

Perspective



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Welcome to the first issue of *The Lender's Perspective*. This newsletter is designed to address legal issues that impact lending in Florida. Whether making loans or collecting bad loans, *The Lender's Perspective* will provide timely and valuable insight to the creditor.

Deficiency Judgments Following Mortgage Foreclosure

By Douglas L. Waldorf, Jr., J.D., M.B.A.

With increasing loan default rates and decreasing real property values, it is no surprise that mortgage foreclosures have reached an all-time high. As a bank attorney, I am frequently asked whether a lender should pursue a deficiency judgment if the collateral cannot be sold for enough money to pay off the debt. This article provides an overview of Florida law as it applies to obtaining a deficiency judgment and highlights certain factors which should be considered in deciding whether to proceed. The focus is on obtaining a deficiency judgment following a real estate mortgage foreclosure, although the process is the same for loans secured by non real estate collateral.

Deficiency Defined

Florida law defines "deficiency" as the amount by which the total loan indebtedness exceeds the fair market value of the collateral real property measured at the date of the foreclosure sale. The loan indebtedness will be the amount determined by the court to be due to the lender as evidenced by the foreclosure judgment. This will generally include attorney's fees and court costs. The fair

market value will be determined by an appraisal prepared by a licensed real estate appraiser retained by the lender for that purpose.

How Is a Deficiency Judgment Obtained ?

A deficiency judgment will not be entered automatically. Instead, further legal action by the lender is required. Florida courts have generally interpreted the law in the state as favoring deficiency judgments provided the lender can establish that the fair market value of the real property is less than the total debt owed. Most lenders will pursue a deficiency judgment by filing a motion for deficiency in the existing foreclosure case rather than filing a new complaint. This is a cheaper method as there are cost savings obtained by avoiding new filing fees and service of process fees. As with other types of legal actions, there is a period of time within which the claim must be brought or it will be barred by law. That time period is referred to as the "statute of limitations" and it varies depending on the type of case. To avoid statute of limitation issues in a deficiency claim, the motion should be filed within one (1) year of the last record activity in the foreclosure case. Many times this will be the date on which the certificate of title was issued. If the lender chooses to file a new lawsuit, it must be brought within five years of the date the claim arose which,

conservatively, should be considered as the date of the loan default. In any event, the lender will want to discuss the statute of limitation issue with its counsel as the foreclosure case nears completion.

It is important to note that the defendants against whom deficiency is sought must have been personally served in the lawsuit. Service of process by publication, while adequate for foreclosing a mortgage interest in real property, will not be sufficient in a deficiency action. This may make it difficult to seek a deficiency against debtors who cannot be readily located. The deficiency will normally be sought not only against the borrower but also any guarantors of the loan.

The lender's motion for deficiency judgment will ultimately be scheduled for hearing, at which time the lender and its counsel must be prepared to present evidence as to the property's fair market value. Many times the issue of deficiency will be uncontested and the lender will, in those cases, have little difficulty in obtaining the judgment. However, the debtor at a contested hearing may produce its own appraiser to testify as to property value in an effort to refute the evidence that the bank has presented. This "battle of the experts" will often be decided on the reputation and credibility of the appraisers. Most of the deficiency actions recently filed in Florida have centered around residential

properties and have been uncontested. However, as more commercial loans enter foreclosure, it is likely that the number of disputed deficiency cases will increase.

Preparing to Pursue a Deficiency

After completion of the foreclosure and the public sale of the foreclosed property, the lender will need to obtain a current appraisal of the property which evidences its fair market value as the date of the foreclosure sale. In addition to obtaining the appraisal, the lender should take photographs to document the condition of the real property as of the date of the foreclosure sale or as close thereto as possible. The appraisal should be prepared by a licensed appraiser with experience in providing expert testimony in the jurisdiction in which the real property is located. The lender must consider the fact that the appraisal may be discoverable in the ongoing deficiency litigation. The work product of any expert who is retained in anticipation of being called to testify as to his findings will likely be subject to discovery by opposing parties. For this reason, the lender should discuss with its litigation counsel the best manner in which to retain an expert appraiser.

“Call Now to Avoid a Deficiency Judgment!”

You may have seen the advertisements touting sure-fire ways to avoid foreclosure, deficiency judgments and adverse credit reporting. Recently, many “self help” sources and even some attorneys have advised debtors that they can reduce their potential deficiency liability by sending unsolicited deeds in lieu of foreclosure to the lender. Their argument, in the event the bank refuses the deed, will be that the deficiency amount should be fixed at the time the deed was tendered. In this manner, they hope to convince courts not to award additional attorney’s fees and costs incurred beyond the date of tender. There is no historical case precedent in Florida to support this and it is, in fact, contrary to established deficiency case law. To date, we have not seen this particular position litigated but it is my opinion, at this point, that these arguments will not be successful in reducing the deficiency amounts.

There is one way to prevent entry of a deficiency judgment and that is a bankruptcy filing by the debtor. This will stop any pending litigation and will prevent efforts to collect a judgment already obtained.

What Happens If We Win ?

Remember the old adage “...we won the battle but lost the war..” ? In considering whether to pursue a deficiency action, it is important to realize that, even if successful, the bank will simply become an unsecured judgment creditor. Merely obtaining the judgment will not necessarily generate any recovery of money for the bank. Instead, the bank will have to pursue additional post judgment collection efforts in an attempt to collect the judgment. The bank will have to spend money in the form of legal fees, appraiser fees, and court costs to obtain the deficiency judgment as well as fees and costs for further judgment collection efforts. While at least a portion of these fees and costs are awardable as a part of the deficiency, they may or may not ultimately be collected from the judgment debtor.

Mr. Waldorf is a Board Certified Real Estate Lawyer whose practice focuses on banking industry clients. He represents lenders in commercial and residential loan transactions, mortgage foreclosures, deeds in lieu of foreclosure, forbearance agreements, and defaulted loan workouts.

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In the next issue of The Lender’s Perspective, we will review the judgment collection process in Florida.

This update is for general information only and should not be construed as legal advice or legal opinion on any specific matter. The hiring of a lawyer is an important decision that should not be based solely on advertising. Before you decide, ask us to send you free written information about our qualifications and experience.



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