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SENIOR LEGAL GUIDE

A Self-Help Guide to Foreclosure Prevention

This guide is meant for California seniors who have contacted the Senior Legal Hotline (SLH) because they have fallen behind on their mortgage payments or can foresee doing so in the near future. Know that you are not alone; millions of seniors nationwide face similar dilemmas.

The guide is meant to help you understand what may lie ahead – and what you can do to achieve the best possible outcome in keeping with your goals. Each person’s answer will be different, and you may want to contact SLH again for additional help. But meanwhile, please read, think and begin to act in a way that makes sense for your situation.

First, become familiar with the foreclosure process for California.

Foreclosure time line

Missed first mortgage payment →

- 60-90 days
(could be more or less)

Notice of default →

- 90-day waiting period
(minimum required by law; can be more)

Notice of trustee’s sale →

- 21-day waiting period
(minimum required by law; can be more, and can be postponed, then rescheduled without notice)

Right to reinstate →

- Up to five days before sale

Trustee’s sale of the property →

- Property sold at auction
- No post-sale right of redemption

Let’s say your mortgage payment is due today, and you aren’t able to pay it.

After you miss two or three payments – no set rule, could be less or more – you may receive a **notice of default** from your lender. It becomes official when it is filed in the **Recorder’s Office** in the county where your property is located. You should get a copy in the mail, too.

At this point, you can still save your home, but if you do not make arrangements with your lender within 90 days, you’ll probably receive a **notice of trustee’s sale**. Also filed in the county Recorder’s Office, it sets a date and time when your house will be sold at auction – but no sooner than 21 days from the date of recording. The notice must be mailed to you within 10 business days of recording and at least 20 days before the sale, and it must be published in a local newspaper of record.

You have up to five days before the sale to **reinstate the loan** by paying the past-due balance to bring it current, plus late fees/costs (set by state law), or by making other arrangements with your lender.

Up to the moment of sale, you can save the house only by paying the full amount of the loan, reaching some other agreement with the lender or filing for **bankruptcy**. Bankruptcy can freeze the foreclosure process temporarily but it alone will not prevent foreclosure. (See also below, page 5.) Once the sale occurs, it is almost impossible to reverse.

What you can do if you are facing foreclosure

If you find yourself behind on your mortgage or fear that you may soon fall behind, there are some options to consider, depending first on whether or not you want to keep your home.

► *If you want to stay in your home*

Repayment plans, modifications and refinances

If you want to stay in your home, you can **contact your lender**, or more accurately, the **servicer** of your mortgage. A “servicer” is often not the owner of the mortgage but collects payments on the owner’s behalf. You can usually find the phone number for your loan servicer on your monthly billing statement.

_____ When calling your servicer, be prepared with a plan of action. If you are behind or fear that you will soon fall behind due to a temporary hardship, such as increased medical expenses associated with a condition that is only temporary or temporary loss of income, you may be eligible for a **repayment plan**: You start making your regular monthly payment on time again, catching up on the past-due amount with small extra payments each month.

If you are behind or expect to fall behind due to hardship of a more permanent nature, such as loss of income due to a change in life circumstances, or an increase in payments under an adjustable-rate mortgage, you can request a **loan modification**. Unlike a repayment plan, where none of the loan terms change, in a modification the servicer may reduce the interest rate, extend the length of the loan, reduce the principal balance (least common) – or a combination of these – to make the loan more affordable.

A **refinance** is a whole new loan, with the same or a different lender, and not necessarily tied to hardship. See the box, right, for the latest in government-sponsored help with modifications and refinances.

The latest plan from Washington

*HUD and the Treasury Department have announced a plan that offers incentives to servicers and borrowers for **modifications or refinance loans**. These may be good solutions for some distressed borrowers – whose existing loan balances and terms are within certain limits. Your servicer or a nonprofit housing counselor (at SLH or elsewhere) can help you decide whether this or any other plan (they tend to come, go and change) is best for you.*

To consider a repayment plan, modification or refinance, servicers generally require:

- **Financial worksheet:** a list of your monthly income sources and amounts, and expenses (utilities, food, transportation, etc.). Some servicers also require a list of assets and liabilities (what you own and what you owe). When listing your expenses, think about whether any part of your monthly budget can be tightened by eliminating unnecessary expenses. This can help make your mortgage more affordable.
- **Verification of income:** Every source of income will require verification. For example, if your only source of income is a monthly Social Security benefit, provide a copy of a Social Security award letter indicating its amount. If you are employed, you will likely be asked to provide an IRS W-2 form or recent pay stubs.
- **Bank statements:** Usually your servicer will require that you submit copies of bank statements for the last several months.
- **Tax returns:** Most servicers will also require your two most recent federal tax returns.
- **Hardship letter:** For a repayment plan or modification, you will usually need to explain why you fell behind on your mortgage or think you will fall behind soon. Examples of hardship include increased expenses (including an upward adjustment in mortgage payments); loss of income due to layoff or other cutback; or disability that results in increased medical expenses or loss of income.

Although it is good to have these items ready before contacting your servicer, requirements vary among them. Ask the representative you speak to for a list of the documents needed.

Sample hardship letter

Jane Borrower
1234 Main Street
Anytown, XX, 12345

Date

XYZ Mortgage Company
5678 Foreclosure Street
Anycity, XX, 56789

RE: Loan Number: _____
Property Address: _____

To Whom It May Concern:

I* am writing to explain the unfortunate circumstances that caused me to become delinquent on my loan. I have done everything I can to make ends meet, and I would like you to consider modifying my loan so that I can stay in the home I've been living in for the last ____ years.

The main reasons why I fell behind on my mortgage payments are _____
(Make this part as long as needed; see discussion above on common hardships)

If approved for a loan modification that I can afford, I am confident that I can resume payments on time and in full. I hope you will work with me and I thank you in advance for your cooperation and attention to this matter.

Sincerely,

(Signature)

Printed Name

** If there is more than one borrower, replace "I" with "we" in the letter, and have both sign.*

Additional mortgages can complicate matters

If you want to discuss a modification, short sale or deed in lieu of foreclosure with your servicer, it can be more difficult if you also have a **subordinate loan** (second, third, etc.) secured by the same property. Exactly how it plays out depends on many factors, from the type of loan and its terms to the inclinations of the various servicers and owners of the loans. Before you get into any negotiations, make sure the servicers and any loan counselors helping you are aware of all loans on the property.

A lender who forecloses without going to court (99.9 percent of the foreclosures in California) can never collect a portion of the debt that exceeds the foreclosure sale price. This is called the "**one action rule.**" But if you lose the house to foreclosure by a primary lender, the owner of a subordinate loan may try to collect any unpaid debt from you, and may even sue you in an attempt to recover. Its success will depend mostly on your financial situation.

Challenging foreclosure in court

Because almost all foreclosures in California are **non-judicial**, with no court filing necessary, any legal challenge to the validity of the loan being foreclosed or the foreclosure process must be initiated by the debtor. There are any number of potential arguments – failure to make disclosures or obtain signatures according to truth in lending law, fraud or misrepresentation, failure to provide a contract in the borrower's language, to name a few. In addition, if the borrower was over 65 or a "dependent adult," a lender's

violations could also constitute elder abuse.

Pursuing such a case successfully, however, demands expert knowledge of the law, rules of court and procedures. With your home at stake, you should obtain a knowledgeable, reliable attorney to represent you. Senior Legal Hotline can help determine whether the facts of your case may merit a lawsuit, and if so, how to go about finding an attorney. If you think you may have been victimized by illegal actions, don't delay; for most matters, time limits apply.

Bankruptcy may help

A bankruptcy court filing puts an immediate freeze (called a **stay**) on any legal action involving the filer's property, including foreclosure or eviction. But the delay may be very short-lived. To have it last longer, you must propose a plan under **Chapter 13** of the Bankruptcy Code to resolve your debt problems – and convince the court that it is realistic.

Typically, such a plan involves using your income to pay some or all of your debts over a period of several years, with regular payments to the court beginning immediately. When stopping a foreclosure is the goal, a plan could involve a home loan refinance or modification, a sale or any number of other options, depending on your circumstances. It could also involve the elimination (“**discharge**”) of unsecured debt such as credit cards, payday loans and bank loans). If debt secured by a home is greater than its fair market value, subordinate home equity loans may also be discharged.

Timing is critical when filing for Chapter 13, since the basis for what you can afford to pay during the plan is determined by your average income during the six months prior to filing. If you expect to lose income in the near future, or recently lost income, waiting until that loss is reflected in that six-month look-back period will increase your chances of a successful bankruptcy plan.

If laws were broken in the making of a home loan or in a foreclosure process, you may be able to file an **adversary complaint** within the bankruptcy case. You must still prove your case, as explained above, but in some instances the bankruptcy court may be a better place to pursue a judgment.

As with any lawsuit involving complex laws, rules and procedures, it is extremely difficult to succeed without representation by an attorney who has specific expertise. In a Chapter 13 case, payment of attorney fees may be structured into the bankruptcy plan, avoiding the need for a large payment up front.

Reverse mortgages

Another option for borrowers over 62 is to obtain a **reverse mortgage**. This is a loan made against the equity in your home, but repayment is postponed until you sell or move (or fail to maintain the property, pay taxes, etc.) or until death. The most you can borrow is set by a formula involving your age, the house's value and interest rates. You can receive payments as monthly installments, a line of credit, a lump sum or in some combination of those. The loan balance increases as interest and other fees are added each month.

Reverse mortgages were originally designed for older homeowners with paid-off (or nearly so) homes but low incomes who want to use the equity to enable them to remain in the home when they might not be able to otherwise. Obtaining a reverse mortgage to pay off an existing loan, sometimes under threat of foreclosure, was not uncommon – but historically, even that required having plenty of equity.

Nowadays, many homeowners suddenly have little – or even negative – equity, due to falling home values and/or unaffordable payments, perhaps due to abusive loans they

Reverse mortgages are complex, involve high up-front costs and are generally advised only if a borrower is determined and will likely be able to remain in the home for a long time. They may affect a borrower's finances in ways that normal home loans do not.



Anyone considering a reverse mortgage should obtain expert, unbiased counseling early on, from Senior Legal Hotline or another HUD-approved agency.

didn't understand. In such situations, some seniors for whom a reverse mortgage is an acceptable option otherwise are proposing a **short payoff**, in which the servicer accepts the amount obtained in a reverse mortgage as payment in full. If you have lost your home in foreclosure, you may even be able to use a reverse mortgage to repurchase the property, if you have some funds you can use to cover part of the price.

► ***If you do not want to stay in your home***

If you do not want to stay in your home, you may be able to reduce the damage to your credit record that would result from a foreclosure. One option is to put the house up for sale before you fall behind. In today's market, however, many homeowners face the problem of owing more on their mortgage than their house is worth (referred to as being "under water"). Your servicer may be willing to accept the sale amount at current market value. This is called a **short sale**. It must be carefully negotiated and can take many months to finalize.

Another option is to offer your servicer a **deed in lieu of foreclosure**, in which you hand over the keys to the property in exchange for the servicer's agreement to cancel the note and deed of trust on the mortgage. Just as with a short sale, however, the servicer must agree for this arrangement to go through.

Either of these options can help reduce the damage caused by falling behind on your mortgage. If your home is already scheduled for foreclosure sale, however, or you are in the later stages of the foreclosure time line, a short sale or deed in lieu may not help your credit all that much.

Tax consequences of 'debt forgiveness'

Even though a foreclosing lender cannot sue for excess debt thanks to the one action rule, a foreclosure, short sale, deed in lieu or modification that involves principal reduction can leave the former borrower with a tax bill for the **forgiven debt**, which may be treated by the IRS as ordinary, taxable income. Many become aware of this only when they receive a form 1099-C from the servicer (or former servicer), indicating that the "income" was reported to the IRS.

But there are several ways that a federal tax liability can be avoided:

1. If the loan was for **purchase of a principal residence**, or if the seller financed the purchase of any property, the loan is considered "**non-recourse**" under California law. That means that even without the one action rule, if a sale is for less than the amount of the debt, there can be no collection of the difference – and the IRS therefore does not consider the forgiven portion to be taxable.

Important: *State tax law differs from the federal rules described here in several important respects, and both are subject to change. Anyone facing possible tax liability for forgiven debt should consult a CPA or other tax professional.*

2. Some additional types of mortgage debt forgiven or canceled by a lender in 2007, 2008 or 2009 may be exempt due to a **qualified principal residence** exclusion passed by Congress in 2007. It applies if the debt was used to buy, build or substantially improve (repairs don't count) a principal residence, or to refinance debt incurred for those purposes (not for other purchases, to obtain cash, pay off other bills, etc.). A principal residence is the home "resided in" preceding its loss to foreclosure, short sale, etc. Any amount of forgiven debt can be excluded, as long as the loan balance was less than \$2 million (\$1 million if married, filing separately). IRS form 982 must be filed with a tax return to claim this exclusion.

3. The **insolvency exclusion** applies if a debtor's liabilities exceed assets at the time of foreclosure, short sale, etc. Liabilities include mortgage and all other debt; assets include the fair market value of the house, stocks, mutual funds, CDs, cash, cars, personal property and some annuities. If the taxpayer's liabilities exceed assets (calculated just before the foreclosure or other event) but the difference

is less than the amount of the forgiven debt, that difference would be excluded but the remaining amount of the forgiven debt would be considered taxable income. IRS form 982 is used for this purpose as well. The taxpayer has the burden of proving insolvency. Insolvent taxpayers must attach to their tax return a list of assets and liabilities at the time the debt was forgiven, and appraisals may be required. A taxpayer may take either the insolvency or the qualified principal residence exclusion (No. 2, above), but not both.

4. By the same logic, the insolvency exclusion also applies to any **debts discharged in bankruptcy**. They are not taxable.

- ▶ *Since a foreclosure, short sale or deed in lieu are all considered forms of a sale, there may also be a **capital gain** to report, even if the taxpayer is insolvent. The gain may or may not be taxable, depending on other rules – most typically, the exclusion of up to \$250,000 (\$500,000 for a married couple) of gain on a principal residence occupied for two of the previous five years. A modification involving principal reduction will cause a downward adjustment of the property’s basis, potentially affecting the capital gains calculation when the property is eventually sold.*

Don’t wait until it’s too late

If you are having trouble with your mortgage, it is best to contact your servicer as soon as possible to discuss your options. Whether or not you want to keep it, the worst thing you can do is wait and allow your home to go into foreclosure. Once you determine your goals, you can formulate your plan of action.

Don’t be discouraged if at first you don’t succeed in negotiations. With the ever-changing nature of loan modification and home retention programs amid the current crisis, there’s a good possibility that if you try again later (even after being denied a loan workout plan previously) you could succeed the next time around. This is especially true if the nature or extent of your hardship has changed.

More resources

U.S. Department of Housing and Urban Development (HUD),

- At www.hud.gov, you can access a list of additional approved housing counseling agencies in your area that can assist you with mortgage-related issues.

U.S. Treasury Department

- See www.makinghomeaffordable.gov for the latest programs and eligibility requirements for government-assisted modifications and refinances.

U.S. Internal Revenue Service (IRS), www.irs.gov

- For information and assistance with tax issues, including contact information for the IRS Taxpayer Advocate, an independent division within the IRS that helps taxpayers resolve their tax issues.
- For details on taxability of forgiven debt, see IRS publication 4681.

Law Help California, www.lawhelpcalifornia.org

- A web site providing access to self-help information and how to contact organizations for free or low-cost legal help in California, with a special section on foreclosures.

AARP

- For resources and information on reverse mortgages, visit www.aarp.org/revmort.
- Tax-Aide program for help with income tax preparation during tax season, call 888 227-7669 or visit https://locator.aarp.org/vmis/sites/tax_aide_locator_adv.jsp. www.aarp.org/taxaide.



If you are over 60 in California, you can get free advice by phone from the Senior Legal Hotline regarding your questions about this or any other issue. Hours of operation are Mon.-Fri. 9 to 12 and 1 to 4, and until 7 p.m. on Thursdays. You can also submit your question by e-mail from our web site, www.seniorlegalhotline.org.