

# BESIDES TAKING MY HOUSE, CAN THE BANK ALSO GET A MONEY JUDGMENT AGAINST ME?

by John C. Nolan

The decline (“free-fall?”) of the housing market has caused more and more lawyers to be consulted about the extent of the rights and obligations of a home purchaser in the event of a default in the payment of a home mortgage.

Formerly an area of law that was in little demand, this has now become a guaranteed topic of conversation at every cocktail party and service club fundraiser. More importantly, the concept of possible *additional* liability after foreclosure has a direct and personal impact upon many of our friends and clients.

Many of us used to just assume that no deficiency judgment ever occurred. Now, we know that’s not correct, but when, exactly, can one occur?

Recent articles have been presented in various periodicals, both legal and non-legal, seeking to explain California’s system of real estate trust deeds and how it works. As a consequence, this article will not repeat those presentations, but will, instead, focus *only* on the possibility of a *deficiency judgment* following a foreclosure – a situation that might arise where the current value of the real estate security is *less* than the amount of the unpaid debt.

As an opening remark, let it be known that deficiency judgments – on obligations to experience more than just the forfeiture of the property upon foreclosure – can occur *only* if a *judicial* foreclosure is pursued. If your client or friend is *only* being made subject to a power of sale foreclosure, he or she will *not* be subject to any deficiency judgment, because Code of Civil Procedure section 580d simply and directly prohibits that from occurring.

All right, let’s assume that your friend/client is actually being sued for a judicial foreclosure. Does he or she necessarily face the possibility of a deficiency judgment?

The short answer is “No,” but, to understand how and when he or she could become subject to a deficiency judgment, the following, rather commonly occurring, fact patterns can help better explain what could happen, and whether the purchase-money exemption from deficiency judgment (Code of Civil Procedure section 580b) is, somehow, not applicable:

## Situation 1

Husband and Wife acquire their house, financing a portion of the purchase price with a loan from Bank B that is secured by a deed of trust. Later, in an effort to reduce their interest rate, they obtain a new loan from Bank X, and pay off the debt to B, giving a new note and deed of trust to X. Husband and Wife default, and the value of the home is less than the debt. Is it possible for X to get a deficiency?

X can recover a deficiency for a loan that was not a purchase-money loan. According to Miller & Starr, if the *refinanced* loan is by a lender (X) *distinct* from the first loan (B), the refinanced loan is not a deficiency-exempt purchase-money loan, and therefore, does *not* qualify for protection under the antideficiency limitations.<sup>1</sup> However, if the second refinanced loan is by the same lender, the second loan remains subject to the antideficiency limitations of the first.<sup>2</sup> Several cases, however, support the concept that a new note – secured by the same property to replace an older note – remains a purchase-money note subject to the purchase-money limitations.<sup>3</sup>

- 1 Miller & Starr, CALIFORNIA REAL ESTATE 3d § 10:253 (2003).
- 2 See *Union Bank v. Wendland*, 54 Cal.App.3d 393 (1976). In that case, though, the bank was unable to recover the deficiency on a third note, secured by a second deed of trust, that was used to make payments on a first note, secured by a first deed of trust. The court concluded that the second deed of trust merged into the first, thus invoking the protection of Code of Civil Procedure section 580d. (*But see* *National Enterprises, Inc. v. Woods*, 94 Cal.App.4th 1217, 1229-30 (2001) (disagreeing with the court in *Union Bank*, criticizing the court’s merger of the lesser estate deed of trust into a greater estate.) The court looked at the bank’s intent when securing the later note with a deed of trust, stating that when the bank “designated the residence as security for the third note it clearly evidenced an intention that the residence was to secure the first as well as the third note. Had its intention been otherwise it would have demanded a different security for the third note.” *Id.* at 407.
- 3 Miller & Starr, *supra* note 1, at § 10:240 (2003) (citing *Savings & Loan Bank v. Massanet*, 18 Cal.2d 200, 208 (1941); *Ghirardo v. Antonioli*, 14 Cal.4th 39, 49-50 (1996); *Costanzo v. Ganguly*, 12 Cal.App.4th 1085, 1090; *Ziegler v. Barnes*, 200 Cal.App.3d 224, 229 (1988); *Palm v. Schilling*, 199 Cal.App.3d 63, 76 (1988); *Jackson v. Taylor*, 272 Cal.App.2d 1, 5-6 (1989); *Syrek v. Gould*, 244 Cal.App.2d 149, 150-1 (1966); *Lucky Investments, Inc. v. Adams*, 183 Cal.App.2d 462, 466 (1960)).

In light of these cases, Roger Bernhardt states that “[no] court has yet directly addressed the question of whether refinancing a purchase money loan eliminates antideficiency protection.”<sup>4</sup> The answer, then, is that a deficiency *could* exist, but is not an absolute certainty.

## Situation 2

Same facts as in situation 1, above, except instead of getting a complete new loan from Bank X, Husband and Wife keep their loan from Bank B, and get a home equity line of credit loan from Bank Z. Husband and Wife default on their payments to Z. Can Z get a deficiency?

The equity line of credit was taken for a reason that is wholly unrelated to the purchase of the house. Based on the above, Z can recover the deficiency amount, not only because it is a different bank, but also because the loan was taken with the known intent that it would not be used as purchase money.

## Situation 3

Same facts as in situation 2 above, except Husband and Wife default in their payments to Bank X, and X forecloses. Can Z get a deficiency, and if so, how?

This scenario involves a junior creditor, Z, seeking payment *after* the senior creditor, X, has already foreclosed and taken all the value of the security. Z’s second action, a nonsecured action on the debt, *bypasses* California’s antideficiency statutes, and allows Z to sue the debtor directly where no security remains.

*National Enterprises, Inc. v. Woods* discusses this matter.<sup>5</sup> There, the court stated that a senior creditor’s judicial proceeding on the property prevents all other junior creditors from pursuing their payment owed based on the property. The court stated: “[T]he purpose of limiting a secured creditor to only one lawsuit to enforce its security interest and collect its debt is not upset where one suit per debt is permitted, as here – unless, of course, the two debts are a subterfuge for one. Moreover, [the concept] of compelling the exhaustion of all security before the entry of a deficiency judgment is not thwarted if an independent junior lienholder is permitted to bring an action after the senior lienholder has exhausted the security.”<sup>6</sup>

4 Roger Bernhardt, CALIFORNIA MORTGAGE AND DEED OF TRUST PRACTICE 3d § 5.69 (2008).

5 National Enterprises, Inc. v. Woods, 94 Cal.App.4th 1217, 1232–3 (2001).

6 *Id.* at 1233–4.

## Situation 4

After fully paying off their home, Husband and Wife obtain a loan from Bank B to finance some investments. Later, with most of the loan still outstanding, Husband and Wife sell to P, who makes arrangements with B to “assume” Husband’s and Wife’s loan. After the passage of some time, P defaults. Can B get a deficiency from P? Can B get a deficiency against Husband and Wife?

The couple, having fully paid off their home, is prevented from having their subsequent loan qualify as a purchase-money loan. B lent the couple money for investments unrelated to the house. P assumes a loan that was not originally purchase-money, but for P, this was effectively purchase-money.

Bernhardt offers various ways courts could construe such a case.<sup>7</sup> First, B, the creditor, could argue that the original non-purchase-money loan and its terms were not changed merely because P arranged a separate, distinct agreement.<sup>8</sup> Bernhardt notes that this would not prevent the creditor from recovering a deficiency judgment against the original trustor (Husband and Wife). Second, P, the grantee, could argue that the assumption agreement should be read as a purchase-money loan, stressing substance over form. Third, Husband and Wife could argue that P should not be protected from a deficiency judgment because, if B recovers a deficiency judgment against them, this would prevent them from recovering anything from P.<sup>9</sup> Despite the uncertainty, P is at much greater risk than if he had simply used a brand-new loan to buy from Husband and Wife.

## Situation 5

Same facts as in situation 4 above, except that, instead of making arrangements to “assume” Husband and Wife’s loan, P acquires the home “subject to” the note and deed of trust in favor of Bank B. Can a deficiency be obtained, and, if so, against whom?

Here, P has simply acquired the property subject to the note and deed of trust *without* B’s participation. B was not privy to the transition of the loan from Husband and Wife to P. For B, this loan is still a non-purchase-money loan, and a court would likely view it as such. Bernhardt discusses this situation as it occurred in *Indusco Mgmt.*

7 Bernhardt, *supra* note 4, at § 9.128.

8 Bernhardt cites three cases addressing this position: *Paramount Sav. & Loan Ass’n v. Barber*, 263 Cal.App.2d 166 (1968); *Brown v. Jensen*, 41 Cal.2d 193 (1953); and *Stockton Sav. & Loan Bank v. Massanet*, 18 Cal.2d 200 (1941).

9 *Frangipani v. Boecker*, 64 Cal.App.4th 860 (4th Dist. 1998).

*Corp. v. Robertson*,<sup>10</sup> where “a nonassuming purchaser guaranteed the seller’s original non-purchase money note and was treated throughout the opinion as a guarantor rather than a borrower.”<sup>11</sup> Thus, here, P might be considered as a guarantor of the note and not afforded any antideficiency protection. A deficiency could still apply to Husband and Wife who originally borrowed the amount, because for them this was not a purchase-money transaction.

From the foregoing, it is apparent that many situations are far from being black and white. It is equally clear that far greater dangers *may* exist that what we might have believed, simply based on a casual and quick analysis.

One more – and closing – caveat. Remember that the exemption from deficiency judgments provided by Code of Civil Procedure section 580d applies *only* to situations where the seller is the payee of the purchase-money note and deed of trust, or where an outsider (bank?) provides the funds, but *only* for “a dwelling for not more than four families . . . .” Therefore, any vacant property or any commercial or industrial property is *not* exempt from a possible deficiency judgment, unless the holder of the debt is the seller.

Hopefully, property values will soon return to their earlier levels. However, in the meantime – attorney beware – your quick answer may well not be the right answer.

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<sup>10</sup> *Indusco Mgmt. Corp. v. Robertson*, 40 Cal. App.3d 456 (1974).

<sup>11</sup> *Bernhardt*, *supra* note 4, at § 9.132.

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