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FORECLOSURE

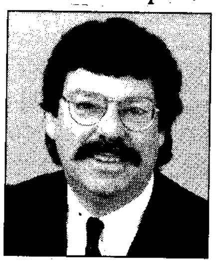
Sale Bidding And Deficiencies

Full Price Is Not Always The Best Price - Or The Smartest Bid

BY BRUCE J. BERGMAN, © 1996

When the time for a foreclosure sale arrives, should the lender or servicer simply bid up to the sum owed - the upset price - or are there other considerations?

Precisely how to handle this certainly can vary from state to state, but in many jurisdictions, there may very well be a dispositive relationship between how much is bid and how much of a deficiency remains.



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So, while it may be both easy and sensible - in some states and on some occasions - to just bid up the amount due, in New York that method would absolutely assure that no deficiency could be pursued.

Full bidding and bankruptcy

The compulsion to bid the full amount of the debt may arise from the well-publicized Durret rule [Durrett v. Washington National Ins. Company, 621 F.2d 201 (5th Cir. 1989)], which held that where the amount realized at a foreclosure sale is less than 70% of the property's fair market value, the sale could be set aside in bankruptcy court.

There were, however, other cases which rejected Durrett, and in New York it was never firmly followed anyway because different bankruptcy districts adhered to differing approaches.

In the end, the issue was effectively rendered moot in 1994 when the U. S. Supreme Court ruled in BFP v. Resolution Trust Corp., 114 S.Ct. 1757 (1994), that the amount bid at a regularly conducted non-collusive foreclosure sale establishes what is called reasonably equivalent value - thus rendering the sale immune from attack in the bankruptcy court.

So, even if a defaulted borrower files a post-sale bankruptcy petition, there is essentially no danger in the plaintiff having bid well below the upset price. Thus, if bidding the full upset price was based upon the strong impression Durrett had made, that consideration is no longer meaningful.

Bid price on real estate

In New York, where foreclosure of a mortgage is the subject of the action [that is, the foreclosure involves real estate, as opposed to personality (i.e., a co-op)], a deficiency is measured by the difference between:

■ what is due the lender (the sum due per the judgment), and

■ the *greater* of the amount bid at the sale or the value of the property on the date of the sale.

Showing this graphically in numbers should readily add clarification.

Assume the value of the property to be $225,000, with the debt due the lender $300,000. Counsel is directed by lender or servicer to bid the full amount of the debt at sale.

■ Amount due lender per judgment: $300,000.

■ Less sum bid at sale by lender: -$300,000.

■ Deficiency (even though property is worth less than the debt): $0.

Assume the same scenario, but lender or servicer has directed a nominal bid if no bidders are present.

■ Amount due lender per judgment: $300,000.

■ Lender bids $500, but credit given for value of property:-$225,000.

■ Deficiency: $75,000.

With a property worth $225,000, it is highly unlikely that anyone would have bid $200,000. If they had, the lender could have directed counsel to bid no higher than the value of the property.

That there are multiple permutations of the numbers is apparent. But a vital consideration is this. If there is any likelihood that a deficiency will be sought (that requires a genuine shortfall, in an amount worth purusing, and parties liable who have assets to pay any judgment which results; some lenders seek judgments even if no assets are available on the theory that some day, some of these borrowers will have something), then a lender or servicer must be careful not to bid higher than the probable market value.

Every dollar bid above value diminishes the deficiency. (This applies in states where this formula or some like version prevails.)

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Bid price on co-op

The co-op situation is different. Instead of being controlled by the strict New York statute relating to mortgage foreclosure (RPAPL ¶S1371), it is the Uniform Commercial Code (UCC) which has application.

That provision presumes that the foreclosure sale was conducted in a commercially reasonable manner. If it was (although that can become a bit sticky), then the amount derived at the auction sale is deemed to be reasonable.

Turning again to a monetary example, assume a debt on the co-op loan of $200,000. Assume further that the precipitous decline in the co-op market has driven this apartment's value down to a mere $50,000, which is not so farfetched. At the sale, no one appears to bid, so the lender bids a nominal $500. The deficiency is:

- Debt: $200,000.
- Less amount bid: -$500.
- Deficiency: $199,500.

Assuming, as we do here, that the co-op unit could be sold for $50,000, the lender or servicer would probably concede that value in advance and seek a deficiency of $150,000.

Likewise, if the borrower protested and asked for the credit the lender or servicer would be quick to agree, even though not obligated to do so. But the statute doesn't require it. Again, though, if the lender had bid up to the debt, no deficiency would be available.

So, the lesson in the end is the same for the co-op. Be careful when directing the amount of the bid. The full amount might have a deleterious effect later. SM

New York Raises Fee For Referee

The law has been changed in New York by the state legislature so that the fee awarded to a referee to sell in a foreclosure case is increased from $200 to $500. The statute became effective June 26.

On a technical basis, this change has been accomplished by chapter 225 of the Laws of New York, 1996, which amends the CPLR §8003(b). Part of the practical result is obvious: The foreclosure process in New York (certainly the sale portion) will now cost somewhat more.

The referee fee is a disbursement to be incurred in each case where the sale is actually conducted. It is important to note, though, that some referees demand that their fee be paid when a sale is adjourned. If the referee in fact appears at the sale and then it is adjourned, such a fee request is probably well founded. The referee who requires payment merely on the basis that the time to schedule the sale was set aside has a less compelling argument, but it is not entirely without merit. The key here is that the referees have in the past asked for $200 just because they agreed to schedule a sale. Might they now call for the new $500? They just may, and time will tell. A dilemma for foreclosing plaintiffs is that a content referee, rather than a disgruntled one, is more likely to be accommodating in setting a new sale date. And since time is money, the mood of the referee may be one to weigh.

On this point, too, although the increased expenditure of $300 for each New York foreclosure which proceeds to sale is unwelcome, it may encourage some recalcitrant referees to serve rather than slough off the appointment. In other words, the referee who seemed more interested in the vacation or the other cases - or whatever else occasionally causes referees to be slow to agree to schedule the sale - may now be far more cooperative.

Even the referees who declined to serve, thus forcing a motion for a successor referee, may now see the wisdom of discharging their duties. Maybe the new fee is a mixed blessing.

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