

## **DELAY IN FORECLOSURE MAY NOT BE DEFENSE TO DEFICIENCY**

Arguments over delays in the time it takes to foreclose can have a huge impact on any resulting deficiency judgment. It often takes a bank years and years to complete a foreclosure. Sometimes foreclosures are filed, dismissed and then refiled years later. In most instances, the property owner loses and the lender wins.

Once the bank takes the property, the case is then over, right? Not quite.

In the aftermath of the financial meltdown, lenders were often not pursuing deficiency judgments against the borrowers. A deficiency occurs when the property sells for less than the amount owed.

Although it is still uncommon for lenders to pursue deficiencies, that trend is changing. This is especially true in commercial foreclosures and with personal guarantees.

Commercial loans are universally worded to favor the lender at the expense of the borrower. Typical default provisions include forcing the borrower to pay lender's legal fees, much higher default interest rates and special fees and charges. Miss just one payment and it can quickly become impossible to catch up.

Often the borrowers don't care much about the fees. Instead, they just want to remain in the property for as long as possible.

So who cares about high default charges and delays? The guarantors!

If a business or person has guaranteed a note, they are on the hook for any deficiency. The longer it takes for the property to foreclose, the higher the deficiency amount.

Let's take an example.

Smith's Bakery is owned by Mike and Debbie Smith. They have a \$1 million note and commercial mortgage on their bakery. They default in their first year of operation. At the time of the default the building is worth about \$1 million and the loan balance is also \$1 million.

Instead of quickly selling the property, the noteholder and bakery enter into a series of forbearance agreements. Twice the property is put in foreclosure only to be dismissed a few months later. Part of the delay belongs to the bakery and part belongs to the noteholder which happens to be a commercial mortgage backed securities trust. The trust has difficulty locating the original note.

Finally, after three years the property is sold. No maintenance was done during this time, however, and there is substantial water damage from an unrepaired roof leak. Insurance covers the repairs but not damage from the resultant mold.

When the property finally sells, it only fetches \$500,000 dollars. Worse, because of legal fees and default interest, the balance on the note is now \$1.3 million.

The trust isn't happy about losing \$800,000 and decides to sue for the deficiency. Mike and Debbie file bankruptcy but at the time of the loan, Mike's parents agreed to sign as guarantors.

Are they liable? One of the defenses they raise is the 3-year delay in the foreclosure. They argue that they should not be responsible for the delay and the resultant mold damage, extra interest and legal fees.

The delay defense makes logical sense but these defenses are very fact specific. Often the loan and guaranty documents force guarantors to waive all defenses. This issue was recently raised in a lawsuit filed in Orange County, Florida. Unfortunately for the guarantor, the court ruled in favor of the lender.

Buyers of distressed property can buy both the property and the lender's judgment. That means even if the bank doesn't pursue personal guaranties, a third party debt buyer may. If you are being sued on a deficiency or personal guaranty, it is essential to have good legal representation.

Many "foreclosure defense" lawyers do not handle commercial cases or are really bankruptcy lawyers that claim foreclosure knowledge. If you find yourself facing a personal guaranty suit, insist on a skilled lawyer that concentrates in lender liability actions.

--