Short Sale Senate Bill 458 signed into law on July 15, 2011

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According to California Senate Bill 458 signed into law on July 15, 2011 and effective immediately, deficiencies in short sales are now illegal for lenders and lien holders. The law provides that junior lien holders no longer have any deficiency rights against the borrower after a short sale. Previously, a 2010 law banned senior lien holders from collecting deficiencies after short sales.

The new law prohibits deficiency judgments after a short sale and further prohibits lenders from requiring the debtor to pay any deficiency amounts. Although lenders are prohibited from requiring payment of additional compensation in exchange for a short sale approval, borrowers can still voluntarily offer a monetary contribution to the lender in hopes of obtaining a short sale approval.

The terms of the law also permit a lender to request or negotiate for a debtor to contribute or, contributions from the parties other than the borrower in a transaction to contribute, such as lenders, agents, or other parties. This is what most in the industry have wanted and now hail as a victory for the consumer; because it removes the potential for the deficiency liability after the short sale is approved and completed, thus bringing more certainty to the short sale process for the debtor. Until now it has left a lot of sellers with the jitters not knowing what the final outcome would be. Additionally, by removing this impediment, the short sale process will be quicker and easier for the seller.

This law also applies to those short sales now pending, but not yet closed and there is an exception to the new law if the borrower committed fraud related to the short sale. This could be in the form of the borrower lying in the short sale application about their income, assets, or hardship status at the time of the application. Additionally, there is an exception if the borrower causes intentional damage to the property or they are grossly negligent in their neglect of the property. Under these circumstances the lender would be allowed to seek appropriate damages from the borrower.

All this said, it is possible that the new law will have a negative impact on short sales. Short sales will still require the approval of all lien holders on the property in order to close escrow. Junior lien holders may be less likely to approve a short sale now because of the new law. If the lien holder can no longer look forward to receiving future monies from the debtor, then they may be less likely to negotiate the approval of a short sale now.

Now because of the new law, some lien holders may decide a short sale is not to their benefit and decline approvals, believing they may recover more money from pursuing the deficiency against the borrower instead of accepting the small amount they would receive from the short sale. Thus, the new law may have the unintended negative impact of reducing the number of approved short sales, which would ultimately force more borrowers into foreclosure, the thing most of us are trying to lessen and avoid.