CALIFORNIA FORECLOSURE LAW

Real Estate Law Topics - DEFAULTS AND FORECLOSURES

i. Non-judicial foreclosures

1. What is a non-judicial foreclosure?

In California, the most common type of foreclosure is non-judicial. Under the standard form mortgages or deeds of trust, the power of sale clause gives the lender the power to sell the property, upon default, without involving the court system. Because non-judicial foreclosures are created by contract, their precise terms can be altered, to some degree, by contract. The California Legislature, however, has enacted a comprehensive set of laws, which set minimum standards for non-judicial foreclosures. These laws protect borrowers.

2. The first step in foreclosure: the Notice of Default

As a rule, lenders do not start foreclosure proceedings, when the borrower is a few days late on a payment. Generally, lenders do not declare a default, until the borrower is substantially behind in his or her payments. This is, however, a decision for the lender; it has the legal power to declare a default, and start foreclosure, as soon as there is a default.

When a lender decides to start foreclosure proceedings, the first step is for the trustee under the Deed of Trust or mortgage to record a Notice of Default and an election to sell. This is a legal document, which must be mailed to the borrower, to any one else who has recorded a Request for Copy of Notice of Default and/or Sale in the form specified by Civil Code Section 2924b and to all other parties listed in Civil Code Section 2924b. The Notice of Default must also be recorded.

Civil Code Section 2924 describes in detail the information which the Notice of Default must contain. Among other things, it must state the amount which is in default and the amount which must be paid by the borrower to reinstate the loan and to avoid the foreclosure. The Notice of Default must comply strictly with the format set out in Civil Code Section 2924c(b)(1).

Small inaccuracies in the Notice of Default will not invalidate a later foreclosure sale. *Knapp v. Doherty* (2004) 123 Cal. App. 4th 76; 20 Cal. Rptr. 3d 1. The lender, however, is bound by its Notice of Default; in seeking a foreclosure, a lender is not permitted to rely upon defaults other than those stated in the Notice of Default. *Miller v. Cote* (1982) 127 Cal. App. 3d 888; 179 Cal. Rptr. 753.

3. Reinstating the loan after default

a. Loan acceleration after default

i. What is acceleration of a loan?

Most mortgages or deeds of trust give the lender the right to accelerate the note upon default. This means that, if the borrower misses one payment, the lender can declare the entire amount of the mortgage – not just the missed payments – to be due. These acceleration clauses in promissory notes ordinarily are enforceable under California law. In some non-real estate contexts, if one payment is missed on a debt, the lender can accelerate the loan, demand payment in full and the borrower can do nothing, except pay in full or suffer the consequences.

ii. Notice requirements for loan acceleration

Although acceleration clauses ordinarily are enforceable, Civil Code Section 2945.5 sets forth a notice requirement for them. This statute applies only to deeds of trusts and mortgages against residential property, with one to four units. For acceleration clauses in such deeds of trusts or mortgages to be enforceable, the clause must be set forth in full in the body of the deed of trust or mortgage, and the promissory note or other document establishing the debt.

iii. Limits on loan acceleration

Lenders may not accelerate loans, against residential real property, due to certain routine transfers which occur upon death, marriage or divorce. Civil Code Section 2945.6 prohibits the acceleration of loans, secured by residential real property, because of the following:

(1) Transfer of property, upon the death of one spouse, to the surviving spouse, if the survivor is already liable on the loan;
(2) Transfer of the property into cownership with the owner's spouse;
(3) Transfers resulting from divorce or separation;
(4) Transfers to inter vivos trusts in which the borrowers are the beneficiaries of the trust;
(5) A junior lien or encumbrance is put upon the property.

The protections of this statute may not be waived. The statute applies to residential real property, with one to four units.

b.Reinstating defaulted loans

i. The statutory right to reinstate defaulted loans

Civil Code Section 2924c(a)(1), creates a statutory right to reinstate defaulted real property loans. After reinstatement, the loan is de-accelerated. In other words, after the note is de-accelerated, the borrower needs only to make the monthly payments.

ii. Who has the right to reinstate the loan?

Under Civil Code Section 2924c(a)(1), the following parties have the right to reinstate a defaulted loan:

- The borrower, called the "trustor" (under a deed of trust) or the mortgagor (under a mortgage), or any successor in interest to the borrower;

- Either the lender or the borrower, under any junior deed of trust, mortgage or other lien against the property.

In other words, any one who has a financial interest in the property, which might be wiped out by a foreclosure, has the right to reinstate. This includes the owner of the property, the borrower under the loan or anyone with an interest in a junior deed of trust, mortgage or other lien in the property.

iii. What is the deadline to reinstate a defaulted loan?

The right to reinstate the loan continues until five business days before the noticed date of the foreclosure sale.

“Business days” means weekdays, other than holidays. It does not include Saturdays, Sundays or bank holidays.

After this deadline passes, the lender does not have to accept reinstatement. During this time, the lender can go ahead with the foreclosure unless the entire amount of the loan (not just the amount in default) is tendered.

If the foreclosure does not occur on the first noticed sale date, and if a new sale date is noticed, then a new right of reinstatement comes into existence, which also continues until five days before the new noticed sale date.

iv. How much may the lender charge to reinstate the loan?

In order to reinstate the loan, the lender may demand payment of the following:

(1) All of the amounts, which are set out in the Notice of Default, which may include all amounts in default of principal, interest, taxes, assessments, insurance premiums or advances made by the lender to pay senior liens and other amounts needed to protect its lien.

(2) All “recurring obligations” which means all monthly payments under the loan, which come due after the Notice of Default, plus all amounts due under senior liens, all taxes and insurance payments advanced by the lender after the Notice of Default. Note, however, that foreclosing lender cannot demand payment of amounts advanced for monthly payments on senior liens, if the Notice of Default did not mention such first mortgage. *Little v. Harbor Pacific Mortgage Investors* (1985) 221 Cal. Rptr. 59; 175 Cal. App. 3d 717.

(3) All “reasonable costs and expenses actually incurred” by the lender in enforcing the mortgage or deed of trust. These “reasonable costs” are limited to: “the costs incurred for recording, mailing, including certified and express mail charges, publishing, and posting notices required by Sections 2924 to 2924i, inclusive, postponement pursuant to Section 2924g not to exceed fifty dollars ($50) per postponement and a fee for a trustee's sale guarantee.” Civil Code Section 2924c)(c). The lender is also permitted to charge trustee fees or attorney fees, but these are limited by Civil Code Section 2924c(d).

The lender may NOT demand that principal be paid, which would not have been due had the default not occurred. In other words, the amount needed to reinstate must be calculated only the defaulted amounts, plus

costs. It may not include the full, accelerated amount of the loan.

v. How can you find out how much is needed to reinstate the loan?

Under Civil Code Section 2943, lenders are required to provide information on how much is needed to reinstate loans. The borrower under the loan, his or her successor in interest, anyone with a financial interest in a junior lien against the property and escrow agents are all authorized by the statute to request, in writing, information from the lender

Two types of information may be requested: a beneficiary statement, which states how much must be paid to reinstate a defaulted loan; and a payoff demand statement, which states how much is needed to pay the loan in full. (The payoff demand statement is requested, when the property is being sold, the loan is being refinanced or the loan is otherwise going to be paid in full.)

The lender is required by law to respond to such a request within twenty-one (21) days of receiving it. Please note, however, that such a demand for information can only be made for two months after the Notice of Default is recorded. If the Notice of Sale has been recorded, then the lender need not respond to the request for information.

vi. Procedure after a loan is reinstated

If a loan is reinstated, the lender must, within twenty-one (21) days of the reinstatement issue a Notice of Recission of the declaration of default. Civil Code Section 2924c(a)(2). The trustee under the Deed of Trust must record the Notice of Recission, within thirty (30) days of receiving it.

3. Notice of sale

Three months after the Notice of Default is filed, if the default has not been cured, the trustee may issue a Notice of Sale, which must be produced at least twenty (20) days prior to the actual date of the sale. The requirements for the Notice of Sale are set out in detail in Civil Code Section 2924f.

The Notice of Sale must say exactly when and where the sale will take place. It must describe the property which is to be sold, and it must say what the total debt is against the property, as well as an estimate of what the costs of foreclosure will be.

The Notice of Sale must be posted, both in a public place in the city or judicial district in which the property is located, and on the front door of the property, at least twenty days prior to sale. (If the property is in a gated community, so the front door cannot be reached, the posting may be near the gate or other equivalent place.)

The Notice of Sale must also be published, once a week, for at least three weeks, starting at least twenty days prior to the sale. The publication must be in a newspaper of general circulation. The statute goes into great detail about how to determine an appropriate newspaper for publication of the notice.

The Notice of Sale must also be recorded, at least fourteen (14) days prior to the sale date.

4. Non-judicial foreclosure sales

a. Sale procedures

Non-judicial foreclosure sales must be held in the county in which the property, or part of it, is located. The sale must be held between 9 a.m. and 5 p.m., on a weekday. Civil Code Section 2924g. The sale can be conducted by trustee, or his or her agent, including his or her attorney. Civil Code 2924a. If the property consists of several parcels or lots, they are sold separately, unless the deed of trust or mortgage specified to the contrary. When several lots are being sold, enough is sold to pay the debt, and the remainder are not sold.

The sale is by auction, and must be made to the highest bidder. At the sale, the holder of the mortgage or deed of trust is able to "credit bid" up to the full amount of his or her debt. This means that the lienholder need not pay cash, but instead gets credit for an amount up to the full amount of the debt owing. All other bidders must pay cash or cashier's checks. Civil Code Section 2924h.

b. Postponement of sales

Foreclosure sales may be postponed, at the discretion of the trustee, by agreement between the lienholder and the trustee or by court order or operation of law. Postponements must be announced at the time and place noticed for the sale. An additional Notice of Sale is not required, unless the postponement or postponements, are for longer than 365 days. Civil Code Section 2924g(c)(1). Postponements may be announced at any time, up to the conclusion of the sale.

If a postponement is caused by a court order, or operation of law, the new sale may not occur any sooner than the seventh day after the action is dismissed, the court order expires or the legal prohibition on the sale otherwise ends. Civil Code Section 2924g(d). If, however, the sale is postponed due to the filing of a bankruptcy, and the stay imposed by the bankruptcy comes to an end, the sale can occur immediately, without the seven day delay.

c. Distribution of sale proceeds

The proceeds from a foreclosure sale are distributed in the following order:

(1) To pay the costs and expenses of the sale, including trustee and attorney fees;
(2) To pay the debt secured by the mortgage or deed of trust;
(3) To pay debts secured by junior mortgages or deeds of trust, in their order of priority; and
(4) The remainder, if any, goes to the owner of the property or his or her successor in interest.
Civil Code Section 2924k.

5. When can non-judicial foreclosure sales be attacked in court?

California law is not entirely consistent on the question of when a non-judicial foreclosure sale may be challenged in court. The law contains many general statements that, on the one hand, properly conducted foreclosure sales can not be attacked except in extreme circumstances, *Melendrez v. D & I Investment, Inc.* (2005) 127 Cal. App. 4th 1238; 26 Cal. Rptr. 413 and, on the other hand, that the courts will carefully scrutinize non-judicial foreclosures and set them aside if the borrower's rights have been violated. *Stirton v. Pastor* (1960) 2 Cal. Rptr. 135, 177 Cal.App.2d 232.

These contradictory statements can perhaps best be reconciled by saying that, on the one hand, foreclosure sales will not be set aside due to relatively trivial errors in procedure, *Knapp v. Doherty* (2004) 20 Cal.Rptr.3d 1, 123 Cal.App.4th 76 (Notice of sale sent out a little early did not invalidate sale when all else OK), nor will foreclosure sales be set aside simply because the sales price was less than fair market value. *Melendrez v. D & I Investment, Inc.* (2005) 127 Cal. App. 4th 1238; 26 Cal. Rptr. 413. Sales, however, will be set aside for truly substantial issues which deeply affect the rights of the borrower. *Bank of America, N.A. v. La Jolla Group II* (2005) 129 Cal.App.4th 706, 28 Cal.Rptr.3d 825. (Sale void when held after borrower and lender agreed upon repayment plan, and lender agreed to delay sale, but lender failed to communicate this to trustee.)

An important rule is that the purchaser of the property generally can not be sued, as long as he or she is a bona fide purchaser or BFP. A BFP "is one who pays value for the property without notice of any adverse interest or of any irregularity in the sale proceedings." *Nguyen v. Calhoun* (2003) 105 Cal.App.4th 428, 442, 129 Cal.Rptr.2d 436. As a rule, a BFP is not chargeable with any of the problems of prior owners. Thus, a sale to a BFP can seldom be set aside. Note, however, that the buyer in La Jolla Group II claimed BFP status to no avail. (The logic of the La Jolla Group II Court was that BFP status creates a presumption that the notice requirements of Civil Code Section 2924 were followed, but not that the underlying sale was valid.)

ii. Judicial foreclosures

1. Filing a complaint

Unlike non-judicial foreclosure, judicial foreclosure involves formal litigation in state court. Thus, a judicial foreclosure is initiated, not by filing a Notice of Default, but by filing a complaint in the appropriate court, which is usually the California Superior Court for the county in which the property is located.

The complaint must name as defendants all parties who have a recorded interest in the property and whose interests will be affected by a foreclosure. There is a severe remedy for failing to name parties. If a person has a recorded interest in the property, such as a junior lien, a homestead interest, a lease or any other type of interest, and he or she is not named in the complaint, then the decree of foreclosure will not affect his or her interest. In other words, the foreclosure only wipes out interests of parties who are named in the complaint. Code of Civil Procedure Section 726(c). (Holders of trust deeds or mortgages which are senior to the lien being foreclosed need not be added as parties to the complaint, because their lien will not be affected by the foreclosure anyway.)

As a matter of prudence, a foreclosing party should add as defendants anyone who may have an interest or who the lender wishes the judgment to bind. The spouse of the owner should almost always be added. If anyone has guaranteed the debt, he or she should be sued as well.

If a senior mortgage-holder is foreclosing judicially, a junior mortgage can foreclose its lien, in the same action, by filing a cross-complaint for foreclose of its lien.

2. Recording a lis pendens

As soon as the foreclosure complaint is filed, the foreclosing lender should file and record a lis pendens. A lis

pendens, also known as a Notice of Pending Action, is a document, which is filed with the Superior Court and recorded in the County Recorder's Office in any action which affects title to, or possession of, real property. Code of Civil Procedure Section 405. The purpose of a lis pendens is to put the world on notice that a claim is being made against a property.

If a lender files and records a lis pendens, after filing the foreclosure complaint, then the decree of foreclosure will be valid and binding against any party who takes title to the property after the recordation of the lis pendens. If, on the other hand, the lender does not file and record a lis pendens, then the foreclosure does not affect parties who took title after the foreclosure action was filed but before the decree of foreclosure.

3. The decree of foreclosure

Again, a judicial foreclosure is a form of civil litigation. Thus, after the complaint is filed, the ordinary rules of civil litigation apply. The Summons and Complaint must be served upon the various Defendants, according to the technical rules relating to service of process. Each Defendant has thirty days after service of process to respond to the Complaint, by filing an Answer, a Cross-Complaint, a demurrer or a motion to strike. Once the complaint is at issue, both sides have the right to conduct discovery under the ordinary rules.

Ultimately, according to the local procedures of the particular Superior Court, the matter will come to trial. How long this will take varies according to the practice and procedures of the local court. Some years ago, it would often take a number of years for most civil litigation to come to trial. In recent years, the California courts have made a great effort to speed up civil litigation. As a result, in Los Angeles County Superior Court, at least in the Downtown Court, most civil cases come to trial within one year of the filing of the complaint. In some other counties, however, trial can still take several years to occur. A motion for summary judgment can sometimes be brought to speed up the process, although summary judgment motions are themselves subject to a number of cumbersome procedural requirements. Code of Civil Procedure Section 437c. By ordinary business standards, civil litigation is ordinarily a slow process.

Assuming the lender prevails at trial, or upon summary judgment, it will obtain a decree of foreclosure. This decree should specify against whom the judgment is entered, and the amount of the judgment. The decree can also award costs and attorney fees. If there is more than one lien against the property, the decree should determine the relative priority of the various liens.

If the lender is seeking a deficiency, the decree should state that a deficiency is being sought, the amount of the debt must be listed and the decree should specify that the sale is subject to the borrower's right of redemption.

4. The Writ of Sale

After the decree of sale, the next step is for the lender to obtain a Writ of Sale. A Writ of Sale is issued by the Clerk of the Court. It is directed to the levying officer of the County, which is usually the Sheriff. In Los Angeles, the Sheriff's Department has a division which deals exclusively with foreclosures. The Writ of Sale must include the information listed in Code of Civil Procedure Section 712.020 and Code of Civil Procedure Section 716.010(b).

Along with the Writ of Sale, the lender must submit to the levying officer a certified copy of the judgment. It is

prudent, prior to submitting this package to the levying officer, to call them, and to ask if they have any special requirements. Foreclosures are taken very seriously by most levying officers, and they often have a list of technical requirements with which the lender must comply.

5. The Notice of Sale

The next step in the foreclosure process is for a Notice of Sale to be given. Notices of sale must be given in the same way as Writs of Execution. Notices of Sale must contain the same information as they do with non-judicial foreclosures, and, if the judgment provides for a deficiency, it must state the sale is subject to the right of redemption and it must state the amount of the debt, plus interest and costs.

At least 20 days before the sale, the Notice of Sale must be served upon the borrower and lienholders against the property, either personally or by mail. The Notice of Sale must also be posted in a public place in the County or judicial district in which the property is located, and it must also be posted on the property itself. The Notice of Sale must also be published once a week, for at least three weeks, in a newspaper of general circulation in the County or judicial district in which the property is located. The first publication must be at least 20 days prior to the sale.

6. Foreclosure Sale

The foreclosure sale itself is held in the same manner as a non-judicial sale, except that the sale is by the levying officer, usually the Sheriff. The sale must be between 9 a.m. and 5 p.m. on a business day. The sale is to the highest bidder. If the property consists of separate lots or parcels, the sale will ordinarily be by lots, until the debt is paid. The debtor may request that the property be sold either by lots, or together. The order of sale of the lots may be specified by the debtor. The levying officer must honor this request, unless he or she believes that this approach would not result in the highest price.

The property cannot be sold unless the amount bid exceeds the minimum amount, which equals the total of all preferred labor claims, senior state tax liens, and any deposit by the beneficiary (if the beneficiary is not the buyer). Code of Civil Procedure 701.620. The levying officer must release the property when the minimum bid is not received.

As with non-judicial sales, the lender may credit bid the amount of its secured debt. The lender, however, must pay in cash the costs of sale, preferred labor claims, exempt proceeds and other statutory claims. Payments must be in cash or cashier’s checks. Code of Civil Procedure 701.590(b).

7. Postponements of foreclosure sales

When both the debtor and the creditor request a postponement in writing, the levying officer must grant one. Code of Civil Procedure 701.580. The levying officer also has the power to delay the sale, when he or she believes that it is in the best interests of the party. Postponements are announced orally at the time of the sale.

8. Distribution of sale proceeds

The proceeds from a foreclosure sale are distributed in the following order:

(1) To pay the costs and expenses of the sale, including trustee and attorney fees;
(2) To pay the debt secured by the mortgage or deed of trust;
(3) To pay debts secured by junior mortgages or deeds of trust, in their order of priority; and
(4) The remainder, if any, goes to the owner of the property or his or her successor in interest.
Civil Code Section 2924k.

9. Fair value hearing

What happens if, when a property is foreclosed upon, it sells for less than the debt against it? Is the property owner/borrower liable for the difference between the total debt and the amount for which the house sold, which is called a "deficiency"?

Whether the property owner is liable for a deficiency is governed by the Anti-Deficiency Laws, which are discussed in another section. Assuming that a deficiency is available, how is the amount of the deficiency set? When the Anti-Deficiency Laws were passed, the California Legislature was fearful that lenders would manipulate the amount of the deficiency. Specifically, they were afraid that, at foreclosure sales, outsider bidders would not attend the sale, the lender would submit an artificially low credit-bid, and the borrower would then, in addition to losing his or her property, have to pay an unfairly high deficiency judgment.

To guard against this possible abuse, the amount of the deficiency is set, not by the amount which the property sold for in foreclosure, but by the "fair value" of the property. "Fair value" means fair market value, upon the date of the foreclosure sale. Fair value ordinarily is set by appraisal.

To set fair value, the creditor must file a motion for valuation of the property within three months of the foreclosure sale. Code of Civil Procedure 726(b). If such a motion is not filed within three months of the sale, then the lender can not recover a deficiency. At least fifteen days notice of the hearing must be given to all parties against whom a deficiency judgment is sought. Any party in interest may present evidence at the hearing of the fair market value of the property, on the date of the sale. Alternatively, a probate referee may be appointed to determine the fair value of the property, if requested by any party or on the court's own initiative.

10. Buying the property back: the right of redemption

In judicial foreclosures, in which the lender may obtain a deficiency, and has not waived that right, the borrower, or his or her successor-in-interest, is permitted to "redeem" the property: to buy it back, by tendering the amount paid in the foreclosure sale, plus interest. Code of Civil Procedure 729.010 to 729.090. If, after the fair value hearing, there is, in fact, no deficiency, the borrower has three months in which to redeem the property. If there is a deficiency, however, the borrower has up to one year to redeem the property.

The right of redemption cannot be waived, at the time that the loan is made. It can, however, be waived, at a later time, if the borrower receives some independent consideration in exchange for the waiver.

As long as the redemption period lasts, the new owner of the property, who purchased it at the foreclosure sale, does not have full ownership of the property; he or her ownership is subject to being set aside by the borrower's redemption rights.

iii. Differences between judicial and non-judicial foreclosure

1. Non-judicial foreclosures do not usually involve the courts

The first major difference between judicial and non-judicial foreclosures is that non-judicial foreclosures need not, and usually do not, involve the courts. Judicial foreclosures, however, by definition, require court action. Judicial foreclosures are consequently more costly than non-judicial.

2. Non-judicial foreclosures are usually faster

The second major difference between judicial and non-judicial foreclosures is speed. A non-judicial foreclosure can be completed in four months. A judicial foreclosure can rarely be completed in less than a year.

3. No right of redemption in non-judicial foreclosures

The third major difference between the different types of foreclosure is that the right of redemption exists in judicial foreclosures, but not in non-judicial foreclosures. As a practical matter, this makes judicial foreclosures take even longer for the lender to complete.

4. No deficiency judgment in non-judicial foreclosures

The fourth major difference between judicial and non-judicial foreclosures is the only positive one, favoring judicial foreclosures, from the lender's perspective. Deficiency judgments can never be obtained in non-judicial foreclosures. They can only be obtained in judicial foreclosures. Thus, virtually the only reason that a sane lender would ever want to conduct a judicial foreclosure would be if the property is worth far less than the debt, and the borrower has substantial assets other than the property. In such a situation, a deficiency judgment may be worth pursuing, and that is almost the only reason a judicial foreclosure ever makes sense to a lender.

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