

# HOUSE BILL REPORT

## HB 2614

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### As Reported by House Committee On: Judiciary

**Title:** An act relating to residual debts following short sales of owner-occupied residential property secured by deeds of trust.

**Brief Description:** Limiting deficiency judgments pertaining to residual debts following short sales of owner-occupied residential property secured by deeds of trust.

**Sponsors:** Representatives Kenney, Ryu, Hasegawa and Santos.

#### **Brief History:**

##### **Committee Activity:**

Judiciary: 1/26/12, 1/30/12 [DPS].

#### **Brief Summary of Substitute Bill**

- Prohibits a beneficiary from obtaining a deficiency judgment, under certain circumstances, when there has been a short sale of residential real property secured by a deed of trust.

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### HOUSE COMMITTEE ON JUDICIARY

**Majority Report:** The substitute bill be substituted therefor and the substitute bill do pass. Signed by 12 members: Representatives Pedersen, Chair; Goodman, Vice Chair; Rodne, Ranking Minority Member; Shea, Assistant Ranking Minority Member; Eddy, Hansen, Kirby, Klippert, Nealey, Orwall, Rivers and Roberts.

**Staff:** Trudes Tango (786-7384).

#### **Background:**

In Washington, most loan obligations for residential real property are secured by deeds of trust. Under the Deeds of Trust Act, a beneficiary may use the non-judicial foreclosure process when a borrower defaults on the loan obligation. When there is a non-judicial foreclosure sale of residential real property under the Deeds of Trust Act, the beneficiary may not obtain a deficiency judgment.

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*This analysis was prepared by non-partisan legislative staff for the use of legislative members in their deliberations. This analysis is not a part of the legislation nor does it constitute a statement of legislative intent.*

A "short sale" is a real estate transaction in which the proceeds of the sale are insufficient to pay the debts encumbering the property and the borrower is unable to pay the difference. Selling the property in a short sale can be one option for the borrower to avoid foreclosure. Generally, a beneficiary with a security interest in the property must consent to receiving less than the beneficiary is owed in return for releasing its lien on the property. Depending on the terms of the agreement between the borrower and the beneficiary, the borrower may or may not be liable for the remaining amounts owed that are not covered by the sale.

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**Summary of Substitute Bill:**

A beneficiary may not obtain a deficiency judgment on the obligations secured by a deed of trust against a borrower in any case when, as a consequence of or in conjunction with a sale of owner-occupied residential real property resulting in proceeds that were insufficient to pay the obligation in full, the beneficiary reports to the Internal Revenue Service that the beneficiary has canceled all or a portion of the borrower's debt. This provision applies only when the property that was sold was occupied by the borrower as the borrower's principal residence at the time of the sale.

**Substitute Bill Compared to Original Bill:**

The substitute bill: (1) removes the provision prohibiting a beneficiary from obtaining a deficiency judgment when the beneficiary consented to the short sale; and (2) specifies that the bill only applies when the property that was sold was occupied by the borrower as the borrower's principal residence at the time of the sale.

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**Appropriation:** None.

**Fiscal Note:** Not requested.

**Effective Date of Substitute Bill:** The bill takes effect 90 days after adjournment of the session in which the bill is passed.

**Staff Summary of Public Testimony:**

(In support) Homeowners think they have extinguished their debt after a short sale, but they find out that the lender intends to collect the rest of the debt. The lender generates the Internal Revenue Service (IRS) form, then "double collects" by getting the benefit of the loss in its accounting but collecting the rest of the debt.

(With concerns) This is a good concept, but the specific language needs to be changed to provide more certainty and clarity for homeowners. The bill must be clarified so that it only applies to single family owner occupied residential real property and not to sales when the

home was used as collateral for a commercial loan. The bill should allow lenders to review the circumstances in its totality and allow lenders to say no to a short sale.

(Opposed) The second part of the bill regarding the lender consenting to the short sale is most problematic. If the bill is enacted as written, lenders will veto these sales because they will lose all ability to pursue a deficiency judgment. Community banks fund small business activities which are often funded with home equity lines of credit. The decision to release collateral for the short sale is separate from the decision to relieve the debt. The bank's ability to collect on a debt extends far beyond the single transaction. The notion of "double dipping" is not accurate. The bank would have to issue a revised IRS form and show it as income if the bank is still pursuing the debt. Short sales are complicated transactions. All parties who have a lien must agree to the sale and this type of legislation will make the process more complicated.

**Persons Testifying:** (In support) Representative Kenney, prime sponsor.

(With concerns) Bob Mitchell, Washington Association of Realtors; Stacy Augustine, Northwest Credit Union Association; and Denny Eliason, Washington Bankers Association.

(Opposed) Brad Tower, Community Bankers of Washington.

**Persons Signed In To Testify But Not Testifying:** None.