

NEW LAW PROVIDES GREATER PROTECTION FOR HOMEOWNERS IN DEFAULT

By D.W. Duke and Michael Wilson

On July 15, 2011 Governor Jerry Brown signed California Senate Bill 458 into law. SB 458 amends CCP §580e to preclude holders of any trust deeds securing residential properties, consisting of dwellings of one to four units, from pursuing a homeowner (trustor or mortgagor) for a deficiency where the holder of the trust deed has agreed in writing to the short sale, unless the homeowner has been guilty of fraud or waste, or unless the homeowner is a corporation or a political subdivision.

Prior to January 1, 2011 there was some uncertainty as to the consequences of a short sale where the holder of the first trust deed decided to pursue a deficiency judgment after the short sale had occurred. The reason is that a short sale is not a foreclosure and thus was not subject to the anti-deficiency protection of CCP §580d. In a short sale, the lender in the first position forgives the balance due on the loan and releases the security on the real estate in exchange for a payment of an agreed upon amount by a third party, called the "short sale purchaser." While there is no known case where a holder of the first has successfully pursued a deficiency after a short sale, many homeowners were unwilling to accept the risk that a lender might attempt to do so and for that reason, they allowed their homes to foreclose rather than enter into a short sale transaction.

To resolve any ambiguity concerning the ability of the holder of the first trust deed to pursue a deficiency after a short sale, the California legislators enacted SB931 which went into effect as CCP §580e on January 1, 2011. CCP §580e precluded the holder of a first trust deed from pursuing any deficiency after agreeing to a short sale and releasing the security interest. However, CCP §580e did not address the holders of junior trust deeds. As a result, many holders of junior deeds were agreeing to a short sale but only if the borrower agreed to negotiate with the junior lien holder after the short sale escrow had closed.

To protect homeowners from holders of junior trust deeds who would seek to recover the deficiency, the legislators amended CCP §580e, to include all trust deed holders on qualifying property regardless of the position they hold, provided the short sale is agreed to by said trust deed holders, and the homeowner has not been guilty of waste or fraud and is not a corporation or a political subdivision. In other words, holders of junior trust deeds are now barred from seeking a deficiency judgment or suing the homeowner for breach of contract on the loan, after a short sale that they have agreed to occurs. There is no requirement that the property be the residence of the party who obtains a short sale. The statute applies to any residential real estate property, consisting of one to four dwelling

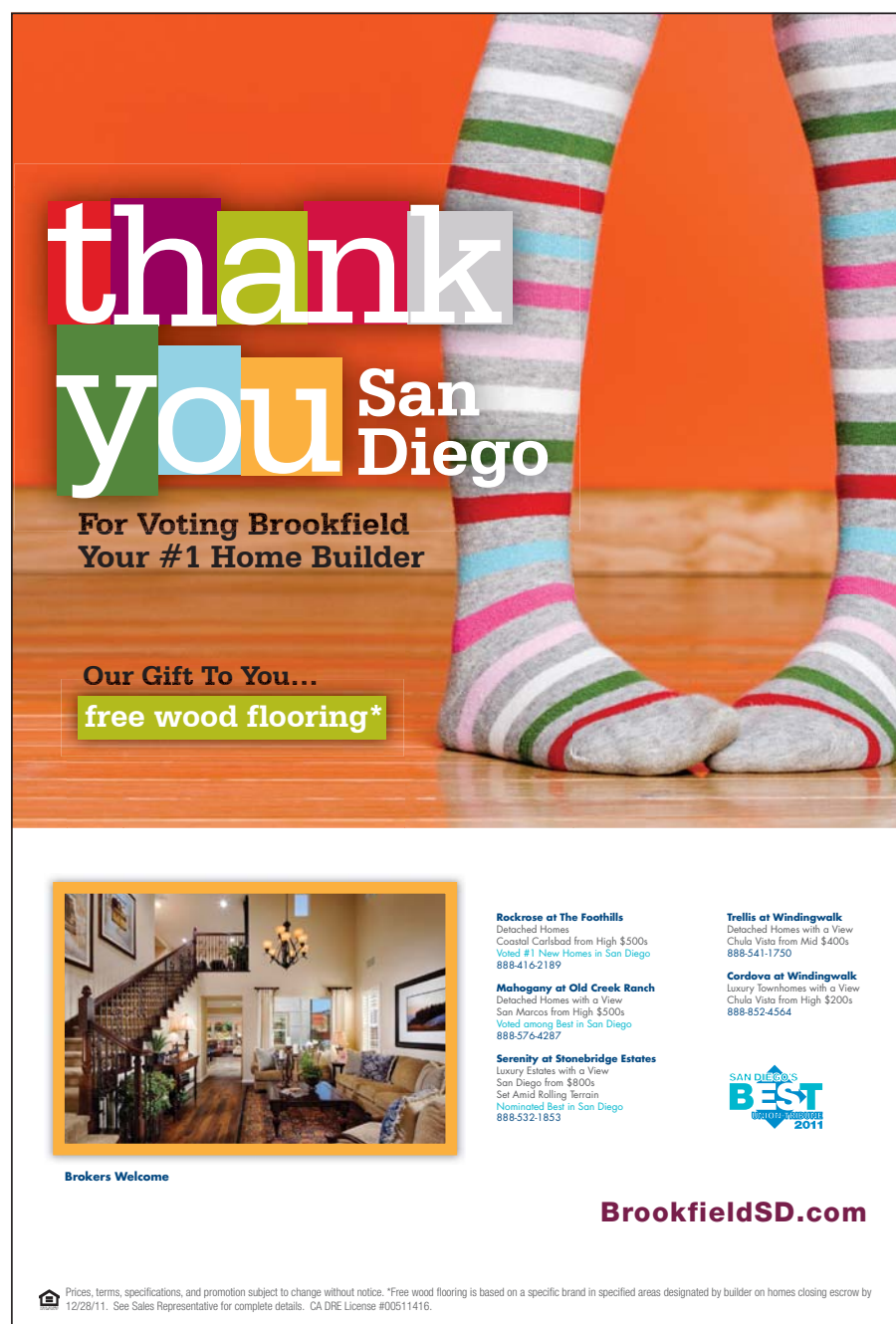
units, where the holder(s) of the trust deed(s) agrees in writing to a short sale, and the homeowner has not been guilty of fraud or waste and is not a corporation or political subdivision.

As amended CCP §580e now provides even greater protection for homeowners facing foreclosures. This amendment also specifically states that the borrower cannot be required to pay any additional compensation, aside from the proceeds of the sale, in exchange for the written consent of the sale. Previously, lenders engaged

in fraudulent practices whereby the homeowner, or the buyer, would often be required to negotiate outside of escrow and to secretly pay some amount of money to the second trust deed holder in exchange for a release of the lien. Not only did this activity constitute mortgage fraud but it was also an illegal practice. Now it is spelled out clearly by statute that this is prohibited. Further, the amendment states that any waiver of these protections shall be deemed void and against public policy. While this amendment may lead to borrowers

having a more difficult time obtaining the approval of junior lien holders, it will provide those who do obtain the approval with the peace of mind to know that they are no longer responsible for any deficiency.

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