

What Today's Real Estate Investors Need to Know About Foreclosure-Related Lawsuits in Virginia

(Part One of Two)

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If a borrower defaults on a mortgage in Virginia, the lender does not need to file a lawsuit in a court in order to foreclose on the real estate. In December 2010, a bill was introduced in the Virginia General Assembly requiring court approval for foreclosure on all new mortgage loans. See S.B. 798 (Va. 2011). In February 2011, the Senate Courts of Justice Committee decided not to move the bill forward. Given the General Assembly's disinterest in transforming Virginia into a judicial foreclosure state, lenders and borrowers should not expect a radical transformation of foreclosure law in 2011. While a lender is not required to file suit in order to sell a distressed property, courts in Virginia can become involved in disputes over real estate loans at the parties' request. If your client is investing in real estate in the current economic environment, he must be aware of how the court system may become involved in the foreclosure process.

In a non-judicial foreclosure state such as Virginia, the lender secures the Promissory Note made by the borrower by filing a Deed of Trust in the local land records. The Deed of Trust authorizes a Trustee to sell the property at a public sale in the event of a default by the borrower on the Promissory Note. See Va. Code § 55-59(7). Default is most often due to non-payment. The bank-appointed Trustee must

follow the foreclosure terms of the Deed of Trust and the Code of Virginia, which includes giving certain notices. See Va. Code §§ 55-59.1 to 55-59.4.

Short Sales

Many investors today consider investing in real estate where the current owner has a past-due loan. Sometimes the owner tries to avoid foreclosure by negotiating with the lender to sell the property for which the sum owing under the loan documents exceeds the current sale price. This scenario is called a "short sale." Short sales are attractive to investors because the property tends to be in better shape than those that have been through foreclosure. However, few short sales actually close. Short sales frustrate loan servicers, borrowers, and Realtors because it is difficult to persuade the financial institutions that hold the promissory notes to agree that a short sale will reduce the lender's losses. For this reason, investors tend to avoid short sales unless the property is of unique interest.

Foreclosure Sales

Some investors buy homes at foreclosure trustees' public sales. Normally the only bidding party is the mortgagee bank itself. However, foreclosure sale properties are attractive to some investors seeking to acquire the property at the lowest

possible price. Unfortunately, buyers at foreclosure sales do not enjoy the typical benefits of purchasing real property, including many warranties and disclosures that give investors peace of mind concerning their investment. If a problem arises with property purchased at a foreclosure sale after settlement, the investor may lose months of rental income pending resolution of the issue, regardless of who is responsible for the problem.

Post-Foreclosure Sales

Alternatively, investors may seek to purchase properties already foreclosed upon by the lender. Most financial institutions holding the promissory note secured by the deed of trust are not in the business of holding foreclosure homes as long-term investments. Sales of bank-owned properties to investors do not possess the peculiarities of short sales or foreclosure trustee's sales.

Part Two of this article will discuss the common types of legal actions arising out of the foreclosure process. Wise investors, and their attorneys, take into account the pendency or threat of such a suit in weighing a potential purchase.

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Free Mental Health Law CLE

On Friday, May 27th from 10 a.m. to 1 p.m. the Mental Health Law Committee will be hosting a free CLE (including one hour of ethics) on the campus of the George Mason University School of Law in Arlington regarding recent developments in mental health law. Learn about recent developments in Mental Health Law in Virginia with an emphasis on involuntary civil commitment, why these developments affect lawyers in every area of practice, and why every lawyer needs to be educated on these issues.

For more information or to register, please contact one of the Committee's co-chairs, Lara Jacobs at jacobs.lara@gmail.com or Ron Page at rpage@rpagelaw.com, or the Committee's Board liaison, Nathan Veldhuis, at nathan.veldhuis@allenandallen.com.

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Part Two: Foreclosure Related Lawsuits and Investment Decision Making

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An investor considering purchase of real estate encumbered by a distressed loan wisely considers any foreseeable litigation in making an informed decision. Three common types of court filings frequently occur during the foreclosure process: (1) suits brought by the borrower attempting to prevent or void the foreclosure sale, (2) bankruptcy filings and (3) actions brought by the purchaser after the foreclosure sale to evict the previous owner.

Equitable Actions

If a borrower goes into default and the bank's trustee schedules a foreclosure sale, the borrower may file a suit requesting that the court enjoin the foreclosure from taking place. In order to bring such a suit, the owner must be able to show that the threatened foreclosure is not proper under the loan documents or law. The plaintiff may seek a preliminary injunction against the sale of the property while the dispute is pending. Alternatively, the borrower may bring an action requesting the court to declare a completed foreclosure sale void. Purchasing a property which has been involved in litigation requires particular care in the title examination process. A civil suit challenging a foreclosure may impair an investor's ability to sell, refinance or lease a property for months or even years.

Bankruptcy

Any bankruptcy filing by the borrower results in an "automatic stay" of any foreclosure proceedings. See 11 U.S.C. § 362(a)(4). If the lender wants to proceed with a foreclosure after the borrower files

for bankruptcy, it must file a motion with the bankruptcy court. See Fed. R. Bankr. P. 4001. Whether such foreclosure may proceed depends upon the circumstances of the case and whether the borrower filed for a liquidation or a reorganization of the debts and assets. A wise investor avoids purchasing an investment property from anyone who is in bankruptcy unless there is a bankruptcy court order that authorizes the sale.

Unlawful Detainer

For most home owners with distressed mortgages, their first experience with the Virginia court system is when the new owner attempts to evict them after purchasing the property at the foreclosure sale. After the bank or other purchaser obtains the trustee's deed, the prior occupants may refuse to abandon the premises. One of the peculiarities of Virginia law is that a homeowner may lose title to their property without a lawsuit, but the new owner has to get a court to order the sheriff to transfer possession. This process of determining who has the right of possession is known as "Unlawful Detainer." See Va. Code § 8.01-126. Some borrowers attempt to have the foreclosure sale set aside during the unlawful detainer action. While a defendant in an unlawful detainer has a right to assert defenses at trial, challenging the new purchaser's title is usually unsuccessful. The subject of an unlawful detainer is determining the superior right to possess and occupy the property and not to resolve title disputes. See *Morris v. Deane*, 27 S.E. 432 (Va. 1897); *In Re Boswell*, 238 F.3d 410, 410 (4th Cir. 2000)(unpub. per curiam); *Bank of New York Mellon v. Nguyen*, No. CL-2009-16787,

2010 WL 1805356 (Fairfax Co. Mar. 30, 2010). The purchaser of property at a foreclosure sale may bring an unlawful detainer case against any of the continuing occupants. Tenants may have certain rights to possession under the Protecting Tenants at Foreclosure Act of 2009, Pub. L. No. 111-22, as amended & extended by Pub. L. No. 111-203. An investor purchasing a property at a foreclosure sale must be prepared for the possibility that the occupants may contest the unlawful detainer and retain possession of the property for several months. If the investor purchases the property from the bank (or whoever bought it at the foreclosure sale), the bank would probably complete the unlawful detainer process prior to putting it up for sale.

The 2011 real estate market presents an alluring array of opportunities to investors who have access to sufficient funds to invest, the patience to shop for and manage properties, anticipate rising property values and are willing to take risks. Although Virginia is not a judicial foreclosure state, the court system frequently becomes involved in the process. Foreclosure related lawsuits can disrupt an investor's plans for resale or leasing of the property. The discerning investor considers active lawsuits involving property she is interested in and any foreseeable disputes that may affect her investment plan.

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