

THE PROS AND CONS OF BIDDING AT FORECLOSURE SALES

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When they learn of my experience in dealing with foreclosure issues, friends and acquaintances looking for bargains often inquire about the benefits of buying properties at foreclosure sales. There certainly are bargain properties available, but there are also significant risks as well.

Although it is essential to conduct a title search before bidding at a sale, actual title insurance typically is unavailable in these transactions. It is important to keep in mind that any secured creditor may foreclose – not just holders of first trust deeds. Title to the property obtained at the sale will be in the same position of priority as was the foreclosing trust deed. So a person acquiring title at a foreclosure of a second trust deed will step into its shoes and therefore will take title subject to the preexisting first deed of trust. The new owner will need to take over the payments on the first, or refinance. If the first trust deed contains a “due on sale” clause, as is often the case, refinance may be necessary since the first lienholder may reject payments from the new owner and may institute its own foreclosure due to the change in ownership. I have seen several cases where inexperienced bidders grossly overpaid for property based on a mistaken belief that they were buying property free and clear when in fact it was subject to a substantial existing senior trust deed. The auctioneer will not announce whether the foreclosing trust deed is a first or second or whatever, and often will decline to answer questions about title priority since he or she is forbidden to provide title information. It is the bidder’s duty to investigate these title issues for his or herself.

Information about the physical state of the property is also less available than for a regular sale. No Transfer Disclosure Statement disclosing defects is required as would be for a normal sale. The foreclosing lender is obligated to disclose defects known to the lender, but not to search for them. Since the lender usually never resided in the property, it is often not aware of these defects. A potential bidder can theoretically ask the property owner for access to see the interior prior to the sale, but a person facing foreclosure owes no obligation to provide access and is not likely to be so

accommodating under these circumstances. Homeowner's insurance obtained after the sale generally excludes coverage for preexisting defects and conditions, even if not known to the buyer. I have recently been called upon to defend a person who purchased at a foreclosure sale property that was found to be infested with mold after the property was resold to a third party. My client denies having knowledge of the mold, but he is still embroiled in this lengthy and expensive lawsuit in which the buyers are claiming over \$600,000 in damages and for which my client has no insurance coverage.

A bidder at a foreclosure sale must bid cash or cash equivalent (cashier's check or certified funds). So it is not possible to put money down and obtain a loan for the balance. It is generally advisable to bring a number of cashier's checks in various amounts so that you can submit only enough money to cover the bid amount. The cashier's checks may be made payable to yourself and then endorsed over to the auctioneer if you are the successful bidder.

Bidding is by a normal auction process that starts with a credit bid submitted by the foreclosing lender that may be in the full amount of its loan or any lesser sum that the lender chooses. It is illegal to "chill the bidding" by colluding with other potential bidders to keep the price down. There are a number of professional investors who regularly bid at foreclosure sales. Several have companies set up to make whatever repairs are needed, deal with the occupants by negotiating with them or initiating evictions, and market the properties for quick resale. The professionals are generally aware of every property coming up for bid, so if you think you have found a significant bargain and you are the only bidder, you might want to be suspicious that you may have overlooked something significant such as whether you are truly buying the property free and clear of senior liens, or whether you might instead be bidding on a second instead of a first trust deed.

If you are deemed to be the successful bidder, the auctioneer will hold on to your funds and you will receive a receipt. The sale is final and it is a misdemeanor to cancel your payment once the sale is complete. A deed called a "trustee's deed upon sale" will be issued by the trustee within ten days for recording. If something happens after the sale such as the borrower filing bankruptcy or filing suit to set the sale aside, you will no doubt be a named party defendant in that lawsuit which may drag on for several years.

You will not have an instantaneous right to possession of the property if it is occupied. The former owner and/or any tenants will need to be evicted through an unlawful detainer lawsuit. Former owners get a 3-day notice to quit and paying tenants get a 90 day notice. If there is a lease, you will likely be obligated to honor it unless you or a family member intends to occupy the property. Some professionals offer “cash for keys” whereby they offer money to the occupants to convince them to vacate the property voluntarily without the need for an unlawful detainer action. The lawsuit itself usually takes an additional two months or so. Unfortunately it is not unusual for disgruntled former owners to damage the property before they vacate it. You may be able to sue them for intentional damages caused after the sale is completed, but these are persons who could not avoid foreclosure to begin with, so their recoverable assets may be limited. Deferred maintenance is likely, so be sure to factor repair costs into your bid calculations.

So foreclosure sales may give rise to opportunities for bargain purchases, but at substantial risks including, but not limited to, those outlined above. On the other hand you may also want to consider alternatives such as purchases via short sales or of bank owned realty where you can visit and evaluate the property prior to purchase and are far less likely to be faced with issues involving bankruptcy, eviction, lawsuits, damage to the property, the absence of title insurance, and the need to come up with cash to cover the entire purchase. If you are considering any such investments or opportunities, I suggest you call our office to arrange a meeting to discuss your concerns and options in more detail.

Lawrence Dreyfuss is president of The Dreyfuss Firm, a professional law corporation located in Irvine, California. He is a 1974 graduate of UCLA and a 1977 graduate of The UCLA School of Law, and has more than 35 years civil litigation experience. He handles cases throughout California in state and federal trial and appeals courts concerning real property transactions and non-disclosures, secured lending and foreclosures, title problems, partition of jointly owned property, broker liability, contract disputes, and numerous other business and real estate issues. Mr. Dreyfuss has received the highest possible ratings (AV) for legal expertise and ethics from Martindale Hubbell, the preeminent national resource for attorney evaluations.

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