

Foreclosure for Dummies

Recently, Texas attorneys received a flyer from the state bar advertising *The Texas Foreclosure Manual*. The manual is designed to assist attorneys in understanding the foreclosure process with in depth analyses of cases and statutes. Apparently, the state bar recognizes the growing trend in Texas foreclosures and the need to inform attorneys about the process.

The flyer raises an interesting question. If Texas attorneys need assistance, where does that leave the average licensee or homeowner? This article attempts to breach that information gap.

Rules governing foreclosure originate from three sources. Borrowers contractually consent to the first two at the inception of the loan.

Lenders reported 27,649 single-family residential foreclosures in 2005, according to Dr. James Gaines, research economist with the Real Estate Center. This number reflects only the sales in which lenders reacquired properties. The actual number is greater.

The real estate lien note, also called the promissory note, is the first. By signing this document, the borrower pledges to pay the amount of the note according to the stated terms and provisions. This instrument continues the borrower's personal liability to repay the balance of the note when the foreclosure sale generates insufficient revenue.

The deed of trust, also called the mortgage or mortgage instrument, is the second source. By signing this document, the borrower grants the lender (mortgagee) a security interest in the property being purchased or pledged as security (collateral) for the loan.

The deed of trust empowers a person designated as the trustee with authority to sell the collateral when a default occurs. The trustee conducts the foreclosure sale and conveys title to the highest bidder.

Relevant statutory and case law provide the third source, the key statute being Chapter 51 of the Texas Property Code. The most recent changes to foreclosure laws occurred after the collapse of the real estate market in the 1980s.

Several events result in a default and trigger the foreclosure process. The primary cause is the borrower's failure to tender a scheduled payment stipulated in the promissory note. Other causes include failure to keep the property insured or to pay the property taxes.

Once a default occurs, the lender may declare the full amount of the note due and payable under a provision known as the acceleration clause. Without this clause, lenders could not foreclose on the unpaid balance of the note but only on the missed payments. For residential loans, lenders may not accelerate the note immediately. Instead, they must give the homeowner 20 days' written notice to cure the payments in default. The notice must be sent by certified mail, return receipt requested. This right cannot be waived.

After accelerating the note, the mortgagee requests that the trustee sell the property. Chapter 51 of the Texas Property Code delineates the process. The trustee must strictly comply with Chapter 51 and any other requirements set forth both in the deed of trust and the promissory note to ensure a valid foreclosure.

The trustee begins by sending a notice to the debtor, posting an identical notice at the courthouse and filing it in the deed records. The notice alerts the debtor and all who read it that the property will be sold on the first Tuesday of the month occurring 21 days after the notice was forwarded, posted and filed. It specifies the earliest time the sale will begin. The notice must be sent to the debtor's last known address.

The preliminary figures for 2006 are not encouraging. Based on the first four months of the year, Texas lenders expect to foreclose and reacquire approximately 30,000 single-family properties this year.

On the appointed date, the trustee conducts a public auction at or near the courthouse. As of September 1, 2005, the commissioner's court may designate a public place other than the courthouse for the sale as long as the location is in reasonable proximity to the courthouse and accessible to the public. The sale may occur anytime between 10 a.m. and 4 p.m. but within three hours of the time specified in the notice.

The sale must take place even if the first Tuesday of the month falls on a holiday. If the trustee fails to conduct the sale on the designated date, the entire process of sending, posting and filing notices must be repeated.

The trustee begins the sale by reading a copy of the posted notice and stating the terms of the sale. Generally, the trustee requires cash-only sales. If a bidder requests time to return with the cash, the trustee must temporarily adjourn the sale to accommodate the request. All parties present may bid, including the lender, debtor and even the trustee.

However, the trustee may not bid on his or her behalf or on behalf of a company or corporation owned by the trustee. If the trustee is the lender, all bids are on behalf of the mortgagee. If the trustee is not the lender, the bid must be on behalf of a disinterested third party. If the mortgagee enters the highest bid, the lender acquires the property without any out-of-pocket costs as long as the bid price does not exceed the debt. The lender simply credits the bid price against the debt.

As the final step, the trustee conveys the property to the highest bidder by way of a trustee's deed. However, Texas statutes impact the purchase and conveyance two ways. First, the purchaser acquires the property "as is" without any express or implied warranties except warranties of title. Second, the purchaser is not a consumer in the eyes of the law and cannot sue for a breach of the Deceptive Trade Practices Act.

Once the sale concludes, the trustee divides the proceeds. First, expenses relating to the sale are paid. These include advertising the sale, sending and filing the required notices, trustee's commission and attorneys' fees other than those provided in the real estate lien note.

Next, the unpaid principal, interest, late fees, attorneys' fees and other unpaid charges as provided in the real estate lien note are retired. Any remaining funds go to the mortgagor.

If the foreclosure sale generates insufficient revenue to cover the first two mentioned items, the debtor remains personally liable. The lender may pursue the debtor judicially for this amount in what is commonly called a deficiency judgment.

Because of abuses and unanswered questions that followed the real estate collapse in the late 1980s, Texas legislators changed the rules for deficiency judgments. Now, lenders must seek deficiency judgments within two years after the foreclosure sale. Formerly, they had four years.

Key Terms

Collateral. Property pledged to the lender in the deed of trust as security for the repayment of the loan.

Deed of Trust. Mortgage instrument that creates a lien on the collateral and allows the trustee to sell it to satisfy the loan debt in the event of a default.

Mortgagee. Lender or holder of the security interest in the property; the lienholder; the mortgage servicer under certain conditions.

Mortgagor. Debtor, borrower and grantor of the security interest in the collateral; owner of the property.

Mortgage Servicer. Last person to whom the mortgagor has been instructed by the current mortgagee to send payments for the debt; the original mortgagee or lender may be the mortgage servicer, if it still receives payments from the debtor.

Nonjudicial Foreclosure. Foreclosure process that involves no judicial intervention and is free of court involvement.

Security Instrument. Deed of trust or mortgage; the document creating the lender's lien on the collateral and giving the trustee the power of sale.

Substitute Trustee. Person appointed by the current mortgagee or mortgage servicer to exercise the power of sale in lieu of the original trustee designated in the deed of trust.

Trustee. Person authorized to exercise the power of sale under the terms of the deed of trust.

The difference in the fair market value of the collateral and the unpaid balance of the note determines the amount of the deficiency judgment. Previously, the courts tied the fair market value of the collateral to the highest bid price generated by the sale. Now, debtors may ask the court to determine the fair market value independent of the sales price. The statute dictates the factors and the manner by which the determination is made.

Any money the lender receives from a private mortgage guaranty insurer must be credited to the debtor's account before seeking a deficiency judgment. However, the private mortgage guaranty insurer may then sue the debtor for the amount paid.

This article covers only foreclosures under deeds of trust. Two other types of residential foreclosures are possible, one under a contract for deed and the other under a home

equity loan. Look for more information in upcoming REALTOR® Newsline for articles on those types of foreclosures

Foreclosures under home equity loans are conducted judicially according to Texas Rules of Civil Procedure 735 and 736.

Written by Judon Fambrough. Fambrough is a member of the State Bar of Texas and a lawyer with the Real Estate Center at Texas A&M University.