

January 28, 2016

California Supreme Court Categorically Bars Deficiency Judgments Against Residential Borrowers on "Standard Purchase Money Loans" Following Short Sales

by Christopher D. Crowell

California Civil Procedure Code section 580e generally bars a lender from collecting any deficiency from its borrower on a residential loan where the lender has agreed to a short sale of the real property collateral for the loan. Section 580e only went into effect on January 1, 2011, and courts have consistently declined to apply the statute retroactively to short sales completed before its effective date.

On January 21, 2016, however, the California Supreme Court issued a unanimous decision insulating residential borrowers from deficiency liability after a short sale regardless of when the sale occurred, under another anti-deficiency statute in the Civil Procedure Code. The case is *Coker v. JPMorgan Chase Bank, N.A.* and will be of interest to lenders holding deficiency judgments or claims arising from pre-2011 short sales.

In 2004 Carol Coker financed her purchase of a condominium in San Diego County with a loan secured by a deed of trust on the property. After Ms. Coker defaulted in her loan payments and the lender initiated the foreclosure process, the lender agreed to release its deed of trust in exchange for payment of the net sale proceeds, which were less than the outstanding loan balance. Ms. Coker expressly agreed that she would be responsible for the deficiency balance remaining on the loan following the short sale.

After completion of the short sale in 2010, Ms. Coker brought an action for declaratory relief claiming that Civil Procedure Code section 580b prohibited the lender from collecting the deficiency. Section 580b, as in effect at the time of the Coker short sale, stated in relevant part that "no deficiency judgment shall lie in any event ... after a sale of real property ... under a deed of trust or mortgage on a dwelling for not more than four families given to a lender to secure repayment of a loan ... used to pay all or part of the purchase price of the dwelling occupied, entirely or in part, by the purchaser."

The lender in *Coker* argued that section 580b, as it read in 2011, was inapplicable because a short sale is not a "sale of real property ... under a deed of trust" as would be the case with a foreclosure sale. The California Supreme Court gave short shrift to this argument and held that section 580b bars all deficiency judgments against residential borrowers on standard purchase money loans following short sales. Reviewing more than 60 years of case law interpreting section 580b (none of which involved a short sale), the Court observed that it had "consistently ... concluded that the statute limits a lender's recovery on any standard purchase money loan, **regardless of how the security has been exhausted and regardless of whether a sale has occurred under the deed of trust securing the unpaid loan.**" (Emphasis added.)

The Court also held that Ms. Coker could not waive the protections of section 580b in exchange for her lender's approval of the short sale, because section 580b — by preventing the aggravation of an economic downturn which would result from burdening defaulting homeowners with deficiency liabilities — provides a public benefit for society as a whole and not merely a private benefit for the individual borrower.

Coker makes it clear that, within the context of a 1-to 4-unit, owner-occupied, California residential property, short sales effectively eliminate any possibility of recovery from the borrower on the deficiency, regardless of when the short sale occurred. As such, even if the borrower consents to personal liability for any post-short sale deficiency, the borrower's consent is unenforceable and the lender may only recover from the value of the property.



Christopher D. Crowell's practice focuses on bankruptcy and commercial law. He has substantial experience representing financial institutions and other secured and unsecured creditors in loan workout negotiations and debt enforcement actions, both inside and outside of bankruptcy.