

# DIFFERENCES AMONG STATE FORECLOSURE LAWS

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## I. Introductory Matters

### A. Mortgages, Deeds of Trust, and Deeds to Secure Debt

The name of the legal instrument used to create a security interest in land varies among the states. However, the differences among these instruments generally are irrelevant for the purposes of this topic. Therefore, for ease of discussion, the term “mortgage” will be used to refer to all types of real property security instruments, including deeds of trust and deeds to secure debt.

### B. Types of Foreclosure Actions

1. *Judicial Foreclosure.* A judicial foreclosure is conducted like any other form of civil lawsuit. The mortgagee sues the debtor to recover the debt and requests the court to order a sale of the mortgaged land to satisfy the debt. If the court grants this request, the land is auctioned at a public sale. If the sale does not generate enough proceeds to pay the loan in full, the judge can enter a judgment against the debtor for the “deficiency”—the difference between the debt amount and the sale price—unless antideficiency legislation prevents it. Depending on the state, a judicial foreclosure can take from three months to five years to complete. It is the only form of foreclosure available in approximately 20 states.
2. *Nonjudicial Foreclosure.* A nonjudicial foreclosure (also known as a power of sale foreclosure or foreclosure by advertisement) does not involve any judicial proceedings. Instead, after the mortgagee satisfies the statutory notice requirements, which vary tremendously among the states, the land is auctioned at a public sale. Depending on the state, the sheriff, the trustee of the deed of trust, or the mortgagee conducts the sale. If the sale does not generate enough proceeds to pay the loan in full, the mortgagee can sue the debtor for the deficiency unless antideficiency legislation prevents it. Depending on the state, a nonjudicial foreclosure can take from one to eight months to complete. It is available in approximately 30 states. In all these states, judicial foreclosure also is available in at least some circumstances, but mortgagees normally opt for the quicker, cheaper nonjudicial foreclosure.

3. *Unique Foreclosure Actions.* A few states have unique forms of foreclosure, such as strict foreclosure, entry without process, actions at law for a writ of entry, and scire facias. Of these, only scire facias involves a public sale of the land. In the others, the lender acquires title to the mortgaged land without a sale.

### **C. Effect of a Foreclosure Sale**

Judicial and nonjudicial foreclosure sales transfer the landowner's title to the purchaser and eliminate the foreclosed mortgage and the junior liens from the title. The proceeds from the sale first are applied to pay the foreclosing lender. Any remaining proceeds normally are used to pay the junior lienors. If any proceeds still remain, the foreclosed owner gets them as compensation for his or her equity in the property.

## **II. State Borrower Protections**

Many states have enacted statutory borrower protections. Some legislatures are motivated by a perceived imbalance in the foreclosure process in favor of the lender; the lender normally is the only bidder at the sale, and, in nonjudicial foreclosures, the lender generally controls the foreclosure process. Other state legislatures enacted these statutes in difficult economic times, such as during the Great Depression of the 1930s. The existence and terms of these statutes differ greatly by state. However, every state recognizes the common law equity of redemption.

### **A. Equity of Redemption**

This common law right enables the landowner and any junior lienor to stop the foreclosure sale by paying the secured debt in full. A lender cannot "clog" the equity of redemption by requiring the borrower to waive it when the loan is made. However, a borrower subsequently can waive the right by deeding the land to the mortgagee, rather than waiting to lose the land in a foreclosure sale (a "deed in lieu of foreclosure"). The landowner can sell the land or can refinance it to exercise the equity of redemption.

### **B. Arrearages Legislation**

A borrower that has defaulted on its mortgage may have difficulty obtaining new financing to exercise the equity of redemption. Moreover, particularly for nonjudicial foreclosures, the short period of time between the commencement of the action and the sale may render a timely private sale extremely difficult. Therefore, many states have enacted arrearages legislation that enables the borrower to reinstate the loan and to stop the foreclosure sale by paying just the amount that was due before the lender accelerated the debt. These statutes usually attempt to limit borrower

abuse of this right by imposing monetary penalties when the debtor exercises the right, by limiting the number of times the debtor can reinstate the loan, or by requiring payment of the full amount due on the date of reinstatement, rather than only the amount that was due on the date of default.

### **C. Statutory Redemption**

Approximately half the states statutorily have created a method for a landowner to recover the property after the foreclosure sale by paying the purchaser. Although the features of this statutory right differ from state to state, the foreclosed owner normally must pay the foreclosure sale price, rather than the amount of the foreclosed debt, to exercise this right. By pegging the redemption price to the foreclosure price, legislatures are attempting to motivate the foreclosing lender to bid at least the full amount of its debt at the foreclosure sale. Statutory redemption also is designed to give the foreclosed owner additional time to raise money to preserve its equity in the land, including by selling it. Some states extend this right to junior lienors. The statutory redemption period can be as long as a year, depending on the state.

Tremendous differences of opinion exist about whether statutory redemption is beneficial. Some argue that it chills bidding at the foreclosure sale, because the foreclosed owner normally can retain possession of the property during the statutory redemption period and can defeat the purchaser's interest in the property. Moreover, empirical studies about the frequency with which the right is exercised differ, but clearly redemption occurs in a minority of foreclosure actions. Interestingly, when the federal government owns a junior lien on foreclosed land, it claims the statutory right to redeem even if the right does not otherwise exist in the state where the land is located.

### **D. Antideficiency Legislation**

Twelve states statutorily limit or eliminate the foreclosing lender's right to recover a deficiency judgment. The statutory terms vary a great deal. For example, in some states, the statute applies only to one type of foreclosure action but not to the other. In other states, the statute applies only to certain types of mortgages, such as a purchase money mortgage.

The states also differ on the extent to which the debtor is protected from a deficiency judgment. Some states allow a deficiency judgment only if the debt exceeds the foreclosed land's actual fair market value, regardless of the sale amount. This approach reflects the fact that the foreclosing mortgagee usually buys at its own foreclosure sale and bids no more than the outstanding debt amount, rather than the land's fair market value.

Other states completely prohibit deficiency judgments. This approach is intended to discourage lenders from overvaluing the property and from lending more than the land is worth. In some states, this approach also is designed to stabilize the economy during an economic downturn. The theory is that borrowers are less likely to default on their other obligations if they are spared a deficiency judgment after a foreclosure. Commentators have criticized both rationales. The true explanation often is that the legislature decided that a borrower should not be subject to further liability after losing the mortgaged land.

#### **E. One-Action Rules**

Eighteen states have a one-action rule. The rule's scope differs among these states. In some jurisdictions, it also is called a "security-first rule," because the lender first must foreclose and then seek a deficiency, rather than just sue to enforce the note. In contrast, the one-action rule in other jurisdictions only prevents the lender from simultaneously suing on the note and foreclosing the mortgage. This version of the rule is designed to protect the borrower from defending a multiplicity of actions. Finally, California's rule limits the lender to one action—normally either a suit on the note or a mortgage foreclosure.

### **III. Federal Preemption**

#### **A. Preemptive Legislation**

Congress has exempted the Department of Housing and Urban Development from state foreclosure laws. Single Family Mortgage Foreclosure Act, 12 U.S.C. §§ 3751-68; Multi-Family Mortgage Foreclosure Act, 12 U.S.C. §§ 3701-17. The exemption eliminates the most important state borrower protections, including statutory redemption and antideficiency laws. Additionally, it authorizes nonjudicial foreclosure, even in those states that do not permit it. Congress has considered a number of bills that would have extended the exemption to all federal entities.

#### **B. Federal Agencies**

Even without legislative authorization, a number of federal agencies have taken the position that they are exempt from state mortgage laws based on the Supremacy Clause of the U.S. Constitution. Popular targets for agencies have been state statutory redemption rights, antideficiency laws, and notice requirements. Substantial conflict exists in the case law concerning the borrower protections that are inapplicable to federal agencies and concerning which entities constitute "federal agencies" for this purpose. Surprisingly, some courts have held that Fannie Mae and Freddie Mac are exempt from certain state foreclosure laws.