

California’s anti-deficiency statutes are found in the Code of Civil Procedure sections 726 and 580a-580e.

Section 726 is the linchpin of the anti-deficiency scheme. Under §726, if an obligation is secured by real property, the secured creditor must first foreclose the real property collateral before it seeks to recover a deficiency from the borrower. This is referred to as the “security first” rule. If a secured creditor sues the borrower for the amount owing without first foreclosing the borrower may assert §726 as an affirmative defense and require the creditor to first foreclose. Alternatively, if not raised as an affirmative defense, a creditor who proceeds to recover the debt without first foreclosing will waive the collateral.

In California, there are two ways of foreclosing real property. One is to file a lawsuit and ask the court to order a foreclosure. This is called a “judicial foreclosure.” Alternatively, if the deed of trust provides for a private power of sale (which they usually do), the creditor may foreclose the property at a trustee’s sale. This is called a “non-judicial foreclosure.” The vast, vast majority of foreclosures in California are “non-judicial foreclosures.”

Section 580d precludes a deficiency action following a non-judicial foreclosure. Thus, if a creditor elects to foreclose non-judicially, it may not recover a deficiency judgment from the borrower. In essence, in non-judicially foreclosing the creditor has waived its right to a deficiency and has elected to take the property to satisfy the entire obligation.

In the rare instances where a creditor forecloses judicially, the borrower may be liable for a deficiency. The amount of the deficiency equals the difference between the amount of the secured obligation and price the property sold for at foreclosure or the fair market value of the property, whichever is *greater*. Importantly, if the creditor forecloses judicially, the borrower has the right to redeem (i.e., buy back) the property for the amount the property sold for at the foreclosure for a period of one year.

Under §580b, no deficiency is allowed *even after a judicial foreclosure* if the collateral was an owner occupied property with 4 or fewer units (e.g., your home). Further, under §580b, no deficiency is allowed *even after a judicial foreclosure* in cases of “purchase money” obligations (i.e., seller financing).

Section 580e is the newest addition to California’s anti-deficiency legislation. Under §580e, no deficiency is allowed if the secured creditor agrees to a short sale. A short sale is a sale of the property for an amount less than the secured obligation.