

Short Sale Deficiencies

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In a short sale, a homeowner sells property at a loss, but can nevertheless be held personally liable for the difference between the loan balance and sales price. To protect short sale sellers from this harsh result, the CALIFORNIA ASSOCIATION OF REALTORS® (C.A.R.) sponsored new anti-deficiency legislation that came into effect on July 15, 2011. This legal article discusses California's protection against short sale deficiencies, including the legal and practical issues that may arise for REALTORS® and their clients under the new law.

I. GENERAL OVERVIEW

Q 1. *What, in a nutshell, is the new law on short sale deficiencies?*

A The new law generally prohibits a mortgage lender from collecting a deficiency or obtaining a deficiency judgment for a short sale involving a loan secured by a one-to-four residential unit property. The new law also generally prohibits a lender from requiring the borrower to pay any additional compensation, aside from the proceeds of the sale, in exchange for a short sale approval. This law applies to first trust deeds, second trust deeds, and other junior trust deeds.

For definitions of the terms short sale, deficiency, and deficiency judgment, see Questions 3 to 5. For applicability of the new law to specific transactions, see Questions 14 to 23. For requirements and guidelines under the anti-deficiency protection for short sales, see Questions 24 to 40.

Q 2. *When did this law come into effect?*

A This law came into effect on July 15, 2011 when it was filed as an urgency statute with the California Secretary of State.

Q 3. *What is a short sale?*

A A short sale is the sale of real property where the seller's mortgage lender agrees to accept a loan payoff for less than what is owed as an outstanding balance. In a short sale, a seller is "upside down," which means the amount owed to the mortgage lender is more than the market value of the property. If the seller cannot or does not want to pay that difference out-of-pocket, the seller can request that the lender accepts a loan payoff for less than what is owed in exchange for releasing the lender's security interest on the property. Each lender has its own guidelines and procedures for considering short sale requests.

Q 4. *What is a deficiency?*

A When more is owed on a mortgage loan than the sales price, the deficiency is the difference between the outstanding loan balance and the loan payoff received by the lender. A deficiency may arise in connection with a short sale or foreclosure.

Q 5. *What is a deficiency judgment?*

A A deficiency judgment is a judicial court ruling that a borrower is personally liable for the difference between the outstanding loan balance and the proceeds received by the lender through a short sale or foreclosure. To obtain a deficiency judgment in California, a lender must file a lawsuit against the borrower and go through the judicial court process. If the lender obtains a deficiency judgment and the borrower does not pay the amount owed, the lender can enforce the judgment by, among other things, garnishing the borrower's wages, attaching the borrower's bank accounts, and placing a judgment lien on the borrower's real property. A deficiency judgment may also have a negative impact on a borrower's credit rating.

Q 6. *What is the legal authority for this law?*

A This law is set forth as section 580e of the California Code of Civil Procedure (CCP). Before it became law, the legislation was referred to as Senate Bill 458 (Corbett) or SB 458 of the 2011-2012 legislative session. The full text of the law is available at www.leginfo.ca.gov.

Q 7. *What is the purpose of the new law?*

A According to the California legislature, the purpose of the new law as an urgency statute is to mitigate the impact of the ongoing foreclosure crisis and to encourage the approval of short sales as an alternative to foreclosure. (See Section 2 of Senate Bill 458.)

Q 8. *Wasn't there already a law on short sale deficiencies?*

A Yes. Before SB 458 became law generally protecting sellers from short sale deficiencies on all deeds of trust for one-to-four residential unit properties, preexisting California law generally protected sellers from short sale deficiencies on first trust deeds only for one-to-four residential unit properties. That preexisting law, which was Senate Bill 931 (Ducheny) of the 2009-2010 legislative session, was in effect for a short period of time starting from January 1, 2011 to July 15, 2011. Now, SB 458 protects sellers not just from short sale deficiencies for first trust deeds, but also for junior mortgage loans, such as second trust deeds and third trust deeds.

Q 9. *Will this law discourage lenders from doing short sales?*

A Not necessarily. Prohibiting a lender from pursuing a deficiency may, at least in theory, discourage certain lenders from approving a short sale, especially if the loan is a recourse loan or the amount of the deficiency is very large. Yet, even without the new law, a lender may not have approved those types of short sales anyway. Furthermore, a lender considering a short sale request looks at many different factors other than a borrower's personal liability. Also, the previous law prohibiting short sale deficiencies for first trust deeds that was in effect from January 1, 2011 to July 15, 2011 (see Question 8) did not seem to have a chilling effect on the short sale practice.

On the flip side, the new law brings much needed clarity to short sale transactions for sellers. The new law should encourage sellers, who may have otherwise been on the fence, to do short sales now that they have an assurance that, if the new law applies to their situation, they will not be held personally liable for any short sale deficiency.

Q 10. *How could a borrower be personally liable for a short sale deficiency if the lender approved that short sale?*

A A lender's short sale approval is generally a voluntary agreement to release its security interest, or its lien secured by real property, despite a loan payoff of less than the balance owed. The short sale approval enables the homeowner to sell the property free of the short sale lender's security interest. The short sale approval may or may not address whether the lender will hold the borrower personally liable for the short sale deficiency. Absent any laws protecting homeowners from short sale deficiencies, some of the ways a lender could handle a deficiency include, without limitation, requiring the borrower to partially or fully repay the deficiency, requiring the borrower to sign a promissory note for full or partial repayment of the deficiency, reserving the lender's right to pursue the borrower for the deficiency, fully releasing the borrower from personal liability for the deficiency, or saying nothing about the deficiency.

Q 11. *Isn't California a non-recourse state?*

A No. California is not a non-recourse state. California law protects borrowers from personal liability after a short sale or foreclosure in certain, but not all, circumstances.

Q 12. *How does the anti-deficiency protection for short sales compare with the anti-deficiency protection for foreclosures?*

A The answer depends on the type of loan and the type of foreclosure. The anti-deficiency protection for short sales generally applies to all deeds of trusts for one-to-four residential unit properties, regardless of whether the property is purchase money or owner occupied.

In contrast, the anti-deficiency protections after foreclosure are generally as follows:

- No deficiency judgment after foreclosure of a purchase money, owner occupied loan for a property with one-to-four residential units (CCP § 580b);
- No deficiency judgment after a non-judicial foreclosure (or trustee's sale) (CCP § 580d); and
- No deficiency judgment after foreclosure for seller financing (CCP § 580b).

Although most lenders in California foreclose by non-judicial foreclosure, a homeowner has no control over the lender's election to pursue a non-judicial foreclosure (no personal liability) or a judicial foreclosure (possible personal liability). Also, even if a first trust deed lender forecloses by non-judicial foreclosure (so no personal liability for the first trust deed), a junior lienholder whose security interest is wiped out in that process may be able to pursue a deficiency judgment against the borrower.

Q 13. Will a short sale with no deficiency balance have less of a negative impact on a borrower's credit rating as compared to a short sale with a deficiency balance or a foreclosure?

A Yes, according to FICO's Banking Analytics Blog. New FICO research demonstrates that a short sale with no deficiency balance has less of an impact on a consumer's credit score compared to a short sale with a deficiency balance or foreclosure. For a simulated consumer profile with a 680 initial FICO score, a short sale with no deficiency balance caused the FICO score to drop to 610 to 630, whereas a short sale with a deficiency balance or a foreclosure reduced the FICO score to 575 to 595. For a simulated consumer profile with a 780 initial FICO score, a short sale with no deficiency balance caused the FICO score to decrease to 655 to 675, whereas a short sale with a deficiency balance or a foreclosure reduced the FICO score to 620 to 640. See Joanne Gaskin's "Research Looks at How Mortgage Delinquencies Affect Scores" dated May 24, 2011 at <http://bankinganalyticsblog.fico.com/2011/03/research-looks-at-how-mortgage-delinquencies-affect-scores.html>.

II. APPLICABILITY OF ANTI-DEFICIENCY PROTECTIONS

Q 14. Under what particular circumstances does California law protect a borrower from personal liability for a short sale deficiency?

A To fall within the protection against personal liability for a short sale deficiency, a borrower must satisfy all of the following requirements, and not fall within any of the exceptions in Question 19:

- Mortgage loan is solely secured by a deed of trust or mortgage (see Question 22 for cross-collateralized loans);
- Mortgage loan is for a dwelling of not more than four units;
- Borrower sells the property for less than the outstanding loan balance;
- Lender provides written consent for the short sale;
- Title voluntarily transfers to a buyer by grant deed or other document of conveyance recorded in the county where the property is located; and
- Proceeds of the sale have been tendered to the lender or lender's agent in accordance with the parties' agreement.

CCP § 580e(a)(1).

Q 15. Does the anti-deficiency protection for short sales only apply to properties with one-to-four residential units?

A Yes. The anti-deficiency protection under CCP § 580e applies only to properties with one-to-four residential units. It does not specifically apply to properties with five or more residential units, commercial properties, or vacant land. However, even if section 580e does not apply, a borrower may be able to raise other legal arguments challenging a deficiency judgment after a short sale. See Miller and Starr, California Real Estate 3d (2003) § 10:255 (stating that "the antideficiency legislation applies to preclude a money judgment against the trustor even when there has not been a foreclosure sale under either a senior lien or the lien securing the purchase-money note") (citations omitted).

Q 16. Does the anti-deficiency protection for short sales only apply to purchase money loans?

A No. The anti-deficiency protection for short sales applies to purchase money loans, refinance loans, and home equity credit lines secured by one-to-four residential unit properties. For such refinances, the anti-deficiency protection for short sales applies to all types of refinance loans, regardless of whether the borrower refinanced to obtain a lower interest rate only or took cash out to make home improvements, to pay off credit cards, or for any other purpose.

Q 17. Does the anti-deficiency protection for short sales only apply to owner occupied properties?

A No. The anti-deficiency protection is for short sales involving owner occupied or non-owner occupied properties. Non-owner occupied properties include rental properties, vacant homes, second homes, or vacation homes. Of course, a lender may elect not to approve a short sale for a non-owner occupied property, but if the lender agrees to the short sale and the other requirements are met (see Question 14), the borrower will not be personally liable for any short sale deficiency.

Q 18. Does the anti-deficiency protection for short sales apply to any type of lien?

A No. The anti-deficiency protection for short sales only applies to notes secured by deeds of trust or mortgages for one-to-four residential unit properties. It does not apply to other types of security interests in real property, such as, but not limited to, judgment liens, homeowners' associations (HOA) liens, tax liens, child support liens, mechanics' liens, attachment liens, or execution liens.

Q 19. What are the exceptions to the anti-deficiency protection for short sales?

A Exceptions to the anti-deficiency protections for short sales are as follows:

- Fraud (see Question 20);
- Waste to the real property (see Question 21);
- Cross-collateralized loans (see Question 22);
- Borrower is a corporation, limited liability company, or limited partnership (CCP § 580e(d)(1));
- Borrower is a political subdivision of the state (e.g. a state government entity) (CCP § 580e(d)(1));
- Deed of trust, mortgage, or other lien securing the payment of a bond or other evidence of indebtedness authorized by the Commissioner of Corporations (CCP § 580e(d)(2)); and
- Deed of trust, mortgage, or other lien made by a public utility subject to the Public Utilities Act (CCP § 580e(d)(2)).

Q 20. What is the exception for fraud?

A If a borrower commits fraud with respect to the sale of the real property securing a deed of trust, the lender can seek monetary damages and use existing rights and remedies against the borrower or any third party (CCP § 580e(c)). For example, if a borrower makes a misrepresentation in his or her request for a short sale, the lender may sue the borrower for monetary damages that the lender suffered as a result, regardless of the anti-deficiency protection for short sales.

Q 21. What is the exception for waste?

A Waste to real property is generally a physical impairment to the value of the property by an act or an omission of an act. If a borrower commits waste with respect to the real property securing a deed of trust, the lender can seek monetary damages and use existing rights and remedies against the borrower or any third party, regardless of the anti-deficiency protection for short sales (CCP § 580e(c)).

Q 22. What is the exception for cross-collateralized loans?

A A cross-collateralized loan is a single loan that is secured by more than one property. If a loan that otherwise satisfies the requirements for anti-deficiency protection for short sales (see Question 14) is also cross-collateralized, the rights, remedies, and obligations of the parties will be treated and determined as if the property sold in a short sale had been sold through a non-judicial foreclosure (or trustee's sale) for a price equal to the sale proceeds received by the lender (CCP § 580e(a)(2)).

Q 23. What must occur after the anti-deficiency law was enacted on July 15, 2011 for the new law to apply to a short sale transaction?

A A short sale transaction should be consummated or close escrow after this law came into effect on July 15, 2011 for the seller to be protected under the new law. See CCP § 580e(a)(1) (prohibiting a deficiency or deficiency judgment in any case in which the borrower "sells the dwelling"). Other time frames during the short sale transaction, such as when the seller entered into a purchase agreement or when the lender approved the short sale, do not appear to be relevant for determining whether the new law applies.

For short sales that closed escrow before July 15, 2011, the new version of CCP § 580e is not explicitly retroactive. However, the previous version of CCP § 580e (see Question 8) may apply, and the seller may be able to raise other legal arguments challenging a deficiency judgment after a short sale. See, for example, Miller and Starr, California Real Estate 3d (2003) § 10:255 (stating that "the antideficiency legislation applies to preclude a money judgment against the trustor even when there has not been a foreclosure sale under either a senior lien or the lien securing the purchase-money note") (citations omitted).

III. ANTI-DEFICIENCY GUIDELINES FOR SHORT SALES

Q 24. What are the specific protections provided by the short sale deficiency law?

A The short sale deficiency law specifically protects a borrower in a short sale involving a one-to-four residential unit property from all of the following:

- Owing a deficiency;
- Having a lender collect a deficiency;
- Having a lender request a deficiency judgment;
- Having a court render a deficiency judgment;
- Being required to pay any additional compensation, aside from the proceeds of the sale, to obtain short sale approval (see Questions 30 to 39); and
- Any purported waiver of the borrower's rights as above (see Question 29).

For definitions of deficiency and deficiency judgment, see Questions 4 and 5.

Q 25. Does the new law require a lender to approve a short sale?

A No. The new law does not require any lender to approve a short sale or to accept a loan payoff for less than the balance owed. Instead, for applicable transactions (see Question 14), the law prohibits a lender that has approved a short sale and has been tendered the proceeds of the sale from pursuing a deficiency or deficiency judgment, and further prohibits a lender from requiring a borrower to pay any additional compensation, other than the proceeds of the sale, in exchange for a short sale approval.

Q 26. *If the first trust deed lender approves a short sale, does this law require the second trust deed lender to also approve the short sale?*

A No. This law does not require any lender to approve a short sale. Instead, for applicable transactions, the law prohibits a lender – whether that lender is the holder of a first trust deed, second trust deed, or third trust deed – that has approved a short sale and has been tendered the proceeds of the sale from pursuing a deficiency or deficiency judgment. It also prohibits a lender from requiring a borrower to pay any additional compensation, other than the proceeds of the sale, in exchange for a short sale approval.

Q 27. *Is a short sale lender required to provide the borrower with a written release from personal liability?*

A No. Although not required, a seller is well-advised to get a written release from personal liability signed by the short sale lender if possible.

Q 28. *What short sale transactions are lenders less likely to approve given the new law?*

A If a lender cannot hold a borrower personally liable for a short sale deficiency, the lender is, at least in theory, less likely to approve a short sale for a recourse loan because the lender could obtain a deficiency judgment against the borrower through judicial foreclosure. Also, given the new law, a lender is theoretically less likely to approve a short sale with a large amount of deficiency if the lender must release the borrower from repaying that deficiency. For example, a lender is more likely to release a borrower from personal liability for a \$20,000 deficiency, rather than a \$200,000 deficiency. Finally, a lender is less likely, at least in theory, to approve a short sale if the borrower has income or assets that could be used to pay a deficiency.

However, as a practice tip, these factors are easy for a listing agent and seller to determine and consider upfront, before deciding to list a property for a short sale. If the odds are stacked up too high against the likelihood that a short sale will close escrow successfully, a listing agent and seller may be better off opting for alternatives. Even a buyer's agent and buyer can make certain upfront determinations of the likelihood of closing escrow successfully, by searching title records and conducting other investigations before writing an offer to purchase a short sale property.

Q 29. *Can a lender require the homeowner to waive his or her rights under the anti-deficiency protection for short sales?*

A No. Any purported waiver of the anti-deficiency protection for short sales is void and against public policy (CCP § 580e(e)). If a lender attempts to require your client as a seller to waive his or her rights, see Question 39 for guidelines on how to handle that situation.

Q 30. *Can a lender require a borrower to pay something out-of-pocket to obtain a short sale approval?*

A No. The law prohibits a lender from requiring the borrower to pay any additional compensation to obtain a short sale approval, other than the proceeds from the sale (CCP § 580e(b)). The law, however, does not prohibit a lender from rejecting a short sale request altogether.

Q 31. *Instead of the lender requiring a borrower to pay a monetary contribution, can a lender condition a short sale approval on a higher sales price than what was submitted?*

A Probably so. Because a lender can reject a short sale altogether, this law is unlikely to prohibit a lender from approving a short sale for a sales price higher than what was submitted, as long as the lender seeks no additional monetary compensation from the borrower. However, under paragraph 1F of C.A.R.'s Short Sale Addendum (SSA) to the California Residential Purchase Agreement (RPA), the seller and buyer are not obligated to agree to a sales price higher than what they originally agreed to and submitted to the short sale lender.

Q 32. *Instead of the lender requiring a borrower to pay a monetary contribution, can a third party, such as the private mortgage insurer, require the borrower to pay a monetary contribution?*

A Not likely in connection with a short sale. The law prohibits a lender, not a third party, from requesting funds from the borrower. So a private mortgage insurer (PMI company) or other third party could ask a borrower for money (no strings attached). However, a third party requesting the borrower to pay a monetary contribution for the purposes of obtaining a short sale approval may face what is perhaps an insurmountable logistical challenge. If a third party requests a monetary contribution directly from the borrower, the typical borrower would not pay or agree to pay unless he or she obtains a written short sale approval from the lender. After all, it is the lender, not private mortgage insurer, who must agree to the short sale approval and issue the short sale approval letter. Yet, for a lender to condition a short sale approval upon the borrower's monetary contribution to a third party may violate the law, because it prohibits the lender from requiring the borrower to pay any additional compensation, regardless of whether such payment is to be made to the lender or someone else (see CCP § 580e(b)). Moreover, a court of law is unlikely to allow a lender to circumvent the law by having a related party to the lender, such as a private mortgage insurer, to be the one to require a borrower to pay a monetary contribution in exchange for a short sale approval. See also, *Bank of America v. Graves* (1996) 51 Cal.App.4th 607, 611 fn. 3 (stating that "The antideficiency statutes are to be construed liberally to effectuate the legislative purposes underlying them").

Ultimately, it will be up to a lender to decide whether to risk violating the law by requiring a borrower to pay a third party in exchange for short sale approval. If that happens to your client as a seller, see Question 38 for general guidelines for handling that type of situation.

Q 33. *Instead of the lender requiring the borrower to pay a monetary contribution, can a lender require a monetary contribution from someone other than the borrower?*

A Yes. The law prohibits a lender from requiring the borrower to pay any additional compensation to obtain a short sale approval, other than the proceeds of the sale (CCP § 580e(b)). The law does not specifically prohibit a lender from requiring compensation from someone other than the seller, such as the buyer, agent, relative, and the like.

Although the short sale lender can require compensation from someone other than the seller, that other person is generally not obligated to agree to the lender's proposed terms. Under paragraph 1F of C.A.R.'s Short Sale Addendum (SSA) to the California Residential Purchase Agreement (RPA), a buyer is not obligated to agree to a short sale lender's request for a monetary contribution from the buyer. Under the C.A.R. Residential Listing Agreement (RLA), a listing broker is also not obligated to agree to a short sale lender's request for a monetary contribution from the broker.

Q 34. *Instead of the lender requiring the borrower to pay a monetary contribution, can a lender require the borrower to pay closing costs?*

A Not likely. The law prohibits a short sale lender from requiring a borrower “to pay any additional compensation, aside from the proceeds of the sale, in exchange for the written consent to the sale” (CCP § 580e(b)).

An argument has been made that interpreting the word “proceeds” to mean “gross proceeds” rather than “net proceeds” would allow a lender to require the seller to pay “gross proceeds” of the sale to the lender, which would mean the seller would be required to pay closing costs to escrow. That argument seems unconvincing on many levels. First, the law explicitly prohibits the lender from requiring the borrower to pay “any additional compensation,” regardless of whether that payment goes to the lender or towards closing costs (see CCP § 580e(b)). Second, among other arguments, nothing in the statutory language warrants a “gross proceeds” interpretation, which the California legislature would have more accurately described as “sales price.” Instead, the phrase “proceeds of the sale” most likely means what a lender typically receives in a short sale transaction and what reconveyance law requires, which is the amount stated in the lender’s short-pay demand statement (Cal. Civil Code § 2943(a)(7)), and not “gross proceeds” or “net proceeds.”

Ultimately, it will be up to a lender to decide whether to risk violating the law by requiring a borrower to pay closing costs. If that happens to your client as a seller, see Question 38 for general guidelines for handling that type of situation.

Q 35. *Instead of the lender requiring the borrower to pay a monetary contribution, can a seller voluntarily offer to pay a monetary contribution?*

A Yes. The law does not prohibit a seller from volunteering to pay a monetary contribution to help ensure that a lender will approve a short sale. For the difference between the lender requiring a monetary contribution and the seller volunteering a monetary contribution, see Question 36.

Q 36. *What is the difference between a lender requiring a monetary contribution from a borrower, which is prohibited, and a borrower volunteering a monetary contribution, which is permissible?*

A The difference between a lender requiring a monetary contribution, which is prohibited, and a borrower volunteering to pay a monetary contribution, which is permissible, depends on the facts and circumstances of each particular transaction, including the chain of events and negotiations between the short sale lender and borrower. However, whether a monetary contribution violates the anti-deficiency law for short sales is, generally speaking, a concern for the short sale lender, not seller (see Question 37).

A seller who wants a lender to accept the seller’s voluntary offer of a monetary contribution is strongly encouraged to make a written offer upfront with the initial submission of the short sale request to the lender to help minimize any concern the lender may have that such contribution violates the law. In making that offer, the seller is also encouraged to clearly indicate in writing the seller’s intent to voluntarily offer a monetary contribution and provide the reason the seller is offering the monetary contribution. The seller may also acknowledge in writing that the lender has not directly or indirectly required any monetary contribution as a condition for approving the short sale.

Q 37. *Can a seller be held liable for violating the anti-deficiency law for short sales?*

A Not likely, as long as the seller does not commit any fraud or waste. This new law is consumer protection legislation generally aimed at regulating the conduct of short sale lenders, not sellers. As long as a seller does not commit fraud or waste (see Questions 20 to 21), it is the lender, not the seller, who should generally be concerned about violating the short sale deficiency law.

Q 38. I am the listing agent representing a seller in a short sale transaction. To get the short sale approved, the lender requires that the seller makes a \$5,000 monetary contribution. I tried to get the lender to remove that requirement given the new law, but the lender refuses. What should I do?

A Requiring the seller to make a \$5,000 monetary contribution under these circumstances is a violation of the anti-deficiency law for short sales (see Question 30). Nevertheless, in this situation, you should, in writing, advise the seller what has happened and request that the seller decides what to do under these circumstances. Also encourage the seller in writing to seek the advice of his or her own attorney, accountant, and other professional as the seller deems appropriate. If you are not an attorney, you should not give the seller any legal advice and you should not make any legal determinations on the seller's behalf. As a member benefit for REALTORS®, you may give a copy of this legal article to your client to help your client decide what to do.

Each seller is different and can make a different decision based upon the seller's own legal determinations, legal resources, financial situation, housing accommodations, adversity towards taking risks, market forecasts, value system, emotional considerations, and many other factors. A seller's options include, among other things, attempting to further negotiate the terms of the short sale with the lender, reporting the matter to the lender's short sale escalation team or similar authority if any, reporting the matter to governmental authorities, seeking assistance from a HUD-certified housing counseling agency, hiring an attorney to represent the seller, suing to enjoin the lender from requiring a monetary contribution, canceling the short sale, paying the \$5,000 contribution willingly, or paying the \$5,000 contribution but suing the lender after close of escrow for its return.

If a seller elects to pay a monetary contribution and sue the lender for its return after close of escrow, a claim up to \$7,500 may be brought in small claims court (to be increased to \$10,000 starting January 1, 2012), depending on the parties' agreement if any for alternative dispute resolution. The seller's claim against the lender would be for a violation of the anti-deficiency protection under section 580e of the California Code of Civil Procedure. Of course, the seller may win or lose a court action depending on various factors including, without limitation, whether the claim is properly filed and served, whether other court procedures are properly followed, whether the seller appears in court for the court hearing, how well the seller argues his or her case, and whether the seller satisfies the burden of proving his or her case. If a seller obtains a favorable judgment but the lender fails to pay, the seller must pursue certain legal procedures to successfully enforce that judgment to get the money back.

More information about suing in small claims court and enforcing judgments is available from the California Courts' Small Claims guide at <http://www.courtinfo.ca.gov/selfhelp/smallclaims/> and the California Department of Consumer Affairs' Small Claims Court Guide at http://www.dca.ca.gov/publications/small_claims/index.shtml.

Q 39. I am the listing agent representing a seller in a short sale transaction. The lender requires the borrower to sign a short sale addendum that states the borrower may be held personally liable for the short sale deficiency. I tried to get the lender to remove that provision given the new law, but the lender refuses. What should I do?

A For a lender to require a seller to agree that that he or she could be personally liable for a short sale deficiency violates the law (see Questions 24 and 29). However, given this situation, you should, in writing, advise the seller to decide what to do and encourage the seller to seek the advice of his or her own attorney or other professional as the seller deems appropriate. If you are not an attorney, you should not give the seller any legal advice and you should not make any legal determinations on the seller's behalf. As a member benefit for REALTORS®, you may give a copy of this legal article to your client to help your client decide what to do.

Each seller is different and can make a different decision based upon the seller's own legal determinations, legal resources, financial situation, housing accommodations, adversity towards taking risks, market forecasts, value system, emotional considerations, and many other factors. A seller's options include, among other things, attempting to further negotiate with the lender for the removal of that provision, reporting the matter to the lender's short sale escalation team or similar authority if any, reporting the matter to governmental authorities, seeking assistance from a HUD-certified housing counseling agency, hiring an attorney to represent the seller, suing to enjoin the lender from requiring that provision, canceling the short sale, or signing the lender's short sale addendum.

For transactions falling under CCP § 580e, a provision in a short sale addendum holding a borrower personally liable for a short sale deficiency should be unenforceable. However, that doesn't mean a seller can sign a provision agreeing to personal liability with total abandon. If the seller signs such a provision, the lender or a third party collection agency may, after close of escrow, attempt to collect such deficiency in violation of the short sale deficiency law, as well as federal and state fair debt collection practices laws.

The lender or third party may also attempt to file a lawsuit against the seller for the short sale deficiency in violation of the law (see Question 24). If so, the seller and seller's attorney have the responsibility of, among other things, claiming the provision is unenforceable as an affirmative defense in an answer to the lender's complaint or by demurrer (and pursuing a malicious prosecution claim if appropriate). If the seller does not properly object to the lender's claim, the lender may obtain a default judgment against the seller. See *Spector v. National Pictures Corp.* (1962) 201 Cal.App.2d 217, 225-26 (holding that an anti-deficiency protection under CCP § 726 is waived if a debtor's fails to raise it as an affirmative defense in an answer or by demurrer).

Q 40. *What if, instead of requiring the seller to agree that the seller may be personally liable for the short sale deficiency as in Question 39, the lender requires a borrower to sign a promissory note for full or partial repayment of the deficiency?*

A Same answer as in Question 39. For a short sale lender to require a seller to sign a promissory note and owe the short sale deficiency violates the law (CCP § 580e(a)(1)). The promissory note could be construed as a purported waiver of the borrower's rights which is void and against public policy (CCP § 580e(e)).

Q 41. *Where can I find additional information?*

AThis legal article is just one of the many legal publications and services offered by C.A.R. to its members. For a complete listing of C.A.R.'s legal products and services, please visit [car.org](http://www.car.org).

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