

CMBA LEGAL NEWS

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EMINENT DOMAIN IS NOT THE SOLUTION

Michael Pfeifer, CMBA GENERAL COUNSEL, PFEIFER & DELAMORA, LLP



"Freedom is never more than one generation away from extinction. We didn't pass it to our children in the bloodstream. It must be fought for, protected, and handed on for them to do the same."

— The 40th President of the United States

It is perhaps a measure of how far removed we are as a society from understanding even the most basic principles of liberty enshrined in our Constitution that various cities and counties are now seriously considering a radical plan to use the governmental power of eminent domain to restructure the mortgages of "underwater" homeowners.¹ Under this plan, originally promoted by San Francisco's Mortgage Resolution Partners, municipalities would seize underwater mortgage loans currently held by private securitization trusts, cut the principal balance of the loans to a level at or below the market value of their real property security, and then

resell the loans to Mortgage Resolution Partners, or other private investors, who would refinance the loans and re-securitize them through the Federal Housing Administration, other government sponsored entities (GSEs), or new private securitization trusts.

The proposal has unleashed a firestorm of criticism from industry trade groups, Constitutional scholars, and even governmental leaders. On August 9, 2012, the Federal Housing Finance Agency ("FHFA") published a notice in the Federal Register requesting comments on the potential use of eminent domain to take mortgages from private-label mortgage-backed securities held in existing investment portfolios and restructure them through the FHA into Ginnie Mae securities.² On September 7, 2012, a coalition of at least 26 trade associations from across the country, including the California Mortgage Bankers Association, and such other noted organizations as the American Bankers Association, the Mortgage Bankers Association of America, the American Securitization Forum,

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VOLUNTARY CONTRIBUTIONS IN SHORT SALES

Potential for Anti-Deficiency Violations by Lenders?

Laszlo Ladi, ESQ., MCCARTHY & HOLTHUS, LLP and **Michelle Hoskinson**, ESQ., THE PERRY LAW FIRM



INTRODUCTION

Prior to SB 458, a hanging point in short sale negotiations was often the

deficiency clause – will the lender waive its right to collect? By taking away the option to require contributions from sellers as well as the option for juniors to collect deficiencies, the bill may ease this hanging point.¹ Some have suggested that lenders may accept *voluntary* contributions from sellers to supplement the sale proceeds. While the law is clear that lenders may no longer require contributions, the suggestion that lenders may

accept voluntary contributions is not as clear as it seems. Lenders should fully evaluate SB 458 and confirm that they are exercising best practices to ensure compliance.

SB 458

Among other things, SB 458 expanded California Code of Civil Procedure section 580e by prohibiting the holder of the note

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PARTNERS

David B. Epstein
Jonathan M. Turner
Michael R. Weiss

633 West Fifth Street
Suite 3330
Los Angeles, CA 90071

Phone: 213-861-7487

Fax: 213-861-7488

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from requiring additional compensation from the borrower (seller), aside from the sale proceeds, in exchange for written consent to the sale.² The prevailing opinion is that this may be circumvented by the "voluntary" contribution of additional funds by the borrower. This interpretation is seemingly driven by realtors³ and perhaps stems from a California Association of Realtors (CAR) legal article that concludes such voluntary contributions are permissible.

Upon closer inspection, especially from the lender's perspective, CAR's position is more nuanced. In fact, CAR states "it is the lender, not the seller, who should generally be concerned about violating the short sale deficiency law."⁴ For example, imagine a short sale negotiation in which a junior lien requires 20% of its balance to be paid while the first only agrees to pay the junior 8%. Should the first accept a voluntary contribution from the seller to make up the difference on the junior? It is the lender, not the seller, who will be in violation of the law if an impermissible contribution is accepted. Accordingly, it is the lender who must have mechanisms in place to maintain regulatory compliance.

DOCUMENTING A "VOLUNTARY CONTRIBUTION"

Even though liability falls on the lender for violation of, CAR makes some recommendations in regard to voluntary contributions. To evidence that the contribution is truly voluntary, CAR encourages the seller to make a written offer with the contribution as part of the initial short sale request and to otherwise document the voluntary nature of the contribution.⁵ If the lender rejects an initial request that does not include additional contribution, but later accepts a request that includes additional contribution, the lender might be viewed as requiring the additional contribution. As a result, the only scenario that is free of doubt is the one described by CAR. However, in practice, it is unrealistic for all parties to be satisfied after just one offer. Due to the difficulty of documenting the voluntary nature of a contribution, the best practice may be to refuse to consider any voluntary contribution from sellers.

WAIVER OF A 580E PROVISION

Seemingly neither the CAR nor any of the other commentators examine subpart (e) of section 580e, which states that any purported waiver of section 580e's provisions is void and against public policy. While the legislature may have targeted contractual waivers at loan origination, a voluntary contribution could be construed as waiver. Taking the issue of waiver into consideration, lenders must be cautious in, or should not consider, accepting a voluntary contribution.

CONCLUSION

The prevailing opinion that voluntary contributions by the seller in a short sale

transaction are permissible is not as clear-cut as realtors would suggest. If voluntary contributions are a necessity, lenders should at a minimum reassess their policies and procedures to correctly document voluntary contributions to keep record of compliance with section 580e. Still, vagaries in documenting contributions, such as keeping the voluntary nature clearly noted and ensuring that voluntary contributions are not construed as waivers, indicate that the best practice may be to forego accepting any voluntary contribution from sellers. Ultimately, the volatile legal atmosphere suggests that any gains lenders receive are outweighed by the risks (including possible class actions) if the transactions are anything but the most clear-cut cases.

- i See Breaking News! California Short Sale Anti-Deficiency Law Expanded by Melissa Zavala, available at <http://www.shortsaleexpeditor.com/in-the-news/breaking-news-california-short-sale-anti-deficiency-law-expanded/>, last visited April 9, 2012; *But See* New State Law Adds Protection For People Pursuing Short Sale, Helps homeowners avoid foreclosure and bankruptcy The San Diego Union-Tribune July 19, 2011.
- ii Cal Code Civ. Proc. § 580e(b)
- iii See Breaking News! California Short Sale Anti-Deficiency Law Expanded by Melissa Zavala, available at <http://www.shortsaleexpeditor.com/in-the-news/breaking-news-california-short-sale-anti-deficiency-law-expanded/>, last visited August 28, 2012.
- iv California Association of Realtors, Short Sale Deficiencies, available at <http://www.car.org/legal/foreclosure-short-sale-folder/short-sale-deficiencies/>, last visited February 24, 2012.
- v *Id.*

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