FORECLOSURE IN CALIFORNIA

GENERALLY:

QUESTION: What happens if I go into foreclosure on my mortgage or trust deed?

ANSWER: You can lose your property in a forced sale and in some cases still owe the creditor money for the sale or promissory note shortfall.

California permits both judicial (a court lawsuit for foreclosure) and non-judicial (sale by trust deed trustee without a court suit) foreclosure. Sale by a trustee is only permitted in sales based upon the *trust deed* type of finance. For pure *mortgages*, the sale by a trustee is not available and the creditor must foreclose by suit, with the sale being conducted by the County Sheriff or Constable. In some cases (though these owner-finance instruments are not commonly seen in recent years due to the availability of bank finance, but may be seen more due to recent recession-generated bank finance scarcity) a sale by nominee (without a lawsuit) can be done under a *contract for deed* or *land sale contract*. Each of these sale/debt instruments, *trust deed*, *mortgage* and *land sale contract* are different. Only trust deeds, by far the more prevalent instrument, are covered here.

JUDICIAL FORECLOSURE:

QUESTION: What is "judicial foreclosure"?

ANSWER: The creditor sues you in the Superior Court and the Court orders the property sold by the County Sheriff or Constable and the Court can, in some cases, lodge a judgment against you for any shortfall in the sale proceeds to satisfy the remaining debt. This judgment for the shortfall is called a "deficiency judgment" and is a remedy highly limited in most California residential real estate finance. See limits for deficiency judgments, below.

In this foreclosure type, a lawsuit is initiated in the Superior Court which accelerates the entire balance due under the promissory note and requests judgment for that balance (plus interest, attorneys' fees and costs). An execution order is also issued, permitting the property to be sold to the highest bidder on a given day, commonly by the Sheriff or Constable, to resolve at least part of the debt. The proceeds of sale are applied to the judgment and if there is any deficiency (the proceeds of sale are less than what was adjudged due), then, in some cases noted below, the balance of the creditor's judgment for money stands and can be further executed against the debtor's other non-exempt assets (other property, bank accounts, etc.) by levy, execution or garnishment. The borrower may have up to 1 year to redeem the property (buy it back for what it was sold for) after a judicial foreclosure. See the time involved and the challenges of a judicial foreclosure under OREGON FORECLOSURES, below all states are very similar in that respect). California processes are about the same but it can in some jurisdictions take even longer to get to a trial and ultimate sale due to the backlog of cases.

NON-JUDICIAL FORECLOSURE:

QUESTION: What is a "non-judicial foreclosure"?

ANSWER: The creditor does not sue in a Court. It sets the property for sale by an appointee Trustee. No "judgment" is assessed against the debtor for any sale shortfall. (This remedy is not available for *mortgage* foreclosure.)

In this foreclosure type, the trustee appointed in the trust deed forecloses the property without a lawsuit. The trustee must give notice of Default and an Election to sell the property. These documents set a given date and place for the sale. Proceeds of the sale are applied to the balance due, plus interest and taxable trustees and attorneys' fees as set by statute. There is no true "deficiency judgment" in this type of foreclosure, as no court or judge is involved in the process at this stage. That is to say, whatever the creditor receives at the trustee's auction is all that the creditor will get and the balance of the debt, if any, is usually absolved in 1-4 unit residential trust deeds. The debtor has up until five days before the foreclosure sale to cure the default and halt the process. The cure is usually to pay those installments that would have been due had the default not occurred, plus interest and default penalties, attorneys and trustees fees as set by statute. The sale may be held on any business day between the hours of 9:00 am and 5:00 pm and must take place at the location specified in the notice of sale. The debtor has no rights of redemption after the sale. In some cases, trustee sale proceeds shortfalls to cover the debt can have further collection action initiated upon them. Generally, these are bare land or commercial property foreclosures or foreclosures on residential second trust deeds, such as Home Equity Lines of Credit ("HELOCS"), or on loans where the loan proceeds were not used to buy the property. There is an attempt in California to legislatively limit the enforcement of HELOCs.

DEFICIENCY JUDGMENTS:

QUESTION: What is a "deficiency judgment"?

ANSWER: A deficiency judgment is a legal judgment against the borrower for any shortfall in a judicial sale of the property to meet the total remaining debt plus taxable interest, fees and costs. To the extent the judicial foreclosure auction yields less than the judgment, a deficiency judgment could be available for judicial sales of the property, whether under a mortgage or deed of trust. See the limits on the creditor's right to seek deficiency judgments or initiate post-trustee sale judicial actions on note shortfalls under the "one action rule," below. Deficiency judgments are not allowed by California law on owner-carried trust deeds and mortgages and on third-party (usually Bank) finance secured by single family detached residences and buildings containing 1 to 4 residential units in which the borrower occupies at least one unit.

THE "ONE ACTION" AND "WORTHLESS SECURITY" RULES:

QUESTION: What is the "one action" rule?

ANSWER: As noted, above, in some cases, the creditor can ignore the lien of the debt on the property and sue in the Court on the promissory note that was signed along with the deed of trust or mortgage. This is an "action on the debt" and not a "property foreclosure." These actions are never available where the creditor would be barred on any deficiency had the creditor simply foreclosed (the creditor will not be permitted to circumvent the anti-deficiency rules—see those, above,) and even where there is a potential deficiency, these creditor actions may still be barred unless they met other criterion, such as being outside of the "one action" rule or the "fair sale" test or the "worthless security" defenses, below.

California's deficiency-judgment statutes were intended to work in tandem with the "one action" rule to avoid multiple collection actions against a debtor. Because the "one action" rule induces most creditors to foreclose on their security interests before seeking a personal judgment, these statutes protect debtors from a deficiency judgment if the property subject to foreclosure is a third-party (not seller-carried finance) loan upon dwelling intended to be occupied by four or fewer families—one of which includes the purchaser—and if the loan secured by the deed of trust or mortgage was used to pay all *or part of* the purchase price of the property being foreclosed. (Cal. Code of Civ. Proc. Code § 580b.)

The purposes behind the One Action Rule and the deficiency-judgment statutes are to prevent multiple actions, compel exhaustion of all security before a deficiency judgment is entered, and ensure that debtors are credited with the fair market value of the secured property before they are subjected to personal liability. (*See* In re: Prestige Ltd. Partnership-Concord v. East Bay Car Wash Partners, 234 F.3d 1108, 1115 [9th Cir. 2000].)

Mortgage and trust deed holders in subordinate title positions behind larger superior liens (where there is little or no equity left to realize upon) will often elect to wait until the superior debt is foreclosed, then take the position that their security position is "worthless" and sue on the note where the creditor thinks there are other assets the creditor might seek to realize from a separate judgment. This right is very deeply restricted, however, on the "one action" and "first against the security" rules of CCP 929(a) and CCP 580(b).

The "one action" rule limits the creditors to a single ("one") action for debts related to a single property, that is to say, they cannot initiate both a foreclosure on the property and an action on the note and where there is the chance under the loans to do both, the creditor is directed to first realize against the security, compelling the creditor to first offset the debt with the property. Where the creditor holds both the first and second title position loans and both were for purchase of the property, it prohibits the creditor from foreclosing on the first loan against the property and waiving the security and suing for the second loan on the promissory note—essentially prohibiting the creditor from taking "two actions". The statute limits the creditor strictly to one collection action.

As to any foreclosure shortfall (proceeds less than the debt) on which a deficiency might actually lie, the debtor can defend by asking for a "fairness hearing," arguing that the sale was a below-market sale. This defense is more likely when either the lender or an affiliate was the "high bidder" at the property sale (called a "credit bid," since the lender only forgives part of the debt as the way of "paying the bid price" to itself). In this type of defense, the debtor usually employs appraisers to prove that a better price could have been obtained and often blames the lender of collusion.

WASTE:

QUESTION: What is "waste" and how does a borrower become liable for it?

ANSWER: "Waste" means the debtor had damaged the property or has allowed the property to become damaged. The debtor can be held accountable for the damages property even where there is no deficiency available from the foreclosure.

Irrespectively of the laws limiting a deficiency in a foreclosure, the debtor can still be liable to the lender for such things as waste (damaging the property beyond normal wear and tear or permitting it to be vandalized or to radically deteriorate before the sale). Waste can also be accomplished by failing to keep the property insured for casualty until the time of sale and a casualty event occurs.

PERSONAL GUARANTYS:

QUESTION: What if I have signed a "Guaranty" for someone on the debt or they have signed one for my debt?

ANSWER: You or they could be liable for the debt or judgment to the extent it falls short of paying off the lender, even on a non-deficiency debt, depending upon how the Guaranty is worded.

Under certain circumstances, it is possible for one who guaranteed a non-recourse debt or judgment to be held liable for the deficiency of the borrower guaranteed, not as a matter of judgment, mortgage or trust deed law, but under the law of guaranty. Guarantees must be carefully read to determine what they cover and how extensively. See, limits under the "one action rule" and "fairness" proceedings, above, which California Courts have applied as an offset or defense for the Guarantor.

WAIVER OF FORECLOSURE FOR SUIT ON NOTE:

QUESTION: Is there any other way a creditor could claim against a debtor on a trust deed or mortgage?

ANSWER: Yes. In some cases such as commercial loans or loans on bare land, the creditor can ignore the lien of the debt on the property and sue on the promissory note that was signed with the deed of trust or mortgage in the Court. This is an "action on the debt" and not a "property foreclosure."

In some cases, a creditor may elect to waive a foreclosure action against the property and simply sue separately on the underlying promissory note by a lawsuit in the Superior Courts. Mortgage and trust deed holders in subordinate title positions behind larger superior liens (where there is little or no equity left to realize upon) will often elect to do this on those loans where direct action is possible and where there are other assets the creditor might seek to realize from with a judgment. See the "one action" rule limitations, above.

NEW PRO-CONSUMER CALIFORNIA FORECLOSURE LAW

QUESTION: Are there any other rules affecting the creditor or debtor in foreclosure?

ANSWER: Yes, and more forthcoming all of the time as the state tries to sort out the financial havoc wreaked by the recent recession. Most favor the consumer.

Under the recent **California Foreclosure Prevention Act,** lenders foreclosing on certain loans are prohibited from giving a notice of sale until the lapse of at least 3 months plus 90 days after the filing of the notice of default. A loan servicer can obtain an exemption from this requirement by demonstrating that it has a comprehensive loan modification program. The purpose of this law is to try to stem the tide of foreclosures and their adverse consequences by providing additional time for lenders to work out loan modifications with borrowers as well as creating an incentive for lenders to establish comprehensive loan modification programs. This bill was enacted into law on February 20, 2009 along with the state budget. Its provisions took effect March 16, 2009 and will stay in effect only until January 1, 2011 at which time it will be repealed, unless it is deleted or extended by statute (Cal. Civil Code § 2923.52(d)).

Under preexisting law, a lender who files a notice of default in the foreclosure process must wait at least 3 months before giving a notice of sale (Cal. Civil Code § 2924). The new law extends that 3-month period by an additional 90 days. Also under preexisting law, the general rule of thumb is that the entire foreclosure process takes a minimum of 4 months from the filing of a notice of default until the final trustee's sale. Under the new law, that general rule of thumb is extended by 90 more days for a total of about 7 months, unless the lender is exempt.

Unless otherwise exempt, the 90-day extension to the foreclosure process applies to loans that meet all of the following requirements: (1) The loan was recorded from January 1, 2003 to January 1, 2008, inclusive; (2) The loan is secured by a first deed of trust for residential real property; (3) The borrower occupied the property as a principal residence at the time the loan became delinquent; and; (4) A notice of default has been recorded on the property. (Cal. Civil Code § 2923.52(a).

A loan servicer is exempt from the 90-day extension to the foreclosure process if the loan servicer has obtained an order of exemption based on the implementation of a comprehensive loan modification program (Cal. Civil Code § 2923.53(a)) (see Questions 89 to 94). The order of exemption must be current and valid at the time the notice of sale is given (Cal. Civil Code § 2923.52(b)). Other exceptions to the 90-day extension include the following: (1) Certain state or local public housing agency loans (Cal. Civil Code § 2923.52(c)); (2) when a borrower has surrendered the property as evidenced by a letter confirming the surrender or delivery of the keys to the property to the lender or authorized agent (Cal. Civil Code § 2923.55(a)); (3) when a borrower has contracted with any person or entity whose primary business is advising people who have decided to leave their homes on how to extend the foreclosure process and avoid their contractual obligations to the lenders (Cal. Civil Code § 2923.55(b)); (4) when a borrower has filed a bankruptcy case and the court has not entered an order closing or dismissing the case or granting relief from a stay of foreclosure (Cal. Civil Code § 2923.55(c)).

A comprehensive loan modification program that may exempt the loan servicer from the 90-day extension to the foreclosure process includes all of the following features: (1) The loan modification program is intended to keep borrowers whose principal residences are located in California in those homes when the anticipated recovery under loan modification exceeds the anticipated recovery through foreclosure on a net present value basis (Cal. Civil Code § 2923.53(a)); (2) it targets a 38 percent or less ratio of the borrower's housing-related debt to the borrower's gross income (Cal. Civil Code § 2923.53(a)). Housing-related debt is debt that includes loan principal, interest, property taxes, hazard insurance, flood insurance, mortgage insurance and homeowner association fees (Cal. Civil Code § 2923.53(k)(2)); (3) it includes some combination of loan modifications terms as specified (Cal. Civil Code § 2923.53(a)); (4)

The loan servicer seeks long-term sustainability for the borrower (Cal. Civil Code § 2923.53(a)).

A comprehensive loan modification program that may qualify for exemption from the new law extending the foreclosure process by 90 days must include some combination of the following features: (1) An interest rate reduction, as needed, for a fixed term of at least five years; (2) an extension of the amortization period for the loan term to no more than 40 years from the original date of the loan; (3) deferral of some portion of the unpaid principal balance until loan maturity; (4) principal reduction; (5) compliance with a federally mandated loan modification program; or (6) other factors that the appropriate commissioner determines. (Cal. Civil Code § 2923.53(a)(3).

A loan servicer is not required to modify a loan for a borrower who is not willing or able to pay under the modification. Furthermore, a loan servicer is not required to violate any contractor agreement for investor-owned loans. (Cal. Civil Code § 2923.53(i)).

A loan servicer may apply to the appropriate commissioner (see Question 94) for an order exempting loans that it services from the new law extending the foreclosure process by 90 days (Cal. Civil Code § 2923.53(b)(1)). The Secretary of Business, Transportation and Housing must maintain a publicly-available Internet website disclosing the final orders granting exemptions, the date of each order, and a link to Internet websites describing the loan modification programs (Cal. Civil Code § 2923.52(f)) (see also Question 96). The notice of sale must include a declaration from the loan servicer stating whether or not it is exempt and whether the 90-day extension is in effect.

MORE CALIFORNIA LEGISLATION:

Deficiencies After a Short Sale:

Last year, the California legislature passed and the Governor signed into law SB 931 which created Cal Cod. Civ. Pro. Sec. 580(e) which provided that there is no deficiency on a lender approved short sale as to the *first* mortgage that otherwise might have had one. Last year's amendment was more of a codification of existing law than a major change, though it could have impacted loans that were refinances and loans and ones that were Home Equity Lines of Credit ("HELOCS"). It would also have likely stopped the unlawful lender practice of asserting a deficiency after the closing of a clearly non-deficiency loan, but this, too, was an unlawful lender practice even before this amendment. The one big change was that it applied to properties in which the owner/borrower was *not an occupant*, altering the general rule of CCP 580(b), the normal anti-deficiency statute, in which debtor-occupancy was mandatory for non-deficiency treatment.

On **July 15, 2011** the Governor signed into law Senate Bill 458, amending Cal. Cod. Civ. Pro. Sec. 580(e) to extend the above consumer protections against *junior* lien holders as well. *The law also prohibits lenders from requesting additional compensation in a short sale in order to obtain lender approval, and expressly makes any contractual provision waiving these protections void as against public polic*y. Like the earlier law, the new amendments are not expressly limited to owner-occupied homes as are other anti-deficiency protections found in Section 580(b).

The new amendments expressly *exclude* from the short sale deficiency protections borrowers who are LLCs or limited partnerships (the earlier protection excluded only corporations). Thus, an owner of an investment property who holds title in an LLC is not protected from lender demands for financial contribution to approve a short sale or either a senior or junior lender's attempts to obtain a deficiency judgment following the short sale. In those cases, since most of the properties ended up in these entities because the borrower transferred them there *after* the borrower obtained the loan, transferring the title back to the borrower *prior to engaging in the short sale* would seem the best step.

SECTION 1. Section 580e of the Code of Civil Procedure is amended to read:

580e. (a) (1) No deficiency shall be owed or collected, and no deficiency judgment shall be requested or rendered for any deficiency upon a note secured solely by a deed of trust or mortgage for a dwelling of not more than four units, in any case in which the trustor or mortgagor sells the dwelling for a sale price less than the remaining amount of the indebtedness outstanding at the time of sale, in accordance with the written consent of the holder of the deed of trust or mortgage, provided that both of the following have occurred:

(A) Title has been voluntarily transferred to a buyer by grant deed or by other document of conveyance that has been recorded in the county where all or part of the real property is located.

(B) The proceeds of the sale have been tendered to the mortgagee, beneficiary, or the agent of the mortgagee or beneficiary, in accordance with the parties' agreement.

(2) In circumstances not described in paragraph (1), when a note is not secured solely by a deed of trust or mortgage for a dwelling of not more than four units, no judgment shall be rendered for any deficiency upon a note secured by a deed of trust or mortgage for a dwelling of not more than four units, if the trustor or mortgagor sells the dwelling for a sale price less than the remaining amount of the indebtedness outstanding at the time of sale, in accordance with the written consent of the holder of the deed of trust or mortgage. Following the sale, in accordance with the holder's written consent, the voluntary transfer of title to a buyer by grant deed or by other document of conveyance recorded in the county where all or part of the real property is located, and the tender to the mortgagee, beneficiary, or the agent of the mortgagee or beneficiary of the sale proceeds, as agreed, the rights, remedies, and obligations of any holder, beneficiary, mortgagee, trustor, mortgagor, obligor, obligee, or guarantor of the note, deed of trust, or mortgage, and with respect to any other property that secures the note, shall be treated and determined as if the dwelling had been sold through foreclosure under a power of sale contained in the deed of trust or mortgage for a price equal to the sale proceeds received by the holder, in the manner contemplated by Section 580d.

(b) A holder of a note shall not require the trustor, mortgagor, or maker of the note to pay any additional compensation, aside from the proceeds of the sale, in exchange for the written consent to the sale.

(c) If the trustor or mortgagor commits either fraud with respect to the sale of, or waste

with respect to, the real property that secures the deed of trust or mortgage, this section shall not limit the ability of the holder of the deed of trust or mortgage to seek damages and use existing rights and remedies against the trustor or mortgagor or any third party for fraud or waste.

(d) (1) This section shall not apply if the trustor or mortgagor is a corporation, limited liability company, limited partnership, or political subdivision of the state.

(2) This section shall not apply to any deed of trust, mortgage, or other lien given to secure the payment of bonds or other evidence of indebtedness authorized, or permitted to be issued, by the Commissioner of Corporations, or that is made by a public utility subject to the Public Utilities Act (Part 1 (commencing with Section 201) of Division 1 of the Public Utilities Code).

(e) Any purported waiver of subdivision (a) or (b) shall be void and against public policy.

SEC. 2. This act is an urgency statute necessary for the immediate preservation of the public peace, health, or safety within the meaning of Article IV of the Constitution and shall go into immediate effect. The facts constituting the necessity are:

In order to mitigate the impact of the ongoing foreclosure crisis and to encourage the approval of short sales as an alternative to foreclosure, it is necessary that this act take effect immediately.

Deficiencies After a Refinance of a Non-Deficient Debt

Last year, the California legislature also passed SB1178, ***but it was vetoed by Governor Schwarzenegger on September 30, 2010.***

This bill would have changed the very bad current law in California that if one REFINANCES a non-deficiency purchase money debt, it magically then become a loan capable of a full deficiency in foreclosure. This has always been a trap for the unwary consumer, particularly those who refinanced old higher-interest loans into lower interest ones. They did not know and were never informed by the new lender that they just left the “safe harbor” of the original purchase money loan which limited the lender solely to a return of the property in the event of a later default. That law would have amended CCP 580(b), the anti-deficiency statute to add a new section at the end which would have appeared in the existing law and read as follows (with italics here for identification)

For purposes of this section, a loan used to pay all or part of the purchase price of real property or an estate for years shall include subsequent loans, mortgages, or deeds of trust that refinance or modify the original loan, but only to the extent that the subsequent loan was used to pay debt incurred to purchase the real property.

Great bill, bringing back honesty and equality to the system. But the Governor killed it so the current law remains. Refinances of non-deficiency loans makes he new loan fully deficient in the event of a foreclosure, meaning the lender can pursue the borrower for the shortfall in the foreclosure proceeds to meet the remaining debt. See the other limitations in this section for those.

Mandatory Notice to Tenants in Foreclosures

The California Legislature also passed and the Governor signed SB 1149, which while providing various new rules in the civil procedure governing foreclosure proceedings and other matters, more importantly *provides a new statutorily-mandated form of notice to tenants after foreclosures.* Specifically, the law requires that any notice to quit regarding a housing unit served within one year after a foreclosure include a separate cover sheet that explains tenants rights. The procedural laws may be found at Cal.Rev.Stat. 1166 and 1161.2(a). The new law requiring notice to tenants is Cal.Rev.Stat. 1161c and reads as follows, with italics here for identification.

1161c. (a) In the case of any foreclosure on a residential property, the immediate successor in interest in the property pursuant to the foreclosure shall attach a cover sheet, in the form as set forth in subdivision (b), to any notice of termination of tenancy served on a tenant of that property within the first year after the foreclosure sale. This notice shall not be required if any of the following apply.

1) The tenancy is terminated pursuant to Section 1161.
(2) The successor in interest and the tenant have executed a written rental agreement or lease or a written acknowledgment of a preexisting rental agreement or lease.
(3) The tenant receiving the notice was not a tenant at the time of the foreclosure.
(b) The cover sheet shall consist of the following notice, in at least 12-point type

Notice to Any Renters Living At [street address of the unit]

The attached notice means that your home was recently sold in foreclosure and the new owner plans to evict you. You should talk to a lawyer NOW to see what your rights are. You may receive court papers in a few days. If your name is on the papers it may hurt your credit if you do not respond and simply move out. Also, if you do not respond within five days of receiving the papers, even if you are not named in the papers, you will likely lose any rights you may have. In some cases, you can respond without hurting your credit. You should ask a lawyer about it.

You may have the right to stay in your home for 90 days or longer, regardless of any deadlines stated on any attached papers. In some cases and in some cities with a "just cause for eviction law," you may not have to move at all. But you must take the proper legal steps in order to protect your rights. How to Get Legal Help If you cannot afford an attorney, you may be eligible for free legal services from a nonprofit legal services program. You can locate these nonprofit groups at the California Legal Services Web site www.lawhelpcalifornia.org *the California Courts Online Self-Help Center* www.courtinfo.ca.gov/selfhelp *or by contacting your local court or county bar association.*

(c) If the notice to quit specifies an effective date of at least 90 days after the notice is served, without qualification, no cover sheet shall be required, provided that the notice incorporates the

text of the cover sheet, as set forth in subdivision (b) in at least 10-point type. The incorporated text shall omit the caption and the first paragraph of the cover sheet and the fourth paragraph of the cover sheet shall be replaced by the following language.

You may have the right to stay in your home for longer than 90 days. If you have a lease that ends more than 90 days from now, the new owner must honor the lease under many circumstances. Also, in some cases and in some cities with a "just cause for eviction law," you may not have to move at all. But you must take the proper legal steps in order to protect your rights.

(d) This section shall remain in effect only until January 1, 2013, and as of that date is repealed, unless a later enacted statute, that is enacted before January 1, 2013, deletes or extends that date.

There are also some mandatory federal rights granted tenants during and after a foreclosure. Under California law, alone, however, if notices worded exactly like this one are not served on the tenant, the tenant has certain rights to remain and/or actions against those who have failed to serve the notice imposed upon them and, as to the original owner who allowed the loan to go into default if not also the foreclosing lender, a failure to give notice could also be a violation of the California Landlord-Tenant Act which requires “obedience to law”. It also still remains “rent-skimming” or “theft of collateral” for a landlord/owner to collect rents while allowing the loan (which usually includes rents as collateral) to go into default. For the most part, this new notice will heavily impact banks’ duties, who commonly take back these properties as REOs. RealtyTrac reports that those constitute 80% of the average current foreclosure market.

Even when there is no deficiency, there can be IRS and credit ramifications, of course, as explained below.

See other consumer defenses to debts under “General Defenses Common to All States,” below. Also see 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!