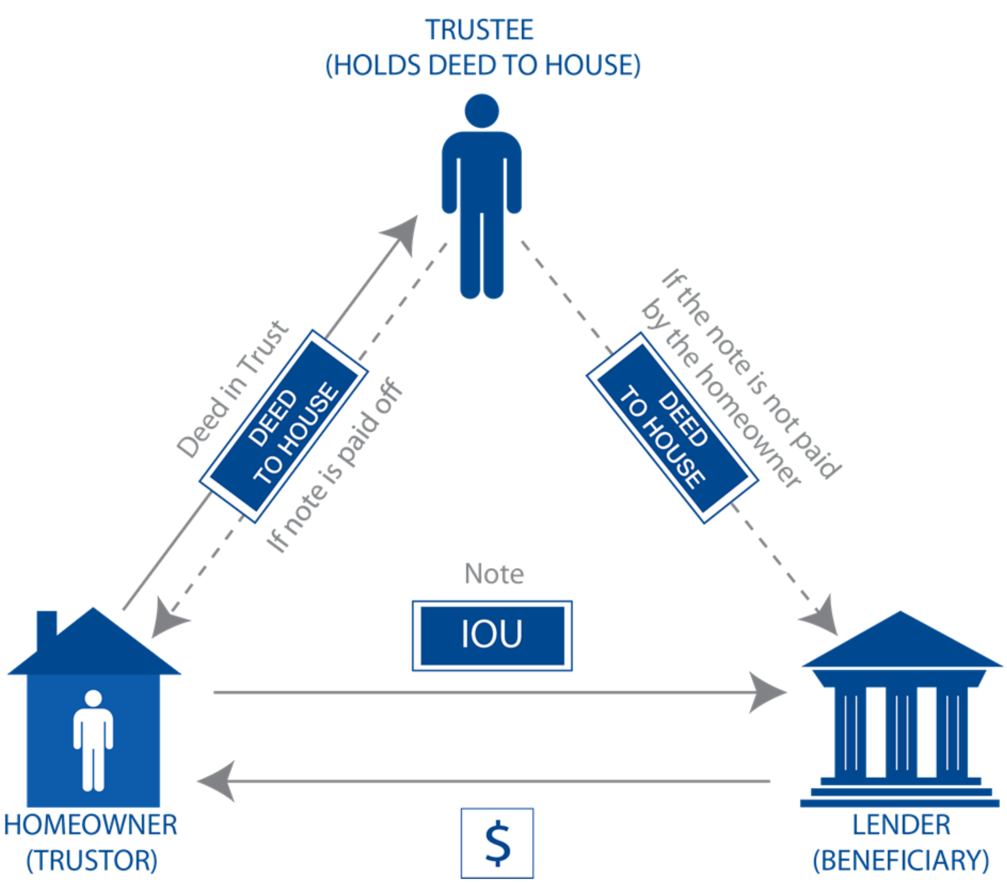
The Security Instrument

The security instrument is the separate legal document or agreement that pledges the house as collateral for repayment of the note. The security instrument goes by various names, such as the "mortgage," the "deed of trust" (DOT), or the "trust deed," depending on its form and the state in which the house is located. In many states, it is typically recorded in the county recorder of deeds offices in order to establish the mortgagee's interest in the property as a matter of public record. This is important because it establishes the mortgagee's rights in the property relative to other parties, including other mortgagees. The majority of mortgages are recorded using a private recordation company known as the Mortgage Electronic Registration System (MERS). When MERS is used, it is listed in county property records as the mortgagee, while the real mortgagee is tracked in MERS' private registry. The validity of MERS' various processes has been the subject of significant and on-going legal controversy.

Lien:
The lender's right to have a specific piece of the debtor's property sold if the debt is not repaid. With respect to residential mortgages, the noteholder retains a lien on the house (as evidenced by the mortgage or deed of trust) until the loan is repaid.

The form of the security instrument affects the foreclosure process. Legally speaking, a mortgage is the granting of a **lien**. The homeowner, as mortgagor, retains title to the property and grants a contingent interest to the lender as mortgagee. Alternatively, a DOT is more akin to a sale and repurchase: the homeowner, as trustor, gives title to the property to the DOT trustee, who holds it on behalf of the lender as beneficiary. The DOT trustee is typically a title company or a local attorney. The DOT trustee is charged with releasing the deed to the trustor if the loan is paid off or with foreclosing if the trustor defaults. In the standard DOT arrangement, if the homeowner defaults, the beneficiary noteholder will appoint a substitute trustee, often an affiliate, to handle foreclosure. The precise duties of DOT trustees may be a potential issue in foreclosures.[b]

Figure 10. Deed of Trust



[b] DOT trustees should not be confused with securitization trustees. Many securitizations involve a trust that holds legal title to the mortgages and notes. These trusts have a trustee – a major financial institution – that acts as an agent for the trust, carrying out functions such as remitting payments to investors in the securities issued by the trust and reporting to investors on the performance of the trust's mortgages. The actual management of the mortgages, though, is carried out by another entity, known as the servicer.

For more information on the servicer, see pages 26-27 of this report, Selected FHFA Programs and Activities.

The Servicer

All mortgage loans are "serviced," meaning the payments are collected and the loan otherwise is administered, including the release of liens upon payoff or the management of defaults. The servicer may be an arm of the original lender, or it may be an unrelated third party, in which case it is acting on behalf of the current owner of the loan, typically under a detailed contract known as a "pooling and servicing agreement" or "loan servicing agreement." As the majority of mortgage loans are sold by their original lender (sometimes referred to as the loan's "originator"), most loans have servicers that are unaffiliated with the original lender. For example, the Enterprises do not service any of the loans they own themselves; instead, they use third-party servicers, typically affiliates of the parties that sold the loans to them.

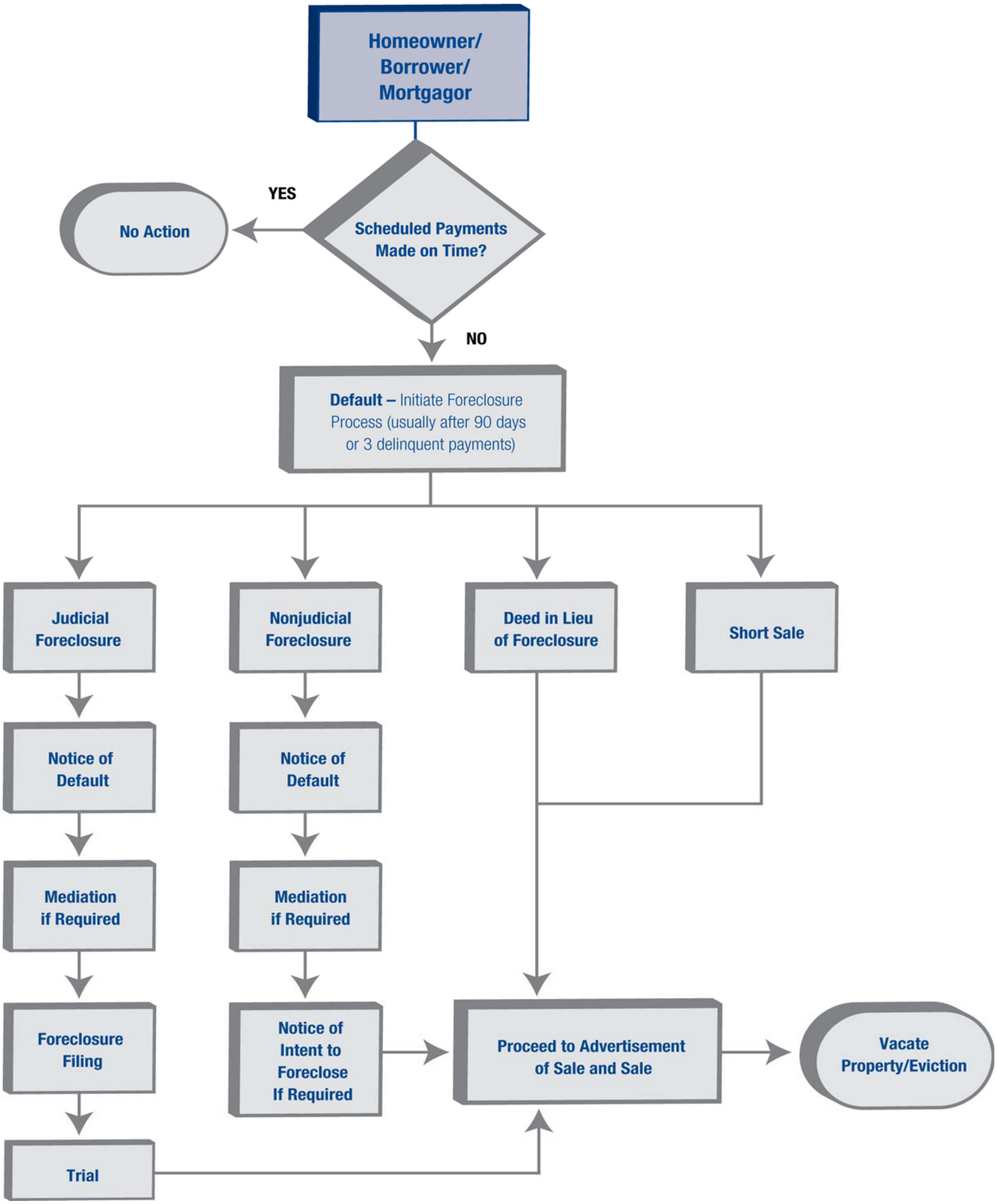
Subcontracting arrangements are common in servicing, so a borrower's contact may in fact be with a subservicer, a vendor, or an attorney engaged by one of these parties. Both servicing and subservicing contracts frequently impose limitations on the servicer's ability to manage the loan, including when and how the servicer may modify or otherwise restructure a loan.

DEFAULT

Default is the prelude to foreclosure. Although various technical defaults are possible, the typical default is a failure to make payments as required on the mortgage. Most mortgages require defined payments each month (though the amount due may vary if the mortgage has an adjustable rate), and mortgage servicers will often refuse to accept partial payments. Figure 11 illustrates the remediation process for a defaulted loan. The outcomes following a default depend on factors such as the amount and degree of delinquency, the borrower's overall financial situation, the value of the property and amount of indebtedness, the servicer's economic interests (as distinct from the mortgagee's), and constraints placed on the servicer by contract and applicable laws. Thus, a defaulted residential mortgage may return to good standing, or be modified, or the property may be sold or repossessed by the mortgagee via foreclosure or a voluntary surrender.

Generally, servicers will not commence a foreclosure until a mortgage is 90 days delinquent – that is, until the borrower has missed three consecutive payments. Thus, a homeowner can conceivably fall behind on a mortgage for a month or two and catch up without the servicer commencing a foreclosure. However, it is important to note that a servicer may legally begin foreclosure proceedings before a mortgage is 90 days late. Ninety days is a common practice, not a legal requirement.

Figure 11. Foreclosure Process Flowchart



Loss Mitigation

In some cases, the default may be cured and the loan reinstated. In addition, depending on individual circumstances, alternatives may exist that permit defaulted borrowers to remain in their homes while addressing their payment delinquency. It is important to note that most of these options are voluntary, but state law and contractual arrangements, including the acceptance of MHA program funds from Treasury, may trigger particular loss mitigation duties on the part of the servicer.

Mediation:
Mediation is a process by which a neutral third party (mediator) assists the homeowner and lender in reaching a fair, voluntary, negotiated agreement. The mediator does not decide who is right or wrong.

Mediation. Many states offer or require pre-foreclosure mediation between homeowners and servicers. In some states servicers are required to mediate in good faith in order to proceed with foreclosure. This may include presenting the homeowner with all appropriate paperwork for a foreclosure and having authority to accept settlement offers.

Modification. Common modifications include extending the mortgage's maturity date, adding past-due payments to the end of the mortgage, and making both permanent and temporary interest rate reductions. In most cases, when appropriately applied, these measures will lower the borrower's re-amortized monthly mortgage payment to a more affordable level.

Figure 12, at the end of this overview, lists those states that offer or require mediation as part of the mortgage loan default remediation process.

Reductions in the borrower's unpaid principal balance are uncommon. Although HAMP permits principal reductions at participants' option, the Enterprises do not provide for principal reductions in their implementation of HAMP. Homeowners should be aware that under certain circumstances the forgiven debt may be deemed income for tax purposes.[1]

A detailed listing of borrower eligibility criteria for HAMP and other MHA assistance programs is available at www.makinghomeaffordable.gov.

The websites of Fannie Mae (www.fanniemae.com) and Freddie Mac (www.freddiemac.com) incorporate utilities that permit borrowers to learn whether those organizations guarantee or own specific home loans.

Forbearance. Lenders may always exercise forbearance on defaulted loans, meaning that the lender may simply decline to proceed with foreclosure. Homeowners have no right to forbearance, unless they are active duty military servicemembers covered by the Servicemembers Civil Relief Act or have been so within the previous 90 days. Note that some types of modifications, such as ones that tack past-due balances onto the end of loans as balloon payments, are sometimes referred to as forbearance.

By contrast to payment reductions, payment forbearance involves temporarily suspending the need to make mortgage payments. In their guidance to loan servicers, Fannie Mae and Freddie Mac permit payment forbearance for up to six months in the cases of unemployed borrowers. Servicers must consider unemployed borrowers for such forbearance before consideration for a HAMP loan modification. Borrowers who are not offered any such forbearance must be evaluated for HAMP.

Common Misperceptions About Enterprise Policies for HAMP Participants

Published reports indicate that mistaken or outdated understandings may persist among participants (both servicers and borrowers) in HAMP for loans owned or guaranteed by the Enterprises. Three common misperceptions are discussed below:

- **HAMP Participants Must Be Delinquent**. HAMP does not require homeowners to be actually delinquent in their payments before participating. Despite reported cases of mortgage servicers indicating that homeowners must be delinquent, and in some cases actually encouraging them to fall behind in their payments, program guidance and the Enterprises' servicer directives explicitly permit participation by homeowners who remain current, but for whom default is "reasonably foreseeable."
- **HAMP Requires a Very Long Trial Period**. The Enterprises' published guidance states that the initial trial period for HAMP participants "must be three months long for mortgage loans already in default and four months long for mortgage loans where the servicer has determined that default is imminent but has not yet occurred," contrary to reported instances of borrowers making trial payments for much longer.
- **The Foreclosure Process Can Proceed While Loss Mitigation Efforts are Underway**. As a result of FHFA's Servicing Alignment Initiative, current Enterprise guidance states that servicers may not commence the foreclosure process as long as they are engaged in a good faith effort with the borrower to resolve the delinquency. "Dual tracking" a single loan for both foreclosure and modification is prohibited. Additionally, before a loan is referred for foreclosure, the servicer must also perform a formal review of the case to ensure that appropriate alternatives were considered.

Refinancing. Another option for handling a defaulted loan is to replace it with a new loan via a refinancing. The terms of the new loan can be whatever the borrower and new lender negotiate; the proceeds of the new loan are used to pay off the balance on the old loan. When the old lender is paid off, the old lender releases its lien on the property.

The difference between refinancing and modification is that refinancing entails a new loan, whereas modification is simply a change to the terms of an existing loan. A refinancing can involve the substitution of a new lender for the existing lender or a new loan from the existing lender, whereas a modification involves the same lender. Because a refinancing involves a new loan, there are generally closing costs associated with a refinancing, whereas modification may or may not involve fees to the borrower.

Traditionally, refinancing requires the payment in full of the existing loan. Most mortgage loans have "due on sale" clauses that require payment of the full balance of the loan upon the sale of the property and further define a refinancing as a sale. Unless the existing mortgage is paid off, the existing mortgagee continues to hold a lien on the property that is senior to the new lender's. Payment in full via a refinancing thus requires the

Equity:
In the context of residential mortgage finance, equity is the difference between the fair market value of the borrower's home and the outstanding balance on the mortgage (and any other debt secured by it, such as home equity loans).

Underwater:
Term used to describe situations in which the homeowner's equity is below zero (i.e., the home is worth less than the balance of the loan(s) it secures).

On October 24, 2011, FHFA announced revisions to HARP to expand the number of eligible homeowners. FHFA-OIG will discuss these revisions in greater detail in the next Semiannual Report.

homeowner to have **equity** in the property, as today lenders will almost never extend credit beyond the value of the property (above a 100% loan-to-value ratio). Accordingly, refinancing has not been an option, generally, for borrowers who are **underwater**, even if they are current on their mortgage. However, the Enterprises will refinance qualifying underwater mortgages they own or guarantee under the federal government's Home Affordable Refinancing Program (HARP). Loans that are held on banks' balance sheets or in private-label securitizations are not eligible for HARP.

In addition, some lenders will accept a "short refinancing" in which they receive less than the full unpaid principal balance, may forgive the remaining balance, and release the lien. They may choose to do so if they believe that they will make more in a partial payment via a refinancing than they will in a foreclosure sale. FHA, for example, offers a short-refinancing program: for qualifying borrowers who do not currently have FHA-insured loans, FHA will insure a new first lien mortgage loan at up to 97.75% loan-to-value ratio based on a fresh appraisal. This means that the existing lender must agree to a write-down of the balance as part of the refinancing. FHA requires that the existing lender reduce the existing balance by at least 10% and that the combined loan-to-value ratio of all mortgages on the property be no more than 115%. While short refinancing may be a valuable solution for underwater borrowers, refinancing with a new lender is often very difficult for borrowers with impaired credit scores (which includes any borrower who has defaulted), or even for those with relatively good credit scores.

FORECLOSURE AND ITS EFFECTS

If loss mitigation efforts do not succeed, the defaulted loan will proceed to foreclosure. There are two basic types of foreclosure. Judicial foreclosures proceed through the court system, while nonjudicial foreclosures take place outside it. The type of foreclosure process and other specific features are governed by state law, which varies considerably among the states, and by the terms of the mortgage itself. Some mortgages permit only one type of foreclosure. Some states permit only one type of foreclosure, while others provide for the possibility of either. State law can also vary depending on the type of property involved (its size and use) and by whether the mortgage was a purchase money mortgage or a refinancing of a previous mortgage. This overview is designed to present a general description of the foreclosure process. Actual state law may vary from the process described herein, and this overview should not be relied upon as a legal guide.

Judicial Foreclosure

A judicial foreclosure is a litigation process with a specific remedy. Generally, the loan servicer, on the noteholder's behalf, commences the foreclosure by filing a suit against the homeowner. If those bringing the suit cannot prove that they are acting on behalf of the party entitled to repayment under the terms of the note, they may lack legal standing to do so. Similarly, a foreclosure may be invalid if the foreclosing party or its representative files suit before becoming the holder of the note and the mortgagee.

Junior Lienholder:
The security interest that can be availed only after the senior lien is satisfied, is called a junior lien. The holder of this security interest is the junior lienholder. Depending on the relative priority of the junior lien, the junior lienholder may be the second mortgagee, third mortgagee, etc. For example, a bank holding a home equity mortgage on a home is the junior lienholder to the bank holding the primary mortgage.

To begin a foreclosure action, the noteholder's representative files various documents with the court in the form of a "complaint." It also must serve the complaint to the homeowner, notifying him or her of the litigation. Additionally, notice must typically be sent to all **junior lienholders**, such as home equity lenders. The specific requirements vary by state, but state law typically requires the foreclosing party to assert for the record that:

- the homeowner is indebted to the foreclosing party;
- the homeowner has defaulted on the loan;
- the loan is secured by a mortgage, and the foreclosing party is or represents the mortgagee; and
- service of process has been made on the homeowner.

These are typically made via affidavits – sworn written statements submitted to the court. For example, the fact and amount of the indebtedness are typically established via an affidavit of indebtedness. State law requires that affidavits be sworn out by affiants who have personal knowledge of the facts to which they attest. Such affidavits are typically notarized.

Robo-signing. In mid-2010, certain leading mortgage servicers were found to be routinely submitting flawed affidavits to courts in foreclosure cases. Affidavits are supposed to be sworn out by affiants with personal knowledge of the facts, which are attested to in the affidavit, such as the fact and amount of the homeowner's indebtedness and that the homeowner had defaulted on the loan. In the course of depositions in foreclosure cases, servicers were found to have employees whose sole job was to sign foreclosure affidavits, as many as 10,000 affidavits in a single month by some employees (roughly one per minute). These employees had no personal knowledge of any of the facts to which they attested.

As robo-signing began to garner media attention, several major servicers imposed voluntary moratoria on their foreclosure activities. All have subsequently resumed foreclosures, although some foreclosure filings have been withdrawn and resubmitted and, in Maryland, a state judge threw out over 10,000 foreclosures filed by Ally Financial Inc. (formerly known as GMAC, LLC) because of robo-signing. Federal banking regulators commenced an investigation of robo-signing practices that resulted in consent orders between leading servicers and the federal regulators, in which the servicers agreed to improved internal controls. State attorneys general are still investigating robo-signing and related issues.

While media attention was focused on the lack of personal knowledge of the affiants and the sheer volume of signatures made by individual robo-signers, more serious issues lurk in the robo-signing scandal. In particular, the backdating of mortgage transfer documents was the focus of the depositions in which robo-signing was uncovered. The date of the transfer of a mortgage is critical for three reasons:

- First, it may affect whether a servicer has legal standing to foreclose; only the mortgagee has such standing. In *Ibanez v. U.S. Bank*, the Massachusetts Supreme Judicial Court upheld the reversal of a foreclosure in which the servicer could not prove that the loan had been transferred to the securitization trust before the foreclosure was commenced.
- Second, it may affect whether the servicer is a "holder-in-due-course," a special legal status that prevents the homeowner from raising certain defenses (including that the homeowner was fraudulently induced into the mortgage) and counterclaims. A party that receives a loan that is in default cannot be a holder-in-due-course, so determining the date of transfer is critical to ensure that the homeowner is not wrongfully deprived of his or her legal rights to raise defenses and counterclaims.
- Third, for securitized loans, tax and trust law rules depend on the date of the transfer. If the loan was transferred too late, there may be adverse tax consequences for the investors in the mortgage-backed securities and the transfer may itself be void under trust law.

Thus, issues related to the timing of transfers of mortgages (often referred to as "chain of title") have profound legal implications.

Generally, state law requires that a copy of the mortgage note accompany the complaint. The foreclosing party may be required to produce the original "wet ink" or "blue ink" note. Often state law requires the filing of the mortgage itself as part of the complaint, but because recorded mortgages (unlike notes) are public records, a reference to the mortgage may be sufficient. Some states also require certification of mandatory loss mitigation efforts, such as mediation, prior to foreclosure.

Most judicial foreclosures are not contested and result in default judgments against the homeowner. In such cases, it is rare for courts to undertake more than a cursory examination of the sufficiency of the foreclosing party's filings.

If a homeowner contests a foreclosure, either because of procedural deficiencies or on the basis of substantive defenses and counterclaims, then the case is litigated like a regular civil action. A homeowner's ability to raise defenses and counterclaims depends on whether the foreclosing party is a "holder-in-due-course" of the defaulted note. To be a holder-in-due-course, the foreclosing party must: (1) possess the actual note; (2) have given value for the note and taken it in good faith; and (3) have no notice of any defect in the note, including that the note is in default. This means that if the note were transferred to the foreclosing party subsequent to the default, the foreclosing party is not a holder-in-due-course, so the homeowner may raise a full battery of defenses and counterclaims in the foreclosure action.

Show Me The Note. Foreclosure defense litigation has begun to feature variations of the "show-me-the-note" defense, in which the homeowner challenges the foreclosing party to prove that it has the right to foreclose. In its most basic form, this defense is a demand that the foreclosing party produce the original mortgage note, but the term refers to a range of challenges relating to the foreclosing party's standing.

Critically, the show-me-the-note defense does not involve a claim that the homeowner is not in default. Instead, it focuses on whether the foreclosing party is the party that is legally entitled to foreclose and has made the required evidentiary showings. Determining the proper party is important for issues of legal standing, holder-in-due-course status, and the homeowner's ability to raise various defenses and counterclaims, and because it affects settlement abilities and incentives. A portfolio lender, for example, may have very different settlement abilities and incentives than a third-party mortgage servicer.

Kemp v. Countrywide Home Loans, Inc., 449 Bankr. 624 (Bankr. D.N.J. 2010) provides an illustration of a successful "show-me-the-note" defense. In *Kemp*, the homeowner had taken out a loan from Countrywide Home Loans, Inc. Countrywide subsequently securitized the loan, selling it to a trust named CWABS Asset-Backed Certificates, Series 2006-8. The Bank of New York served as trustee for the trust and Countrywide as servicer for the trust.

The homeowner filed for bankruptcy, having previously defaulted on his mortgage. Countrywide, as servicer, filed a claim in the bankruptcy on behalf of the trust. The homeowner challenged that claim based on the fact that the mortgage note had not been properly endorsed to the Bank of New York as trustee for the securitization trust and was never placed in the Bank of New York's possession. Accordingly, the homeowner argued, the trust was not a party entitled to enforce the note, as only a physical holder of the note, a non-holder in possession, or someone who has lost a note may enforce a note.

During the trial, Countrywide produced an "allonge" — a separate sheet of paper to be affixed to a note to allow room for additional endorsements. This allonge contained the endorsement that was missing on the note itself (albeit with an error in the name of the trust). Countrywide's official witness, however, testified that the allonge had been created in anticipation of the litigation. The official witness further testified that the original note had never left Countrywide's possession and that the new allonge had never actually been affixed to the note — it was simply a piece of paper with an endorsement, but no indication of what had been endorsed.

The bankruptcy court denied the claim Countrywide had filed on behalf of the trust because the trust could not show that it was a party entitled to enforce the note. The trust was neither a holder of the note (an owner of the note in physical possession of the note), nor a non-holder (someone who lacks ownership of the note) in possession of the note, nor had it lost the note. Because the Bank of New York, as trustee, and Countrywide, as its agent, were not entitled to enforce the note, the bankruptcy claim against Kemp was disallowed.

If the court awards judgment to the foreclosing party, the property is then scheduled for sale, typically by the county sheriff. Sale scheduling is determined in part by requirements for advertisement of the sale for a minimum time period. The homeowner may, of course, appeal the foreclosure judgment.

Nonjudicial Foreclosure

Nonjudicial foreclosures proceed rather differently. There are no court filings or showings of proof required. Instead, in a nonjudicial foreclosure, the foreclosing party must notify the homeowner of the default and the scheduled sale. Sometimes this requires a formal "notice of intent to foreclose." It is also required to advertise the sale. Advertisement requirements vary significantly by jurisdiction, but generally the sale must be advertised in a newspaper of record for the community for a few weeks prior to the sale. The assumption in a nonjudicial foreclosure proceeding is that the foreclosing party has the right to foreclose, provided that it appropriately provides notice and advertises the sale.

A nonjudicial foreclosure may effectively be transformed into a judicial foreclosure if the homeowner brings a quiet title action or the equivalent, which has the effect of contesting the foreclosure sale's transfer of title to the foreclosure sale purchaser. Conversely, foreclosure sale purchasers will sometimes bring subsequent judicial actions to ensure quiet title, particularly if there are any questions about the procedural propriety of the sale.

The Foreclosure Sale

The rules governing the actual foreclosure sale vary by jurisdiction. Sales are conducted by auction, but there are usually few if any rules governing the actual sale in nonjudicial foreclosures. The timing and the bidding in judicial foreclosure sales is frequently specified in detail by statute, including minimum bids, appraisal requirements, deposits, and completion of payment. Some jurisdictions, however, leave details of the bidding up to the local government official, typically the sheriff, who conducts the auctions.

Perfection:
The legal recording of evidence for a creditor's lien on a particular item of property.

Two constant rules for all foreclosure sales are the order of payment and the effect on liens. The proceeds of a foreclosure sale are used first to cover the expenses of the sale. They are then paid to the foreclosing party, and, if there are surplus funds, to junior lienholders in their order of seniority. Rules of lien priority generally follow a first-in-time, first-in-right pattern, with the first lienholder to **perfect** its lien (by making the necessary legal filings or automatically in some cases) having seniority over subsequently perfected (or unperfected) liens. There are many exceptions to this pattern, however. Notably, state tax liens frequently have priority over other previously perfected liens. If any surplus remains, it is paid to the (former) homeowner.

There is no right for prospective buyers (or the foreclosing party) to inspect the property before the foreclosure sale. Prior to the completion of the sale, the property still belongs to the mortgagor/homeowner. Accordingly, third parties tend to discount foreclosure sale purchase bids heavily. Although they can ascertain the external condition of the property, they cannot discern the layout or condition of the property internally, and many foreclosed properties have been damaged prior to sale.

The inability to inspect the property pre-sale, as well as the foreclosing party's ability to "credit bid," means that there are relatively few bidders in most foreclosure sales other than the foreclosing party. Most foreclosure sale properties are purchased by the foreclosing party via a "credit bid." This means that the foreclosing party bids the amount it is owed on the loan rather than bidding with cash. In other words, a credit bidding party merely credits itself rather than writing itself a check. A credit bidding party typically bids in the full amount of the debt owed, which means that a third-party bidder must be willing to pay a higher cash price to win the auction. By credit bidding, the foreclosing party can obtain clear title to the property, inspect the property, fix it as necessary, and then resell it subsequently.

It is important to note that foreclosure sales are frequently cancelled or rescheduled. This may occur for a variety of reasons, including ongoing negotiations between the borrower and the lender; intervening bankruptcy filings; and inability to complete procedural steps, including accumulation of necessary documentation.

Cures

Until the completion of the foreclosure sale, the homeowner may cure the default and stop the foreclosure. Typically this requires payment of the entire mortgage debt, as the lender will have **accelerated** the debt. The lender may be willing, but is under no obligation, to stop the sale if only past due payments are tendered.

Acceleration:
The declaring of a debt due and payable immediately. Lenders may possess this right under certain conditions, according to the terms of the obligation or applicable law.

If the homeowner files for bankruptcy, the foreclosure sale is automatically stayed, and federal bankruptcy law permits homeowners to unwind the acceleration of a mortgage and cure by paying only the past due payments and associated costs.

Deficiency Judgments

The foreclosure sale may not provide proceeds sufficient to satisfy the mortgage debt. In such cases, the noteholder's representative (and any junior lienholders) may seek a deficiency judgment – a legal judgment for the remaining amount of the debt. A deficiency judgment is an unsecured debt, like credit card debt, and collection follows the procedure for other unsecured debt. This means that deficiency judgments are often difficult for lenders to collect, as many states place restrictions on wage garnishment and unsecured debts are generally dischargeable in bankruptcy. Accordingly, noteholders often sell deficiency judgments to third-party debt collectors at substantial discounts from face value. Attempts to collect these debts are typically subject to the provisions of the Fair Debt Collection Practices Act as well as to state debt collection law.

The availability and procedure for a deficiency judgment varies by state and foreclosure process. Generally, deficiency judgments are not available when nonjudicial foreclosure is used because of concerns that private sales might be manipulated to suppress foreclosure sales prices in order to produce a larger deficiency judgment. In some states, deficiency judgments are available automatically following a judicial foreclosure. In others, the foreclosing party must file a motion or a complaint for a deficiency judgment. Even then, there is variation as to whether a deficiency judgment (if allowed) is awarded as a matter of right or by judicial discretion.

Right of Redemption

Figure 12, at the end of this overview, summarizes provisions for right of redemption by state.

In some states, homeowners have a statutory post-foreclosure sale "right of redemption." This means that the homeowner can redeem – reclaim title to – the house by tendering the amount of the unpaid debt and foreclosure sale costs. The length of the statutory redemption period varies considerably, from as short as 10 days in New Jersey to 2 years in Tennessee. The existence of rights of redemption is a factor foreclosure sale purchasers are likely to consider, as they run the risk of being deprived of their foreclosure sale purchase (even though the purchase price is returned). While it is uncommon for foreclosed homeowners to come up with the cash to redeem their properties during the redemption period, the right is exercised at times.

Eviction

If the former homeowner does not voluntarily surrender the property following the foreclosure sale, the foreclosure sale purchaser can have the former homeowner evicted. Eviction is also a state law procedure; the precise process varies by state law, but it is not always automatic. Because foreclosure sale purchasers are often concerned about former homeowners damaging the property before they leave, they are often willing to negotiate with homeowners regarding relocation timetables and costs. They are, however, under no obligation to do so.

Renters Living in Foreclosed Property

Sometimes a foreclosed property is occupied by renters. Renters' rights in a foreclosure involving their landlord vary by state. Since 2009, however, the Helping Families Save Their Homes Act has included minimum protections for renters in the foreclosure of most mortgages, including all mortgages owned by the Enterprises. If the renter has a *bona fide* lease entered into prior to the notice of foreclosure, then the renter may occupy the property until the end of the remaining term on the lease unless the renter is given notice of termination by the foreclosure sale purchaser, in which case the renter has 90 days of occupancy rights. If the renter is not renting under a lease or the lease is terminable at will, then the renter also has 90 days of occupancy rights from notice of termination. Some states give renters additional occupancy rights; others merely give renters the right to notice of the foreclosure.

Liability for Insurance, Taxes, and Homeowners' Fees

Until title passes to the foreclosure sale purchaser, the homeowner typically remains liable for taxes, homeowners' association dues, nuisances, and accidents on the property. Noteholders or their representatives typically have the right to force-place insurance on the property if the homeowner has failed to maintain insurance payments. Force-placement of insurance involves the noteholder's purchasing insurance on the property with itself as the loss-payee. Force-placed insurance can be expensive relative to regular insurance, and some servicers force-place insurance with their affiliates.

Post-sale, the liability falls on the property's new owner. In some communities, however, a phenomenon known as "bank walkaway" has occurred in which a servicer will commence a foreclosure, but not complete it. Frequently, bank walkaway occurs when the property's value is so low that it is not worth the expense of foreclosure. In bank walkaway cases, the homeowner remains the owner of the property, although in many cases he or she will have moved out because of the anticipated foreclosure. Because the homeowner remains the title owner of the property, he or she remains liable for property taxes and upkeep. Thus, the homeowner could be subject to fines and other penalties if the property becomes a nuisance, or the homeowner could be liable for accidents that occur. Similarly, the noteholder's representative may complete the foreclosure and purchase the property itself in the foreclosure sale, but fail to record the deed in its own name. In such cases, the homeowner remains liable for property taxes.

Impact on Credit Score

Mortgage defaults, foreclosures, deeds in lieu of foreclosure, and short sales can have adverse impacts on consumers' credit scores. A default, foreclosure, deed in lieu, or short sale may remain on a consumer's credit report for up to seven years. A bankruptcy may remain on a consumer's credit report for up to 10 years. The presence of adverse events on credit reports is likely to lower a consumer's credit score, which can make it more difficult or expensive for a consumer to obtain credit in the future. Credit reports are also used by insurers and employers, so adverse credit events can affect the cost of insurance and/or employment opportunities.

FORECLOSURE ALTERNATIVES

More information on HAFA is available at www.makinghomeaffordable.gov/programs/exit-gracefully/Pages/hafa.aspx.

Depending on individual circumstances, alternatives may exist to foreclosure proceedings that reduce expenses or legal liability for troubled homeowners. However, like foreclosure, these options will typically result in the homeowner's loss of his or her house. These alternatives may include short sales, deeds in lieu, and bankruptcy. The Enterprises participate in the federal government's HAFA program, which is designed to encourage alternatives to the foreclosure process for troubled home mortgage loans. Participating HAFA servicers may not seek deficiency judgments and may provide relocation incentives of up to $3,000 for eligible homeowners who tender deeds in lieu of foreclosure or do short sales.

Short Sale

Lenders may agree to a "short sale," in which the homeowner conducts a private sale of the house, and the lender releases its lien in exchange for the sale proceeds, even though the sale proceeds are insufficient to pay off the debt. A short sale does not necessarily discharge the homeowner's debt; it merely results in a release of the lien, so the homeowner may still be liable for the deficiency. If the lender forgives the deficiency, it may be imputed as taxable income for the homeowner, particularly if the mortgage had a cash-out component.

There are certain barriers to a short sale. Servicers are frequently wary of short sale offers because of concerns that they are settling the debt at too low a price and that the bidder may have colluded with the homeowner. In addition, the high rate of denials for short sale offers has made realtors reluctant to handle them because realtors are only paid upon consummation of a sale and put in more effort in short sales than for regular sales.

Deed in Lieu of Foreclosure

Lenders will sometimes accept a deed in lieu of foreclosure. This means that the homeowner will surrender title and possession of the property voluntarily, rather than requiring the lender to go through the full foreclosure process. For the lender, a deed in lieu spares the time and expense of the foreclosure process. For the homeowner, a deed in lieu may be attractive because the terms under which the homeowner surrenders the property may be negotiated – the lender may be willing to provide the homeowner with some relocation funds or a more generous timetable for moving out.

Critically, a deed in lieu does not extinguish junior liens, so the lender will acquire the property with junior liens still attached. Thus, if neither the homeowner nor the lender who has taken the deed in lieu pays off the junior lienholder(s), the latter may foreclose on the property. Accordingly, lenders may be reluctant to accept deeds in lieu when there is a junior lien on a property.

Bankruptcy

A homeowner may file for bankruptcy at any point before, during, or after the foreclosure process. Bankruptcy is a federal judicial proceeding. A bankruptcy filing automatically stops the foreclosure process. If a lender wishes to proceed with a foreclosure against a bankrupt homeowner, the lender must get permission from the bankruptcy court to do so.

If the homeowner files for Chapter 7 bankruptcy and has defaulted, the homeowner will not be able to retain the property after the bankruptcy absent the lender's consent. If the homeowner files for Chapter 13 bankruptcy and has defaulted, the homeowner may de-accelerate the note and cure the default simply by making up missed payments rather than the full amount of the note. The homeowner may not, absent the lender's consent, modify the terms of the mortgage in bankruptcy if the property is a single-family residence. For multi-family residences, the homeowner may be able to restructure the mortgage in bankruptcy.

For further information on homeowner assistance programs, borrowers should visit www.makinghomeaffordable.gov or call 888-995-HOPE.

Figure 12. Summary of Foreclosure Process by State

State	Foreclosure Process[2]	Right of Redemption[3]	Mediation Programs
Alabama	Primarily nonjudicial	1 year	None
Alaska	Primarily nonjudicial	No	None
Arizona	Primarily nonjudicial	No	None
Arkansas	Primarily nonjudicial	No	None
California	Primarily nonjudicial	2 years if court grants deficiency judgment	Yes[4]
Colorado	Primarily nonjudicial	Redemption by lienholders allowed only within specified periods	Yes[5]
Connecticut	Primarily judicial	Yes, after judgment and before sale	Yes[6]
Delaware	Primarily judicial	No	Yes[7]
District of Columbia	Primarily nonjudicial	In optional judicial procedure there is a provision for redemption before judgment	Yes[8]
Florida	Primarily judicial	Yes, up to date clerk files certificate of sale	Yes[9]
Georgia	Primarily nonjudicial	No	None
Hawaii	Primarily nonjudicial	No	Yes[10]
Idaho	Primarily nonjudicial	No	None
Illinois	Primarily judicial	Yes, later of 7 months after service of complaint or 3 months after judgment	Yes[11]
Indiana	Primarily judicial	No	Yes[12]
Iowa	Primarily judicial	1 year	None
Kansas	Primarily judicial	3 to 12 months depending on percentage of debt that has been paid	None
Kentucky	Primarily judicial	1 year	Yes[13]

State	Foreclosure Process[2]	Right of Redemption[3]	Mediation Programs
Louisiana	Primarily judicial	No	None
Maine	Primarily judicial	Mortgages after 10/1/75, 90 days. Mortgages prior to 10/1/75, 1 year	Yes[14]
Maryland	Primarily nonjudicial	No	Yes[15]
Massachusetts	Primarily nonjudicial	No	Yes[16]
Michigan	Primarily nonjudicial	1 month to 1 year depending on size of parcel, number of units, percentage of original loan outstanding, and whether property is abandoned	Yes[17]
Minnesota	Primarily nonjudicial	6 or 12 months depending on date of mortgage, size of property, and whether use is agricultural	Yes[18]
Mississippi	Primarily nonjudicial	No	None
Missouri	Primarily nonjudicial	1 year	None
Montana	Primarily nonjudicial	Generally 1 year; for small tracts no	None
Nebraska	Primarily nonjudicial	No	None
Nevada	Primarily nonjudicial	No	Yes[19]
New Hampshire	Primarily nonjudicial	No	Yes[20]
New Jersey	Primarily judicial	6 months	Yes[21]
New Mexico	Primarily nonjudicial	9 months	Yes[22]
New York	Primarily judicial	No	Yes[23]
North Carolina	Primarily nonjudicial	10 days	None
North Dakota	Primarily judicial	60 days or 1 year for agricultural land	None
Ohio	Primarily judicial	Before confirmation of sale with the amount of judgment and associated costs paid	Yes[24]
Oklahoma	Primarily nonjudicial	Up to confirmation of sale	None

State	Foreclosure Process[2]	Right of Redemption[3]	Mediation Programs
Oregon	Primarily nonjudicial	No	Yes[25]
Pennsylvania	Primarily judicial	No	Yes[26]
Puerto Rico	Primarily judicial	No	None
Rhode Island	Primarily nonjudicial	No, except if foreclosure by process of law or by open entry then 3 years	Yes[27]
South Carolina	Primarily judicial	No redemption after sale. Redemption possible for 5 days after sheriff takes possession	None
South Dakota	Primarily nonjudicial	1 year	None
Tennessee	Primarily nonjudicial	Generally no, could be 2 years but right to redemption is routinely waived	None
Texas	Primarily nonjudicial	No	None
Utah	Primarily nonjudicial	6 months for judicial foreclosure	None
Vermont	Primarily judicial	In judicial strict foreclosure with no sale, 6 months. In judicial foreclosure with sale may redeem until sale	Yes[28]
Virginia	Primarily nonjudicial	No	None
Washington	Primarily nonjudicial	8 months	Yes[29]
West Virginia	Primarily nonjudicial	No	None
Wisconsin	Primarily judicial	Up to time of sale; 12 months after judgment unless creditor waives right, if waived 6 months	Yes[30]
Wyoming	Primarily nonjudicial	3 months	None

ENDNOTES

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