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## Post-Foreclosure Deficiency Suits Against Borrowers and Guarantors

By Bonnie Barksdale

In many instances, Texas law allows for foreclosure by private sale. Following a private foreclosure sale in which the sale price is not high enough to fully satisfy the outstanding mortgage amount, the lender is permitted to bring suit against the borrower for the deficiency under Texas Property Code § 51.003. This suit must be brought within two years of the foreclosure sale. The statute permits the debtor to protest the amount of the deficiency alleged by the lender by requesting that the court establish the fair market value of the property on the date of the foreclosure sale. The court determines the fair market value of the property after looking at "competent evidence of value," which may include: (1) expert opinion testimony; (2) comparable sales; (3) anticipated marketing time and holding costs; (4) cost of sale; and (5) the necessity and amounts of any discounts to be applied to the future sales price on any cash flow generated by the property. The statute, while not totally clear, appears to allow the debtor to elect to have the fair market value determined by either a jury or a judge. Either party can introduce evidence of the property's value, but the burden is on the debtor to prove that the fair market value of the property exceeds the foreclosure sale price. The debtor is entitled to an offset against the deficiency in the amount by which the fair market value, less any claim, indebtedness or obligation of any kind that is secured by a lien or encumbrance on the real property that was not extinguished at foreclosure sale, exceeds the sale price at the foreclosure. Claims and liens to be deducted from the fair market value may include contractual liens, mechanic's liens, state tax liens, as well as mechanic's liens against removable property. The offset is the only recourse for the debtor if the fair market value of the property sold at foreclosure is determined to exceed the debt. Texas case law affords other remedies to the debtor if sale defects led to an undervalued price at sale. If there is no request made to determine fair market value or if the request is made and no competent evidence of fair market value is introduced, then the sale price at the foreclosure sale is used to compute the deficiency.

The deficiency provisions of § 51.003 only apply to situations in which the lender actually seeks to recover a deficiency. Many lenders elect at the beginning of the foreclosure process not to seek a deficiency and accordingly do not worry about meeting the requirements of the deficiency statute. If a lender is clearly going to seek a deficiency judgment or is unsure, some lenders elect to hire an appraiser to provide an opinion on the fair market value of the property at the time of foreclosure. Then the lender may choose to bid the lesser of the appraised fair market value and the amount of the indebtedness. Lenders should carefully consider whether or not to obtain a preforeclosure appraisal as it will rarely preclude the debtor from disputing the foreclosure sales price in a deficiency suit. The lender will most likely have to obtain a new appraisal if the debtor challenges the sales price and, in some instances may regret having a preforeclosure appraisal. Also, there may be serious questions about whether the bank wants to bid the appraisal value. The fact that a bid was based on an appraisal probably will not affect the debtor's claim and may just mean that the lender starts the litigation at a higher number than it would have otherwise.

There are instances in which a lender may seek a deficiency against the guarantor of a debt. Texas Property Code § 51.005 sets forth deficiency provisions applicable to guarantors against whom a prior judgment on a guaranty has been obtained. These provisions are very similar to those set forth in § 51.003. Like the debtor, the guarantor is entitled to bring an action in order to determine the fair market value of the property as of the date of the foreclosure sale. The guarantor must be certain to adhere to the requirements of § 51.005 when seeking to establish the fair market value. The time allowed for the guarantor to seek such a determination may be as short as ninety days after foreclosure. Again, the court uses competent evidence of value as described above to determine the fair market value. If the fair market value is found to be greater than the sales price at foreclosure, the guarantor is entitled to an offset against the deficiency in the amount the fair market value, less any claims, indebtedness, or obligations described above, exceeds the sales price at foreclosure.

Many lenders include language in their loan documents that require the borrower, the guarantor, or both to waive the right to offset from a deficiency the difference between an established fair market value and a foreclosure sale price. Borrowers and guarantors should be cognizant of language in loan documents which waives any offset rights. Even general language waiving any and all rights of offset appears to be enough to waive the rights set forth in §§ 51.003 and 51.005 as Texas appellate courts have enforced such a waiver of offsets rights.

In many instances, the lender is able to recover attorneys' fees incurred in a deficiency suit following foreclosure. This right is typically governed by the terms of the note or the deed of trust or, in the case of a deficiency sought from a guarantor, the guaranty.