

NEW LAW PROTECTS HOMEOWNERS FROM LIABILITY AFTER A SHORT SALE FOR THE UNPAID LOAN BALANCE ON THE FIRST DEED OF TRUST

September 30, 2010 was a big day for anyone in California short selling property. On that day, Governor Schwarzenegger signed into law SB 931, will take effect on January 1, 2011 and will be codified in the California Code of Civil Procedure Section 580e, what we commonly refer to as the “anti-deficiency” statutes. This is an important win for upside-down owners. For the last few years, the question has been: what is the deficiency liability following a short sale. This statute answers it in part.

Beginning January 1, 2011, any first trust deed lender who approves a short sale of a residential real property, will be prohibited by law from collecting the unpaid loan deficiency after the sale.

OLD LAW: A short sale occurs when the net proceeds from the sale of real property are less than the balance owed on the loans secured by the property. In a short sale, unless the lender provides a specific written waiver of the unpaid balance of the loan, the lender has the legal right to pursue the borrower for the deficiency.

NEW LAW: On September 30, 2010, Governor Schwarzenegger signed Senate Bill 931 into law, which amends the Code of Civil Procedure to add a new section 580e. This statute applies to first trust deeds secured by one to four unit residential properties that are sold by short sale. Under the new law, when the first lender approves a short sale of residential property containing one to four units, such approval will automatically act as a waiver of the lender’s right to collect the loan deficiency. The first deed lender is then barred by law from pursuing a deficiency judgment against the borrower (seller).

There are exceptions. If the borrower has committed fraud against the lender or waste against the property, the statutory protection is lost, and the lender may sue the borrower for the deficiency plus damages.

The new 580e states in part: “No judgment shall be rendered for any deficiency under a note secured by a first deed of trust or first mortgage for a dwelling of not more than four units, in any case in which the trustor or mortgagor sells the dwelling for less than the remaining amount of the indebtedness due at the time of sale with the written consent of the holder of the first deed of trust or first mortgage. Written consent of the holder of the first deed of trust or first mortgage to that sale shall obligate that holder to accept the sale proceeds as full payment and to fully discharge the remaining amount of the indebtedness on the first deed of trust or first mortgage.”

ANALYSIS: This statute provides a significant new protection to homeowners who sell their residential property by short sale. Prior to the enactment of §580e,

short sellers had no statutory protection from deficiency judgments. This meant that a homeowner could sell a property by short sale and then be sued by the lender for the remaining balance owed on the loan, even though the property had already been sold.

Thanks to this new law, beginning January 1, 2011, the short seller of a one- to four-unit residential property will *automatically* be protected against a deficiency judgment from the first position lender under CCP §580e. This means that a homeowner who sells their property by short sale *cannot* be sued by the first position lender after the sale. This protection applies whether the property was the seller's primary residence, a rental property, or a vacation home, so long as it has fewer than five units. The property need not be owner-occupied for the protection to apply.

However, because CCP §580e only applies to *first position* lenders, junior lenders continue to have the right to pursue a deficiency judgment against a short seller after the sale. To be protected from potential deficiency judgments pursued by any junior lenders, the short seller must, at the time of the short sale, obtain the junior lenders' written waiver of the junior lender's right to pursue a deficiency.

It is also important to remember the statute is not effective until January 1, 2011. It is unlikely to be given retroactive effect. Therefore do not rely upon its protection for short sales that close escrow during the remainder of 2010.

The information presented in this Article is not to be taken as legal advice. Every person's situation is different. If you are upside-down on your loan(s), and considering a short sale, get competent legal advice in your State immediately so that you can determine your best options