



THE CALIFORNIA ANTI DEFICIENCY STATUE: PROTECTING THE HOME OWNER FROM MONEY JUDGMENT AFTER FORECLOSURE

Introduction:

In California, if you owe money secured with a purchase money mortgage or deed of trust (e.g. the money was used to purchase the dwelling) the holder of the Deed of Trust or Mortgage is prohibited from seeking to collect on the Note any sums more than it recovers from foreclosure even if the sums from foreclosure are less than the amount due on the Note (see the article on [Promissory Notes- The Basics.](#))

This powerful protection for the home owner (and for certain others as described below) means that if you default on the Note and are sued or the property securing the Note is subject to foreclosure, the money you will have to pay for the Note secured by your dwelling will be limited to the actual equity in your dwelling and the financial institution is simply out of luck if that foreclosure sale does not pay them the entire amount due on the Note. For example, if you owe five hundred thousand dollars still on the Note secured by your home and, due to your failure to pay, the bank forecloses but due to lower home prices the home is only sold by the bank's trustee for four hundred thousand, the bank has no right to sue you for the remaining one hundred thousand due under the Note. This is called the Anti Deficiency Statute in that the deficiency between the proceeds from foreclosure and the amount of the Note cannot be made up by a separate suit on the Note.

There are numerous angles and oddities about this law, some discussed below, but this article shall seek to outline the basics of this all important aspect of borrowing to purchase a dwelling.

The Basic Law:

California Code of Civil Procedure Section 580 b states the basic law:

No deficiency judgment shall lie in any event after a sale of real property or an estate for years therein for failure of the purchaser to complete his or her contract for sale, or under a deed of trust or mortgage given to the vendor to secure payment of the balance of the purchase price of that real property or estate for years therein, or under a deed of trust on a dwelling for not more than four families given to a lender to secure repayment of a loan which was in fact used to pay all or part of the purchase price of that dwelling occupied, entirely, or in part, by the purchaser.

The above section should be read carefully. Note that the structure must be a home of the person claiming the protection but it can also be home to up to three additional families. Note that the loan must have been incurred for the purpose of purchasing the property. And note that the holder of the deed of trust or mortgage is barred only after seeking recovery from the secured home.

The definition of an ordinary purchase money mortgage has been clearly defined by the courts: it is a mortgage (or deed of trust) given by the purchaser at the time of the conveyance of land to secure the unpaid balance for the price. Stockton Savings & Loan Bank vs. Massanet (1941) 18 C2d, 200,

207. There are literally hundreds of cases involving complex transactions (e.g. the buyer transferred *the Note, the buyer sold part of the property, etc, etc.*) so the issue can become quite complex but the basic thrust of the law is clear: protection of the home owner from having to lose the home plus pay to the financing entity additional sums due to depreciation of property prices.

Because of this statutory goal of protection of the homeowner, the law has been liberally construed to include many transactions that might not seem strictly within the definition. For example, if one takes out a construction loan to build a dwelling and completes same, the construction loan has been held to be equivalent to a purchase money mortgage and subject to the protection of the statute. Allstate Savings & Loan Assn. v Murphy (1979) 98 C.A. 3d 761.

(DO NOT CONFUSE THE ANTI DEFICIENCY PROTECTION OF SECTION 580b WITH THE "SINGLE ACTION RULE" OF CODE OF CIVIL PROCEDURE SECTION 726 WHICH REQUIRES THE CREDITOR TO PROCEED ON FORECLOSING THE SECURITY RATHER THAN SUING ON THE NOTE IN A "SINGLE ACTION." THAT SECTION IS DISCUSSED ELSEWHERE IN THIS WEBSITE.)

Waiver of The Protection:

A common mistake of those seeking protection under Section 580b is to assume that the protection cannot be waived. It is true that the protection of 580b cannot be waived *in advance*, e.g. in the Note or Deed of Trust executed. However, the protective provisions can be waived by subsequent conduct of the debtor including a written agreement to so waive. The leading case is Russell v Roberts (1974) 39 CA 3d 390 in which an agreement with the creditor for an extension of time to pay in return for the waiver was upheld by the Court.

Thus the most critical time for the debtor normally occurs during the weeks after default is declared on payment of the Note and the creditor suggests various ways that the foreclosure can be delayed or stopped if the debtor merely agrees to pay some additional sums and/or waives the protection of the anti deficiency statute. All too often the debtor, hoping to rectify the situation, signs documents that end up waiving vital protections, not fully understanding how dangerous that can be.

The Economic Ramifications of the Anti Deficiency Statute

Just because the bank cannot proceed independently in a separate action for the deficiency against the borrower does not mean the borrower does not suffer. First, the borrower will lose the home in the foreclosure sale. Second the credit history of the borrower will be adversely affected, usually for at least seven years.

There is also danger for the financial institutions in the event the market truly deteriorates. Their security is only as good as the equity on the property. With people borrowing up to ninety percent of the value of the home in an appreciated market, any real deterioration of property values means that the banks will quickly lose any value to their security and the anti deficiency statute means that they will not be able to proceed against the other assets of the borrower. Banks normally carry debts on their books showing equity securing the debt at the value of the property when the loan was made. It is clear to many professionals in real estate that a reduction in value of property in this state could easily result in economic catastrophe to the lending institutions who would find their secured loans as essentially unsecured.

The "Dwelling" Requirement

Note that the protection is only afforded the dwelling of the borrower on the purchase money mortgage but that the building can be up to four family dwelling buildings thus would cover the standard duplex, triplex or four-plex IF the holder of the Note also lives there. The protection does not exist for non dwelling security, e.g. commercial property or rental property in which the borrower does not dwell.

Note that this dwelling requirement does not apply to the seller of property who takes back a deed of trust. Whether or not the property is a dwelling the anti-deficiency rule applies regardless of dwelling status if the holder of the deed of trust is the seller of the property. See DeBerard Properties Ltd v. Bun Raymond Lim, et al. 20 Cal. 4th 659; 85 Cal.Rptr.2d 292 (1999).

Junior Lien Holders (Second Deeds of Trust, etc.)

Note that if the holder of junior liens secures notes not used to purchase the property (thus are not purchase money mortgages) that the protection of this statute would not apply. (Thus "equity lines" used to purchase other things would not require the financial institution to comply with the anti deficiency statute.)

Assuming for the moment there are two lenders who loaned money to purchase the home, each taking back a Deed of Trust or mortgage, in that case, even if the holder of the first deed of Trust wipes out all the equity on the property by their foreclosure, the second deed of trust holder is still barred from seeking relief directly against the borrow under Section 580b. (Brown v Jensen (1953) 41 C.2d, 193.) But be careful here, for the courts have at times eliminated that defense in various complex transactions and refinancing.

Conclusion

Property owners must take time to carefully consider the value of the protections afforded by this statute before taking actions that could forever lose its protection. One of our clients moved from her duplex to live with her sister in another state and when reversals in her business caused her to examine her asset/liability situation she found to her shock that the anti deficiency statute no longer protected her on her prior home precisely because it was no longer her dwelling. She had at first thought her risk was only the equity in the property. She found out that the entire Note, hundreds of thousands greater than the equity, was now a debt she would have to face. When she moved out of the state it never occurred to her to consider the long term effect ending the "dwelling status" of the property would have. A little foresight...or a visit to her accountant and lawyer to discuss risks... would have saved her much anguish.

*These Articles are to give the reader a general description of certain areas of the law. Legal advice is necessary to apply these legal concepts to your particular situation. **The Reader should obtain competent legal advice before relying on the Articles.***

Return to [Articles Index Page](#)



© Copyright 2004, Stimmel, Stimmel & Smith, P.C. All Rights Protected.