

A woman borrowed money from her local credit union to purchase an undeveloped lot on which to build her dream home. She executed a promissory note agreeing to repay the loan over a 10-year period. The loan was secured by a deed of trust that contained a power-of-sale clause. The deed of trust was promptly recorded.

After the woman missed five loan payments, the credit union accelerated the debt and instructed the trustee to initiate nonjudicial foreclosure proceedings as permitted by the jurisdiction. The trustee followed the jurisdiction's notice requirements and procedures. At the foreclosure sale, the credit union was the sole bidder. The winning bid was equal to the remaining obligation on the note, amounting to only 60% of the fair market value of the property.

The woman immediately filed an action against the credit union to set aside the foreclosure sale.

Is the woman likely to prevail?

- A. No, because a court cannot overturn a nonjudicial foreclosure on a deed of trust.
- B. No, because there is no indication that the procedure or price would shock the conscience of the court.
- C. Yes, because a deed of trust can be foreclosed upon only by judicial foreclosure.
- D. Yes, because a lender may not purchase the mortgaged property at a nonjudicial foreclosure.

Explanation:

Foreclosure methods

Judicial sale Judicially supervised public sale of mortgaged property

(all states)

Nonjudicial sale Privately conducted public sale of mortgaged property (permitted only if mortgage contains power-of-sale clause)

(half of all states)

Strict foreclosure Foreclosure without sale of mortgaged property

(few states)

A debtor may give his/her interest in real property to a lender to secure a debt—usually through a mortgage or a deed of trust. A **deed of trust** is created when the debtor conveys the property interest to an impartial third party, as trustee, who holds title to the property for the lender's benefit. If the debtor pays the debt in full, then the trustee must reconvey the property to the debtor. But if the **debtor defaults** on loan payments, the **trustee can initiate foreclosure proceedings** (see table above).

The trustee can initiate **nonjudicial foreclosure** in about half of all states if the mortgage or deed of trust contains a power-of-sale clause—as seen here (**Choice C**). This allows the trustee to sell the property at a public auction without requesting permission from the court. However, the debtor can ask a court to **overturn** the foreclosure if the auction or sales process **violated due process** or the **purchase price was grossly inadequate*** (**Choice A**).

Courts have consistently been unwilling to impose a "fair market value" standard on the purchase price, so the lender can credit bid up to the amount of the outstanding debt without paying additional cash (**Choice D**). Therefore, the winning bid is often below fair market value.

Here, there was no due process violation because the jurisdiction's notice requirements and procedures were followed. And though the credit union's winning bid was only 60% of the property's fair market value, it was equal to the remaining obligation on the note. Therefore, this credit bid was not grossly inadequate. Because neither the procedure nor the price would shock the conscience of the court, the woman is *not* likely to prevail in her action to set aside the foreclosure sale.

*Purchase prices have been deemed grossly inadequate if they are below 20% of the fair market value.

Educational objective:

Nonjudicial foreclosures are allowed in most states if the mortgage or deed of trust contains a power-of-sale clause. However, the court can overturn the foreclosure if the auction or sales process violated due process or the purchase price was grossly inadequate.

References

Restatement (Third) of Property: Mortgages §8.3 (Am. Law Inst. 1997) (adequacy of foreclosure sale price).

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