

# **Special Report**

## **Foreclosure and Probate Estates: Strategies for Prevention and Remedial Actions to Protect Client's Assets and Attorney Fees**

***The Suburban Group***

***Mortgage Bankers*** ***Probate Specialists***

## **Foreclosure and Probate Estates: Strategies for Prevention and Remedial Actions to Protect Client's Assets and Attorney Fees**

*This article is intended to provide the legal professional a framework for evaluating estates which have real property in foreclosure, plan a course of remedial action(s), and avoid the loss of an asset. Perhaps more importantly, this article covers specific guidelines for default preventive actions, which can be employed in all probate and trust matters consisting of encumbered real estate.*

The concerns over protecting assets from forced sale or complete loss has been an increasingly big concern for probate practitioners. The booming California real estate market of recent years is softening and prices for residential property have stabilized in many key indicator areas. This trend historically increases the threat of loss of estate realty due to foreclosure. Accordingly, the exposure to the client and the attorney, which results from an estate with property in default, can be substantial, with many hidden risks.

Estates typically default on a decedent's mortgage due to one or more of the following reasons:

1. Lack of sufficient cash flow/cash reserves in estate
2. Executor/Administrator unaware of loan(s) on the decedent's property
3. Erroneous assumptions by Executor/Administrator that mortgage lender will wait until close of probate for payment of monthly installments
4. Executor/Administrator and/or heirs unwilling or unable to make payments
5. Difficulty in selling realty due to marketability issues such as deferred maintenance (poor condition), title problems, etc.
6. Adversarial relationships between heirs
7. Issues regarding delegation of payment responsibility
8. Poor communication between Executor/Administrator, Attorneys and lenders

According to foreclosure trustee, Rande Johnsen, at Trustee Corp. in Irvine, CA (telephone 949.252.8300), the increased frequency of estates defaulting over past years may be the result of changes in the mortgage marketplace:

1. In the past, lenders offered more flexibility on loan payments once advised of opening probate.
2. Lack of direct relationship between lenders and borrowers
3. Frequent sale of loans to between lenders
4. "Mega banks" and other lender consolidations
5. Bureaucratic collection departments and automated voice banking systems
6. Mounting pressure from lending institutions to reduce their number of non-productive mortgages by investors, bank management, VA, FHA, FNMA, etc.

***Issues & Concerns: Lost Assets, Time and Bad Faith***

Paramount among concerns for the attorney and the personal representative is the loss of real property to a secured creditor through foreclosure. Frequently, the only asset of any tangible value is a single family dwelling, usually the decedent's residence.

Despite the fact that such an asset may easily have a fair market value of \$100,000 or more, the estate is most likely to be focused on realizing the fullest value possible in order to pay creditors, costs of administration and distribute to heirs.

Stopping foreclosure by selling or borrowing, while maybe necessary, only reduces the amount of proceeds available for ultimate distribution. Moreover, while it may be possible to salvage costs of administration from certain mortgage holders (discussed more fully later) there is no straightforward process established to deal with these secured creditors. This leaves the probate practitioner no other choice but to negotiate on a case-by-case basis with no assurance that any satisfactory outcome is available to the estate client.

The same may be said for a Conservatorship in which the Conservatee's property has fallen behind in payments and the lender has started foreclosure action. Often, a loan is discovered in default too late in the process to affect an inexpensive cure. This presents a good argument for using professional fiduciaries (who might act more responsibly).

There are other arguments to support proceeding cautiously to avoid the risk of loss of estate realty due to foreclosure. Protecting the attorney's fees, while not being of primary importance, is a factor after first considering the interests of the client. The time invested on a small, problematic case may not be recoverable as extraordinary fees or may be lost entirely if the property goes to trustee's sale. There are still further exposures to the attorney from litigation by heirs and creditors, and the potential claims of malpractice by dissatisfied estate representatives. In all, accepting a probate in foreclosure is risky business.

***The Foreclosure Process: Understanding the Trustee's Timetable***

The non-judicial foreclosure process is conducted pursuant to Calif. Civil Code § 2924. § 2924 allows lenders to foreclose upon real property securing their loan without the time and expense of a court action. A non-judicial foreclosure can take as few as **111** days from start to finish. The following is a simplified version of the process.

**The Foreclosure Process in Five Steps:**

- Step 1 Notice of Default is Recorded (day 1)
- Step 2 Reinstatement of Loan can occur any time up to and including 5 business days preceding the sale
- Step 3 Foreclosure Sale Date Set (**3** Months following Notice of Default date)
- Step 4 Notice of Trustee Sale prepared, published, recorded, mailed and posted

Step 5 Foreclosure Sale Date (Sold at Public Auction, usually 3-4 weeks following Notice of Sale; may be as few as **111** days)

### **Special Issues and Concerns Regarding Estates in Foreclosure**

#### ***Importance of Trustee's Proper Noticing of Personal Representative(s)***

Since the trustee is responsible for accurate and timely noticing of a pending foreclosure sale, communication with both the lender and the trustee ought to be documented thoroughly. If the trustee has no knowledge of a probate proceeding of the mortgage Trustor (decedent), a non-judicial sale may typically proceed without much chance of a sale being set aside. However, if such a foreclosure sale takes place without the trustee having properly noticed the personal representative (after being informed of the probate), such a sale may either be postponed until the trustee republishes noticing all parties, re-records the Notice of Default, or the estate may enjoin the trustee/lender in a legal action to set aside the sale. Therefore, the importance of informing the trustee and lender of the probate (and documenting same) is vital to protecting the asset. [See: Estate of Yates 25 Cal. App. 4<sup>th</sup> 511; 32 Cal. Rptr. 2d 53 [May 1994], Baker v. West End Financial Corp., Inc.]

#### ***Problems Regarding Insolvent Estates***

California real estate values have experienced dramatic price variations in the past decade. The number of over-mortgaged (under-secured) properties (when values have dropped below loan principal balances) rose dramatically in the early to mid 1990's, and are likely to reappear when the present real estate economy slows. Property sellers who find themselves in this situation may hear a new real estate term: "Short sale."

However, when encumbered estate property is sold, the priority of claims to the sales proceeds, specifically, certain cost of administration or other expenses, have a priority claim over payment to secured purchase money creditors. PC Section 10361 provides that the application of purchase money upon sale of property shall be applied in the following order:

- 1) Expenses of administration which are reasonably related to the administration of property sold as provided in paragraph (1) of subdivision (a) of Section 11420;
- 2) The payment of the expenses of the sale;
- 3) The payment and satisfaction of the amount secured by the lien on the property sold if payment and satisfaction of the lien is required under the terms of the sale.

Section 11420 of California Probate Code (***Priority for Payments of Debts***) further elaborates on this theme, essentially restating PC 10361.

When a non-judicial foreclosure sale takes place, the application of the proceeds and the responsibilities of the foreclosure trustee to distribute proceeds would appear the same as in a traditional, voluntary sale. However, since the trustee represents the lender, there are still important unresolved issues, such as how to treat a credit sale resulting in a reversion back to the secured lender. It's almost a foregone conclusion that the mortgage lending industry will soon lobby to limit their financial exposure.

The main point of discussing these issues regarding noticing and priority of claims in this report is that a fair amount of confusion still exists.

**Preventive Actions:**

What actions can be taken to avoid a foreclosure action in the first place? Here is a brief checklist:

1. **Always obtain a preliminary (title) report, not a profile**, for each property upon opening a probate case. Most title insurance companies will permit you to purchase a report for a modest charge and the cost may be credited toward purchase of a title policy at later time when the property is either sold or financed.
2. **Write to lenders and lien holders.** Keeping these parties informed will lessen the chances of miscommunication and counter-productive efforts on everyone's part.
3. **Obtain account balances from lien holders & creditors.** Know what you owe.
4. **Request proof of lien and debt.** Obtain copies of promissory notes and trust deeds and review terms and conditions for repayment. In some circumstances, recorded judgments or liens may have expired or otherwise be held invalid.
5. **Keep secured loans current.** The total expense to the estate will be minimized if the lender does not deem it necessary to initiate foreclosure to collect on a debt. It's quite possible that the original borrower may have had a history of collection problems with his/her mortgage lender who is now less than motivated to offer much assistance.

**Remedial Actions Available:**

Not all remedies to foreclosure are available to an executor/administrator of a probate estate or other fiduciary as would be available to a natural person. This speaks directly to using certain bankruptcy laws or other actions intended primarily for consumer debtors. However, the probate code does make provisions for the personal representative to enjoin the non-judicial foreclosure sale. Typically, this is done via petitioning the superior court in which the probate has been filed.

1. **Don't let the client procrastinate if a lender begins foreclosure.** The client must be made to understand both the limits to available options and the reality of the situation.
2. **Send all written communication to lender via certified, registered mail.** This single action could help your client buy more time to cure the default or sell. Should the trustee not properly notice the personal representative, this could delay foreclosure.
3. **Advise client/heirs to consider advancing personal funds** to cure the default, or...
4. **Refinance the old debt** with a lender who will lend to a personal rep. in foreclosure, via a § 9800 Petition for Order to Borrow; or with Full Powers under § 10514, to wit:  
"Borrowing; Encumbering estate property: (a) Subject to subdivision (b), the personal representative has the following powers: (1) The power to borrow; (2) The power to place, replace, renew, or extend any encumbrance upon any property of the estate; (b) Only a personal representative who has full authority has the power to borrow money with the loan secured by an encumbrance upon real property."
5. **List the property for sale** with a real estate broker or auctioneer experienced with both probate realty and foreclosure, or...
6. **File an Ex-Parte Petition for Order to Enjoin Sale under a § 9391 Petition.** To quote the Probate Code: "The personal representative shall have the authority to seek

to enjoin any action of the lien holder to enforce a lien against property that is subject to the lien.” if you feel that a case with merit exists.

*Note: An excellent additional resource is available from **Old Republic Title Co.** Request their Titlegram Re: Foreclosure by Gary Bregman. Copies are available free of charge by calling **Larry Christian @ 800-388.4853, X6509.***

### **Conclusions**

Administering estates, which are subject to the effects of a mortgage in default, appear increasingly common and most probate attorneys will encounter the problem sooner or later. While remedies do exist for estates in foreclosure, the better course of action is prevention. The cost in terms of time, money and aggravation typically far outweigh the effort of a few extra steps during the administration process.

**Do you want to learn more about remedial actions for an estate currently in – or in danger of – default?**

**Please contact *Rick Harmon* at:**

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