

# Nebraska Deed of Trust Foreclosures:

## Bidding Strategies for Lenders and Lawsuits for Deficiencies

by *Brandon R. Tomjack*



### Introduction

One of the most significant and highly publicized indicators of the current difficult economic circumstances is the increasing number of real estate foreclosures. In most cases, the lender becomes the owner of the property at the end of the foreclosure process. But, it is not always a good idea for the lender to purchase the property at the foreclosure sale. If the lender purchases the property, the price it bids may determine whether it can seek a deficiency judgment against the borrower or guarantor. This article discusses factors a lender should take into account before it purchases real estate at a foreclosure sale, and how its bid at the sale may affect a deficiency against its borrower or guarantor.

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### Bidding Strategies for Lenders

In Nebraska, the deed of trust foreclosure process ends when the trustee sells the property at a public auction. The lender, who is the beneficiary under the deed of trust, must decide the amount of its initial bid. If the lender's bid is the highest or the only bid, the lender will be the winning bidder. But, if others bid higher than the lender's bid, the party with the highest bid will win and therefore own the property.

Frequently a lender will use its total debt amount, including trustee's and attorneys' fees, as its opening bid. By doing so, the lender ensures one of two things: the lender will either own the property after the foreclosure sale or a third party will purchase the property for an amount that will pay the lender's debt in full. However, this is not always the best way for lenders to determine their opening bid. While there is a chance that the lender's debt may be paid in full, this course of action virtually guarantees that the lender will own the property after the foreclosure sale, and that the lender will not have any right to seek a deficiency against the borrower or any guarantor.

Prior to making its bid, a lender should determine whether owning the real estate is in its financial best interest. There are several factors a lender should consider. Perhaps most importantly, the lender should try to determine the property's approximate value. If the lender purchases the real estate at the foreclosure sale, the lender will not receive any payment until it subsequently re-sells the property. As a result, it is important for the lender to determine the property's value so the lender has some idea of what a third party might pay for the property.



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In today's market, it is not uncommon for a borrower's indebtedness to exceed the value of the lender's collateral. As a result, the borrower's total debt amount does not necessarily correlate to the value of the property. A lender should determine if any recent appraisals exist. If no recent appraisals exist, the lender may want to obtain an appraisal or a market analysis from a qualified real estate agent.

A lender should also view and inspect the real estate before the sale. A recent appraisal may not be accurate if the property has been damaged or destroyed subsequent to the appraisal date. If the borrower has vacated or abandoned the property, it is particularly important to inspect the property to ensure it is properly secured and preserved. If the lender made a construction loan, the lender needs to inspect the property to determine if construction is complete.

A lender should also evaluate the costs it may be forced to incur before it can re-sell the property. Will the property need repairs before the lender can sell it? If the loan was a construction loan and construction is not complete, will the lender complete construction, or will it be able to sell the property in its unfinished condition? What is the amount of realtor fees and commissions the lender will need to pay to when it sells the property? Next, a lender should think about how difficult or easy it may be to re-sell the property. Does the condition and/or location of the property make it more or less desirable for potential buyers? Depending on the market conditions, how long may it take for the lender to sell the property? In addition, a lender should also determine if there are any environmental concerns associated with the property, particularly if the property is commercial property. The lender may need to obtain a phase I environmental inspection before the foreclosure sale to discover any environmental issues that may exist. Many lenders will not want to be in the chain of title if there are environmental concerns associated with the property.

The lender may want to discount its opening bid in order to increase the likelihood that a third party might bid at the foreclosure sale. There are several advantages if a third party purchases the property. First, the lender will receive cash immediately after the sale or shortly thereafter. Second, the lender will not incur any additional costs or expenses of reselling or maintaining the property. Third, the lender will not be in the property's chain of title, which may be especially important if there are environmental concerns associated with the property. Finally, the lender will benefit by avoiding the need to spend any additional time dealing with the foreclosed property.

If the lender decides to bid less than its total debt amount, determining what that bid should be requires the lender to take time to evaluate the facts and circumstances surrounding the real estate. A recent appraisal and inspection of the property

can give the lender an idea of the value of the property, and what third parties may be willing to pay at the foreclosure sale. Also, if the construction of the property is not complete, the lender should determine the cost necessary to complete construction and factor that amount into its bid. Additionally, the lender should factor in an appropriate percentage discount since the sale is a foreclosure sale, or "forced sale". Generally speaking, property sold at a forced sale will sell for less than in a voluntary, arm's length transaction.

## Deficiency Actions

A lender may file suit against the borrower to recover any deficiency that exists after the foreclosure sale. Under the Nebraska Trust Deeds Act, the "deficiency" the borrower may owe the lender is the amount by which the borrower's total indebtedness, together with interest and the costs and expenses of sale, including trustee's and attorneys' fees, exceeds the greater of: 1) the fair market value of the property as of the day of the sale, or 2) the sale price of the property. Neb. Rev. Stat. § 76-1013.

According to the elements set forth in the Nebraska Trust Deeds Act, if the lender bids its total debt amount at the foreclosure sale and purchases the property, there will be no deficiency because the total indebtedness will not exceed the sale price of the property. The amount the lender may re-sell the real estate for at a later time does not factor into the deficiency calculation and has no effect on the lender's ability to recover a deficiency from the borrower or guarantor.

The following examples illustrate when a lender may recover a deficiency against a borrower:

### Example #1

- Borrower owes \$100,000 (including costs of foreclosure and attorneys' fees).
- Fair market value of property on the day of the foreclosure sale is \$100,000.
- Lender purchases property at foreclosure sale with its opening bid of \$75,000. Later, the lender re-sells the property for \$80,000.
- Borrower will not be liable for any deficiency because the fair market value of the property on the day of the foreclosure sale equaled the borrower's total indebtedness. The re-sale amount is not relevant to the deficiency.

### Example #2

- Borrower owes \$100,000 (including costs of foreclosure and attorneys' fees).
- Fair market value of property on the day of the foreclosure sale is \$75,000.
- Lender purchases property at foreclosure sale with its opening bid of \$80,000. Later, the lender re-sells the property for \$60,000.

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- In this circumstance, the borrower will be liable to the lender for a deficiency in the amount of \$20,000 because the borrower's total indebtedness exceeds the sale price by \$20,000, and the sale price was greater than the fair market value of the property on the day of the foreclosure sale. Once again, the re-sale amount is not relevant to the deficiency.

If the lender and borrower cannot reach an agreement to resolve a deficiency and the lender wants to attempt to recover the deficiency, the lender may file a lawsuit against the borrower and/or any guarantor to collect the deficiency. In a deficiency lawsuit, often the only contested issue is the fair market value of the property on the day of the sale. Since the fair market value of the property is a factual matter, the lender may have a difficult time prevailing on summary judgment, depending on how actively the borrower is defending itself. If the lender and the borrower are actively litigating the matter, appraisals can be very important and the litigants may have competing appraisals that the judge must evaluate. On the other hand, if the deficiency lawsuit is not contested by the borrower, the lender may prove the fair market value of the property on the day of the sale by using sources other than an appraisal, such as a realtor the lender may have engaged to market the property after the foreclosure, or even the property's assessed value.

### Statute of Limitations For Deficiency Actions

The most important provision of the Nebraska Trust Deeds Act in regard to deficiency actions is the shortened statute of limitations. The Trust Deeds Act provides that the lender must file its lawsuit to collect a deficiency against the borrower within three months after the date of the foreclosure sale. Neb. Rev. Stat. § 76-1013; *See Sports Courts of Omaha v. Meginnis*, 242 Neb. 768, 497 N.W.2d 38 (1993). As a result, lenders do not have a great deal of time to negotiate with a borrower to resolve a deficiency after a foreclosure sale, and the lender may need to file its lawsuit, even during negotiations, simply to protect its rights. Lenders' attorneys must also be sure that their clients are aware of this shortened statute of limitations and the need to make a quick decision whether or not to pursue a deficiency action against a borrower.

A lender may also pursue a deficiency action against any party who guaranteed the borrower's indebtedness. Recently,

the Nebraska Court of Appeals held that the shortened three-month statute of limitations in Neb. Rev. Stat. § 76-1013 did not apply to a lender's deficiency lawsuit against a guarantor. *Boxum v. Munce*, 16 Neb.App. 731, 751 N.W.2d 657 (2008). In *Boxum*, the lender sued guarantors of two notes that were secured by a deed of trust. The borrowers defaulted, the lender foreclosed the property, and there was a deficiency after the foreclosure sale. More than two years after the foreclosure sale, the lender sued the guarantors.

The Nebraska Court of Appeals, noting that it was a case of first impression, held that the three-month statute of limitations does not apply to guarantors. The Nebraska Court of Appeals based its ruling on the language of Neb. Rev. Stat. § 76-1013, which states that the lender may commence an action "to recover the balance due upon the obligation for which the trust deed was given as security" within three months after the foreclosure sale (emphasis added). According to the Nebraska Court of Appeals, a guaranty from a third party, unlike a promissory note from the principal obligor, is not an obligation secured by a trust deed; rather, a guaranty is a separate and independent contractual obligation, and is itself further security for the principal obligation. *Boxum*, 16 Neb.App. at 739, 751 N.W.2d at 663. As a result, the five-year statute of limitations on actions on any agreements, contracts, or written promises in Neb. Rev. Stat. § 25-205 applies to deficiency lawsuits against guarantors.

### Conclusion

After a lender initiates a non-judicial foreclosure pursuant to the Nebraska Trust Deeds Act, the lender should analyze and evaluate the real estate before simply using its total debt amount as its initial bid. After considering the circumstances surrounding the real estate, the lender may determine it is in its best interest to bid something less than its total debt amount in an effort to encourage others to purchase the real estate. In addition, a lender that bids less than its total debt amount may preserve a possible deficiency action against its borrower and any guarantors. If the lender wants to proceed with a deficiency lawsuit, it is critically important that the lender is aware of the shortened three-month statute of limitations for deficiency lawsuits against borrowers; however, the three-month statute of limitations does not apply to deficiency lawsuits against guarantors. 