

No Recourse Available: The California Legislature Expands Anti-Deficiency

On July 15, 2011, California Governor Jerry Brown signed into law Senate Bill 458 (SB 458), which was sponsored, in part, by the California Association of Realtors. SB 458 prohibits a deficiency after a short sale for one to four residential units, regardless of whether the lender is a senior or junior lien holder. Lenders can neither require the borrower to owe or pay a deficiency as a requirement of the short sale, nor seek a deficiency judgment after the short sale occurs. Exceptions to SB 458 allow lenders to pursue damages when: a borrower has committed fraud or waste; a borrower is a corporation, limited liability corporation, limited partnership, or political subdivision; the lien is secured by a bond; and there is a public utility lien. Any purported waiver of this new law will be deemed void and against public policy. SB 458 amends Code of Civil Procedure § 580e, and is effective immediately.

SB 458 builds on the protections afforded borrowers by last summer's SB 931 (passed in June 2010), and is a continued expansion of rights afforded to borrowers in default in California. The two key protections added by SB 458 are: 1) the anti-deficiency protections apply to both senior and junior lien holders; and 2) contribution from the borrower can no longer be required as a condition of approving the short sale.

Although SB 458 prohibits lenders from requiring additional compensation as a condition precedent to approving the short sale, there is nothing within the language of SB 458 that prohibits a borrower from contributing compensation in an effort to facilitate the short sale. Further, SB 458 allows the lender to negotiate additional compensation from someone other than the borrower, e.g., other lenders, real estate agents and brokers, or family of the borrower.

SB 458 is further evidence of what appears to be California's Legislative policy of shifting to the lenders the burden of the housing market collapse by forcing the lenders to absorb the financial loss associated with decreasing home values. While the Legislature may have good intentions, SB 458 misses the mark. First, SB 458 may increase litigation by opportunistic borrowers alleging impropriety or bad faith by lenders relating to the short sale process. Second, unintended consequences of SB 458 could arise, such as higher short sale prices to offset the effect of no required contribution (which could discourage buyers) and the possibility that foreclosures increase because deals do not get done.