

MORTGAGE FORECLOSURES

- UNDERSTANDING DEFICIENCIES -

In today's volatile real estate market, it is more important than ever for lenders to fully analyze the current market value of the property to be foreclosed, as well as the anticipated market conditions which may affect the market value of the property during, and after, the foreclosure process. This analysis is crucial to the lender's ability to determine the proper foreclosure method.

This article outlines the general foreclosure rules under Minnesota law regarding the creation and preservation of deficiency claims; however, the specific facts in each case may alter the lender's desired method of foreclosure.

Under Minnesota law, there are two (2) primary methods of mortgage foreclosure; foreclosure by publication (advertisement) and foreclosure by action (judicial foreclosure). Typically, foreclosure by publication is the preferred method because it is generally less expensive and takes less time to complete, however, the chosen method of foreclosure will dictate whether the lender will retain its right to a deficiency claim against the borrower, mortgagor or guarantor. Both foreclosure methods apply to residential and commercial properties.

The lender must first determine if the anticipated net sale proceeds from the lender's sale of the property, after the expiration of the redemption period, will be more or less than the amounts due under the loan. Among other things, marketing costs, closing fees, insurance premiums, property taxes and other carrying costs should be deducted from the anticipated gross sale price to determine the anticipated net sale proceeds. If the anticipated net sale proceeds are expected to be less than the amounts due under the loan, the lender must address the issue of the deficiency.

For example, if the lender is owed \$100,000 under the loan and determines that the anticipated net sale proceeds will be \$75,000, the anticipated deficiency is \$25,000.

Once the lender determines that a deficiency is likely, the lender must then determine the likelihood of collecting the deficiency from the borrower, mortgagor or guarantor. In most circumstances, a lender foreclosing by publication waives its right to a deficiency claim against the mortgagor. Under a voluntary foreclosure agreement (which reduces the redemption period to two months) a lender always waives its right to a deficiency claim against the mortgagor. However, a lender foreclosing by action will preserve its right to a deficiency claim against the borrower, mortgagor and guarantor, if any.

For example, if the lender forecloses on a mortgage and there is no separate guarantor, the lender must foreclose by action (judicial foreclosure) to preserve its right to obtain a money judgment against the borrower/mortgagor for the deficiency.

In contrast, if the lender forecloses on a mortgage with a separate guarantor, the lender may foreclose by action and preserve its right to obtain a money judgment against the borrower, mortgagor **and** guarantor for the deficiency; or may foreclose by publication and still preserve its right to obtain a money judgment against the guarantor for the deficiency **but not** the borrower/mortgagor.

In **ALL** foreclosures, whether by publication or action, the amount of the lender's bid at the sheriff's foreclosure sale will determine the amount of the preserved deficiency claim, if any.

Using the previous examples, if the lender is owed \$100,000 under the loan, and determines that the anticipated net sale proceeds from the lender's sale of the property, after the expiration of the redemption period, will be \$75,000, the lender would bid \$75,000 at the sheriff's foreclosure sale and will have preserved a claim for a money judgment for the deficiency of \$25,000.

If a lender's bid at the sheriff's foreclosure sale is equal to the total amount due under the loan, the lender **will not** have created a deficiency and **will not** preserve a claim for a money judgment, regardless of the method of foreclosure.

For example, if the lender is owed \$100,000 under the loan, and determines that the anticipated net sale proceeds from the lender's sale of the property, after the expiration of the redemption period, will be \$100,000 or more, the lender would bid \$100,000 at the sheriff's foreclosure sale and will not have created a deficiency and will not preserve a claim for a money judgment. This remains true even if the net sale proceeds from the lender's sale of the property, after the expiration of the redemption period, are actually less than \$100,000.