FORECLOSURE IN HAWAII

GENERALLY

QUESTION: What are the most common debt instruments for residential finance in Hawaii?

ANSWER: The most common instruments in Hawaii for home purchases, residential equity finance or lines of credit is a mortgage with a power of private sale.

JUDICIAL FORECLOSURE ACTION BY THE LENDER:

QUESTION: What are the creditor's remedies if the mortgage with a power of sale is in default?

ANSWER: In general law, ***except for certain residential non-deficiency mortgages set forth, below,*** the loan secured by real estate may be enforced by the lender or holder of the instrument either by suing the debtor directly on the debt (usually the promissory note the debtor signed), or by a foreclosure against the property, conducting either a judicial foreclosure (in a court) or a non-judicial trustee sale (the latter on loans containing that power, only, which are most of those in Hawaii). See more about what a trustee's or sheriff's sale is, generally, under the heading for Oregon, above. Hawaii laws regarding the method of giving a default notice and the rights after that vary between states, but the sale is always the final event that terminates the debtor's title to the property and the debtor's right to occupy the property.

QUESTION: What happens at and after the foreclosure sale?

ANSWER: Under the foreclosure law the creditor sells the house either for enough to get the entire loan paid off (and the creditor keeps the payoff up to the amount of the remaining loan and expenses to foreclose it) or it sells for less than the unpaid debt amount (very common, recently, due to adverse market conditions) . If there is a foreclosure by a suit in the Circuit Court, the creditor is also awarded a judgment for that short fall against the debtor which the creditor can further pursue by levy and attachment against all of the debtor's non-exempt properties under the debt is paid in full.

FORECLOSURE ACTION BY NON-JUDICIAL SALE:

QUESTION: What happens if the foreclosure sale is a non-judicial foreclosure, i.e. NOT by a suit before the Court, but by private notice and private sale?

ANSWER: **THERE IS A LITTLE BETTER NEWS FOR MOST DEFAULTING HOME-MORTGAGE BORROWERS IN HAWAII WHO HAVE LOST THEIR HOME BY PRIVATE FORECLOSURE SALE.** Foreclosures done by the power of sale—those in which a lawsuit for enforcement and the Court was not involved—will not produce a deficiency judgment against the borrower. ***Under Hawaii law, provided that the sale is done without Court intervention and further provided that the lender and borrower convey title to the property to the buyer at the sale properly after the foreclosure sale, there is NO DEFICIENCY. It is deemed to satisfy the debt in full, even if the foreclosure was not enough to pay the debt.***

MOST HAWAII HOME MORTGAGES ARE FORECLOSED BY THE PRIVATE POWER OF SALE AND NOT JUDICIALLY AND THAT MEANS THERE CAN BE "NO DEFICIENCY" AGAINST THE DEBTOR IN A FORECLOSURE. For one thing, the lenders have usually figured it out that the borrower has no money—hence why the mortgage is even in default--so a deficiency judgment against the borrower would be worthless to the lender. Most lenders have also figured out that faced with a large deficiency, most borrowers will simply seek bankruptcy protection if a deficiency is pressed, anyway. Last, a judicial foreclosure can be long and expensive and invites the files of defenses and counterclaims by the borrower, something the lender usually wishes to avoid. But even when there is no deficiency, there can be IRS, credit, employment and other ramifications.

CAUTION: Note that in order to protect himself against a deficiency after a foreclosure by non-judicial sale, the borrower must voluntarily convey whatever title he has to the buyer at the foreclosure sale to be allowed that protection. If the borrower fails to do that, he can still be exposed to money judgments against him.

EXCEPTIONS THAT COULD STILL MAKE THE CONSUMER OR SOMEONE ELSE LIABLE:

The non-deficiency rule will not apply if the debtor has allowed the property to be wasted by such things as his own bad maintenance, by vandalism of him or others or uninsured losses before the foreclosure sale ("voluntary waste"). Both the mortgage obligation and the law, generally, allow a creditor to recover for damages done by the borrower or borrower's failure to protect the property from damages by other people or events.

RECENT CHANGES TO HAWAII FORECLOSURE LAW:

Act 48 was signed into law by Gov. Neil Abercrombie in May, 2011, in an attempt to stem the state's increasingly high number of mortgage foreclosures and to ensure that borrowers had a fair chance to communicate with lenders and attempt to keep their homes. The bill essentially requires lenders to meet face-to-face with borrowers via a neutral third party, to assure that compromising on a loan - instead of simply foreclosing - is a primary option.

Act 48 also forces lenders to actually show proof that they have the legal right to foreclose on a home - something that consumer advocates claimed was skirted in certain non-judicial foreclosure processes.

Controversy has mounted over "Part 1" of the law, which affects the two non-judicial foreclosure forms in Hawaii noted above. As written in Part 1, the rules allow lenders to get away with giving borrowers poor notice of the foreclosure while discouraging compromise. "Part 2", a second non-judicial process, has more consumer protections in place, as well as judicial foreclosures, in which a state hearing is held where the borrower can state their case for continuing a loan.

Act 48 places a moratorium on all new "Part 1" non-judicial foreclosures until July 1, 2012 with the hope of keeping Hawaii homeowners in threat of foreclosures from quickly losing their

homes. Act 48 also closes the non-judicial loopholes that offshore lenders were exploiting to bypass giving borrowers a chance to explain their circumstances.

There are also questions surrounding Fannie Mae's decision to immediately switch all its Hawaii foreclosures to judicial ones, which some believe was done in an attempt to avoid neutral-party mediation and other elements of Act 48 rather than to benefit borrowers in any way. A serious concern is that if other lenders follow in Fannie's footsteps, the courts will not be able to handle all the foreclosure cases. The Unfair Practices provision of Chapter 667 in Act 48 threatens lenders with class action lawsuits if the foreclosure process isn't done strictly by the standards of the new law.

Starting in October 2011, lenders may submit non-judicial foreclosure notice filings *online* once they have registered with the state. There have been other important changes. Always refer to the laws and the advice of counsel.

GUARANTYS:

Persons who sign a separate document as "Guarantors" of the debt can also be liable for the debt and in some cases can even be liable for a debts of the primary borrower whom they are guaranteeing that are non-deficiency debts for the primary borrower. Guarantors are usually joined (and are in some cases required to be joined) in the initial foreclosure process.

OTHER SECURED DEBTS:

Mortgages secured by bare land, multiple units and commercial and business mortgages and lines of credit (where the property was used as collateral to borrow money to be used elsewhere) all allow deficiencies if the sale proceeds do not equal the unpaid debt, unless they contain a clause which specifically states that the debt is "non-recourse" or that remedies are "limited to a forfeiture of the property and not a monetary judgment" or like language.

OTHER DEBTOR DEFENSES:

The debtor has all of the normal contract and, where applicable in residential financing, all consumer defenses against the lender available in almost every state. See "DEFENSES" under this FAQs column, generally.

. ***See also other debtor ramifications of a foreclosure, below.***

RAMIFICATIONS OF FORECLOSURE OR DEBT RESOLUTIONS COMMON TO ALL STATES

QUESTION: Are there other ramifications for a failure to pay a debt?

ANSWER: Yes, and they must all be considered.

Most any foreclosure or debt reduction in the form of a loan modification, short sale, deed in lieu or other change of a pre-existing debt will have tax, credit eligibility, insurance, professional, licensure eligibility, immigration, employment, security clearances and other impacting affects. These must be analyzed in each case by a competent, licensed professional. In addition, the debtor has a separate liability for "rent-skimming," which is the taking of rents from a tenant at the secured property while not paying the loans against the property. A claim for rent recovery is the recourse in most states, and, in some states, this is also a crime. In all states it is a violation of the residential landlord-tenant acts if it is a residential property and most always a landlord violation of the lease agreement, whether residential or commercial. Real estate agents facilitating such skimming activity by a landlord or owner are in licensure violation in all states. Under current federal law, tenants in good stead with lease that predate the foreclosure will be permitted to remain for the period of their lease or 90 days.

Now how about some DEFENSES COMMON TO ALL STATES?

DEFENSES TO DEBT CLAIMS COMMON TO ALL STATES

QUESTION: Are there more defenses for the debtor in debt-collection actions or is the debtor (residential or commercial loan) strictly limited to what is in the foreclosure statutes?

ANSWER: There are many, many more debtor defenses than were mentioned in discussing the debt enforcements, above. Some defenses have nothing to do with foreclosure rules and are governed by criminal law, laws for general consumer protection, bank regulation, underwriting and appraisal rules and laws, bankruptcy and others.

In every state there are valid defenses to debt claims and these must be raised in any debt analyses or debt dispute by a competent, licensed attorney. Defenses common to bare land, residential and commercial debts incurred within the last 5-7 years are violations of the myriad of Federal and state law related to consumer protection, wrong or false appraisals, national or international subdivision application or subdivision sales defects, defective underwriting and reselling, holder-in-due-course failures by the lenders and their assignees and their collection arms, bait-and-switch, loan-slamming, 100% loans lender-disguised and booked as "equity transactions" through 80/20 and 70/30 dual loans in violation of both warehousing and secondary market underwriting rules, contractual and tortuous bad faith, violation of a lender's own internal or Regulator-required standards, process and rules, dealings with the primary borrowers that void Guarantys, loan terms and Guarantys with terms so onerous they will be stricken as violations of public policy, and, especially in commercial settings, the debt being secured by a defective property or proforma for the property, inappropriate or negligent proprietarily involvement by the lender or its agents in the property, waste by the lender in possession, failure to follow mitigation duties or laws and other defenses among the multiple other contract and tort defenses such as outright statutory or consumer fraud, common law fraud, unlawful collection practices, racketeering and others. The parties need to consult their attorneys for these as they vary with each fact and transaction pattern.

TAX AFFECTS?

TAX AFFECTS COMMON TO ALL SHORT SALES AND FORECLOSURES

QUESTION: Is it true that a borrower can get taxed for the debt forgiven through loan write-offs, write-downs and foreclosures?

ANSWER: Yes.

IRS Section 108 governs the taxability to borrowers of losses, write-offs and write-downs by lenders, i.e. "phantom gain." Borrowers can be liable for income taxes for these excused debts. At the federal level, IRC 108 should be consulted for each application, but, in general, debts for which the only recourse is the property are not considered "phantom gain" when defaulted and written off. Debts which maybe pursued personally against the borrower are eligible for "phantom gain" treatment. Currently, "phantom gains" on purchase money debts against residential property which the debtor occupies—whether or not recourse—are exempt from taxation under a federal law up to $2 million in gain, but this law will "sunset" unless renewed soon. Some states do not recognize the same federal tax rules, so state treatments can vary. On the flip side, there are also losses that the debtor can write down for business or investment property lost in foreclosure or short sales or modified and these can have tax benefits, though often ones that must be spread over long periods of time or tax-planned to trigger along with gains. There are other ramifications. Some of these ramifications can be avoided by an artfully raised and effectuated claims and defense-tradeoffs between creditor and borrower. The debtor should contact a licensed professional for advice and applicability for the particular debtor.

There you have a thumbnail. Aside from Mark Twain's "issue" with the legal system, the judges and the lawyers—with whom he had frequent personal interaction due to his many patent, copyright and investor lawsuits, most of which he lost to his great resultant impoverishment ***if the 22nd Century has taught us anything, it is that knowledge is power.*** Knowing and using the law for one's protection from the ravages of the Bad Guys is now probably one of the most important forms of modern literacy. Especially when there are so many more Bad Guys round these days than was once the case. "Smart" is not only knowing the law, but also knowing when to get help with it and that sometimes means getting a…..(gulp!)…lawyer. But another "Head's Up" here: ***Not all good lawyers—including those that know both the judge and the law—want to work for the Bank.*** Some favor the "Davids" of the world.

'Nuff said.

BIO FOR J. ROBERT ECKLEY

J. Robert Eckley is a multi-state real estate and banking attorney, successful litigator, popular writer, educator and national speaker with an immense personal and professional involvement in forefront issues over the past three decades. He has been a keynote speaker at NAR® National Conventions (receiving a perfect presentation score) and many state Association conventions which have honored him with top ratings. He has established precedent at the Supreme Court and co-founded transactional laws, rules and forms that guide practitioners today. He has been a licensee and/or Realtor® or Realtor® Affiliate for three decades, 5 years of which were with the Beverly Hills Board, 10 with the Phoenix, Scottsdale and Portland Associations, now a member of the North San Diego County Association of Realtors®, was named to numerous Commissioner's Advisory Committees, received a host of leadership and instructor awards, is a CCIM® Affiliate, testified in Congress against the due-on-sale clauses in 1982, successfully fought the clause in state and federal courts, fought against all and defended a half dozen state and nationally chartered banks and thrifts, and has received leadership awards and honors from former California Governor and U.S. President Reagan and former Arizona Governor and now head of U.S. Homeland Security Janet Napolitano, to cover just a few of the miles he has gone. He is a "been there, done that" type who is often as entertaining as he is practical and enlightening! See more at www. eckleylaw.com. To be on his "Counselor's Corner" monthly hotline e-mail to education@eckleylaw.com or call (602) 952-1177 or out of the Phoenix free dialing region 1-800-999-4LAW and ask to get on the hotline!