

The servicing agent/licensee must also provide the lender/note holder with annual accountings of the unpaid principal balance and the collections and disbursements for that year.

7. Recovering your investment when the borrower fails to pay

Lenders and note holders are not always anxious to foreclose. As a result, it is not uncommon for loan payments to be several months delinquent prior to the commencement of a foreclosure.

Frequently, the borrower who is delinquent on your loan is also delinquent on senior liens. Even though your loan may be current, **the borrower may fail to maintain the payments on senior liens**, such as taxes, insurance premiums, and/or deeds of trust. A breach of or default in connection with a senior lien by the borrower constitutes a default under your deed of trust. It is, therefore, important that the status of all senior liens be monitored.

Prior to investing in a junior deed of trust, you should have determined the amount and the debt service (payments) required to maintain the senior lien(s). To protect your investment during any senior lien (loan) foreclosure, it may be necessary for you to maintain the payments (with your own funds) on all senior liens. Curing a senior lien default may not eliminate the need to continue to maintain the payments required by the senior lienor while your junior deed of trust is being foreclosed.

When you are a junior lienor, you should be prepared to cure senior lien defaults and to pay senior lien delinquencies. In this regard, you should determine if you have adequate resources to cure senior lien(s) in case of default before investing. A delay in paying the delinquencies may

cost you (or other junior lienors, if any) more money to protect your interest in the Property. A prompt commencement and processing of the foreclosure should limit the amount necessary to advance (pay) to cure senior lien defaults and to maintain the senior lien(s) without delinquencies until conclusion of the foreclosure sale.

Note: Unless you are prepared to pay the entire amount owed on a senior lien (loan), the due date of your junior lien (loan) must precede the due date of the senior.

If the Property produces income, you may elect to collect the **rents and profits** during the foreclosure process to help maintain senior lien (loan) obligations. As additional security for your loan, you should have received an **assignment of the rents and profits** (usually contained in the deed of trust).

Note: Self-help” in collecting the rents is generally not effective. You may need assistance from legal counsel to petition a court for either mortgagee-in- possession or the appointment of a receiver to collect the rents and profits.

In a “fractionalized” **investment**, it is necessary to obtain the concurrence of more than 50% of the lenders or note holders (measured by the amount of ownership interest rather than the number of lenders or note holders) to commence and direct the foreclosure process. The servicing agent should contact each of the other lenders or note holders for you. However, you should be able to directly contact the other lenders or note holders when necessary.

When foreclosing a deed of trust, all sums owing and secured by the deed of trust are **accelerated** and immediately become due regardless of the maturity date identified in the promissory note, provided that an acceleration clause is included in the promissory note and/or deed of trust. Two

methods are used to foreclose deeds of trust: judicial foreclosure and nonjudicial foreclosure.

In certain instances it may be desirable to file a lawsuit in a local superior court to foreclose on the Property (**judicial foreclosure**). When the beneficiary files a lawsuit against the trustor in a local superior court to judicially foreclose, the Property, unless the default is remedied (**cured**), will be ordered sold at a publicly held sale supervised by the court. The judicial action to foreclose is often more costly and will typically take more time to complete than the second method, which is a privately held public sale (**nonjudicial foreclosure**).

In a nonjudicial foreclosure, the trustee (under the **power of sale** clause contained in the deed of trust) may proceed with the foreclosure at your request and, unless the default is cured, sell the Property without court supervision. This privately held public sale procedure will usually take at least four months to complete. If the deed of trust does not contain a power of sale clause, your only option is to foreclose judicially. Most deeds of trust do include a power of sale clause.

Note: You should examine the promissory note and deed of trust to ensure that, among other provisions, both acceleration and power of sale clauses are included.

One of the major differences between the two foreclosure methods is your right to obtain a **deficiency judgment**, which is available when the loan is a “**nonpurchase money**” mortgage or deed of trust. If the Property is other than one to four residential units, or if it is one to four residential units and the borrower did not intend to occupy, your loan (as distinct from a **seller “carry-back”**) would be “nonpurchase money.” When your loan is used to finance or refinance the equity of the Property (no sale transaction is involved), the loan is also “nonpurchase money.”

If your loan is “nonpurchase money” and you determine the **protective equity** is insufficient to repay the entire amount owed by the borrower, including all of the fees, costs, and expenses of the foreclosure, you may want to consider a judicial foreclosure. **Deficiency judgments** are not available when the nonjudicial foreclosure method is utilized. However, **collateral actions** (a separate judicial action) for fraud, waste, or malicious destruction of the Property may still be possible.

If the Property is foreclosed by a senior lienor, thus extinguishing your “nonpurchase money” junior lien, you still may collect as a “**sold-out junior lienor**.” You may seek to collect as a sold-out junior lienor when either there is no **overage** or an **inadequate overage** is received (insufficient money received from the foreclosure sale over and above that which is owed to the foreclosing senior lender to pay all or any part of the money owed to you). To enforce collection as a sold-out junior lienor, a judicial action for money damages must be brought pursuant to the terms of the promissory note.

Another remedy available to you (to recover your **investment**) when the borrower defaults (fails to pay) is to negotiate a “**deed in lieu of foreclosure**.” A properly executed and delivered “deed in lieu,” with consideration and when accepted by you, will transfer title of the Property to you without going through a foreclosure. Potential advantages to you are the elimination of foreclosure fees, costs, and expenses and immediate ownership and control of the security Property. The disadvantage to you is that you accept title to the Property subject to all junior liens, unlike a foreclosure, which typically removes junior liens as claims against the Property.

Note: You should not accept a “deed in lieu” without securing title insurance coverage against

any title defects and exceptions of record, including junior liens and encumbrances for which you have not agreed to become obligated.

A borrower, in an effort to avoid the sale of the Property by either of the two methods described, may seek the protection of an **automatic stay** (a prohibition against any further foreclosure action) by filing a petition in **bankruptcy** in federal court or bringing an action in state court to restrain the nonjudicial foreclosure sale (**Temporary Restraining Order**).

A bankruptcy petition which is filed in federal bankruptcy court prior to the foreclosure sale of the Property prevents the trustee in a nonjudicial foreclosure, or a state court in a judicial foreclosure, from selling the Property without relief from the automatic stay. A Temporary Restraining Order (**TRO**) will act to delay the trustee's sale until the state court determines whether a preliminary injunction is to be granted until a full hearing or trial can be held on the matter.

You will need the assistance of legal counsel to appear in the bankruptcy court to ask the court to grant **relief from the automatic stay** (a removal of the prohibition against further foreclosure action). The assistance of legal counsel will also be required to respond to a TRO. It is important to act quickly when responding to a borrower's bankruptcy petition or request for a TRO.

Note: Your quick response could ensure that sufficient **protective equity** remains to pay the total amount owed to you, including all fees, costs, and expenses incurred in processing the foreclosure and in responding to the federal bankruptcy petition or state court action (e.g., legal fees, costs, and expenses).

You should remember that while acting to recover your **investment** due to the failure of the borrower to pay, you may not receive income from

your trust deed **investment**. The return of the principal you invested and the income you anticipated may be delayed until the foreclosure sale or, in the absence of a successful third-party bid, until the Property is later sold by you (subsequent to foreclosure).