F I S C A L   I M P A C T   R E P O R T

SPONSOR Park **DATE TYPED** 2-21-05 **HB** 657

SHORT TITLE Deed of Trust Act Changes **SB**

ANALYST Ford

APPROPRIATION

Appropriation Contained		Estimated Additional Impact		Recurring or Non-Rec	Fund Affected
FY05	FY06	FY05	FY06		
			Minimal – See Narrative		

(Parenthesis ( ) Indicate Expenditure Decreases)

Duplicates SB 564

SOURCES OF INFORMATION
LFC Files

Responses Received From

Attorney General (AGO)
New Mexico Finance Authority (NMFA)
Regulation and Licensing Department (RLD)

SUMMARY

Synopsis of Bill

House Bill 657 makes several changes to the Deed of Trust Act. The bill removes restrictions on the use of deeds of trust to secure loans, thereby allowing the use of deeds of trust, instead of mortgages, for residential property (deeds of trust allow for non-judicial foreclosures in the case of default whereas mortgages require judicial foreclosures. Non-judicial foreclosure is generally more expeditious and less expensive).

The bill shortens the time that notice must be provided before a trust property can be sold from 180 days to 90 days and removes the requirement that notice be posted on the property and at the county courthouse. House Bill 657 repeals the current right to reinstate a deed of trust before a trust sale. It also provides for the continuation of a sale in the event of an undisclosed or unknown bankruptcy. The bill provides a 9-month redemption period during which time, a beneficiary or junior encumbrancer may purchase a property that has been sold at public auction. Finally, the bill removes the current time limitation for a beneficiary to file a civil action for a deficiency judgment to recover remaining balances.

Significant Issues

House Bill 657 allows for the use of deeds of trust, and thereby non-judicial foreclosures, for all properties, not just large commercial or low-income properties. This may provide significant benefits to trustors (property owners) and to beneficiaries (lenders). However, it makes other changes to the Deed of Trust Act that could have significant negative impacts to the trustors, beneficiaries, junior encumbrancers (entities with a junior interest on the property, such as a bank holding a second deed of trust) and individuals purchasing property at public auction.

Repeal of restrictions on deeds of trust

The bill repeals Section 48-10-4 NMSA 1978 which limits the use of deeds of trust to business or commercial loans of $500 thousand or more and loans to benefit low income households. This has the effect of allowing deeds of trust to be used on any kind of property.

The use of deeds of trust to secure loans allows for non-judicial foreclosure when a person defaults on a loan. In general, non-judicial foreclosure is more expeditious than judicial foreclosure and is less expensive for all parties involved.

Repeal of right to reinstate

The bill repeals Section 48-10-16 NMSA 1978, which gives a person the right to reinstate the deed of trust up until the day before a sale. This could be a detriment to trustors as well as junior encumbrancers.

Under current law, if a person defaults on his/her deed of trust, he/she can reinstate the deed of trust before the property is sold by paying the amount due plus other specified costs. This section also gives another person the right to reinstate the deed of trust. For example, a junior lienholder who stands to lose his/her investment if the property is sold at auction could reinstate the loan and thereby stop the foreclosure. This would allow the junior lienholder to protect his/her interest in the property by essentially taking over the senior loan. If the trust property is sold at auction and does not receive a high enough bid price to cover all of the outstanding obligations, the junior encumbrancers simply lose their investment.

Repealing this section removes an important opportunity for trustors to avoid foreclosure and for junior encumbrancers to protect their investments. For example, a homeowner could have accrued hundreds of thousands of dollars of equity in his home but fall behind on payments. Without the right to reinstate the deed of trust after the notice of sale has been made, the homeowner would have no way to stop the foreclosure except to file for bankruptcy. If that homeowner were only a few months behind in payments, he could theoretically lose his home and the equity over a few thousand dollars-worth of overdue payments.

Moreover, the junior encumbrancers lose a way to protect their investments by reinstating the deed of trust. The only way to protect their investment would then be to bid on the property at public auction or to redeem the property after sale at auction.

Posting requirements

The bill removes the current provision that requires the notice of sale to be posted at the property to be sold and at the courthouse of the county in which the property is located. Under the current provision, the notice does not have to be posted on the property if it would "breach the peace."

While the bill would continue to require that notice of sale be mailed to the trustor and all those with an interest in the property, as well as noticed in the newspaper, it would remove two avenues of potential notification. Given the seriousness of foreclosing on a person's property, is it wise to remove this notification? If for some reason the trustor did not receive the notice of sale in the mail, the posted notice on the property could provide the person with the only notification that his/her property is going to be sold. In addition, notification at the courthouse provides information to potential investors who may wish to bid at auction. It is in the best interest of the beneficiary, the trustor, and the junior encumbrancers for the property to sell for the highest amount possible at public auction.

Redemption right for beneficiaries and junior encumbrancers:

The bill provides that the beneficiary or junior encumbrancer may redeem the trust real estate up to 9 months after the sale at public auction by paying the purchaser the amount paid for the property, plus specified costs and interest at 10% per year.

These costs do not include the costs of any improvements the purchaser may have made to the property, and the total amount paid to redeem the property may be well below fair market value.

The parties may, in the deed of trust, shorten the redemption period to 1 month.

This provision raises a number of issues. First, it does not include the trustor in the ability to redeem a property sold at auction.

Second, it creates a cloud on the title of the property for 9 months. This would create a strong disincentive for an individual to purchase a property at auction. Investors purchasing properties at auction often wish to resell the property quickly, or make repairs and improvements and then resell the property. In some cases, the purchaser may actually wish to use the property as his/her residence or place of business. The 9-month redemption period would essentially put a freeze on any of this activity. A wise investor would not risk making expensive improvements to the property if there was a risk that the property could be bought back for only the original sale price. The private purchaser or the lender would likely find it difficult to sell the property to another individual as that individual would be hesitant to buy a property for market price knowing that it could be purchased back for a much lower price.

The effect of this change would likely be to lower the amount a property would bring at auction. This is a detriment to all parties. The money from the sale at auction is distributed first to the beneficiary for the amount owed plus specified costs, then to any junior encumbrancers and finally to the trustor. The lower the price at auction, the less likely that there will be enough money to be distributed to all who have an interest in the property.

The purpose of the redemption period is likely to protect junior encumbrancers from having their interests in a property wiped out by a trust sale. However, junior encumbrnacers receive the notice of sale and have the opportunity to protect their interests by bidding on the property at auction. It is important to note that the removal of the provision allowing for reinstatement of the deed of trust reduces the junior encumbrancer's ability to protect its investment before the sale.

Federal law gives the Internal Revenue Service a redemption right for any liens that it may have but that period lasts only 120 days.

<u>Removal of time limit for civil action</u>

House Bill 657 removes the time limit on bringing a civil action to recover deficiency judgment for the balance due. Current law limits this time to 12 months from the date of sale and if no action is brought in that time period, then the amount of sale is deemed in full satisfaction of the debt. By removing this time period, a beneficiary could go after the trustor years later to recover the remaining balance. Given that the foreclosure of one's home or business property can be financially devastating, is it not appropriate for there to be some point of final resolution for the trustor?

FISCAL IMPLICATIONS

By reducing the number of judicial foreclosures in favor of non-judicial foreclosures, the bill may result in cost savings to the courts.

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

This bill duplicates Senate Bill 564.

POSSIBLE QUESTIONS

Does the repeal of the provision allowing for reinstatement unduly damage the property owner's ability to protect his/her investment and avoid foreclosure?

Will the creation of a 9-month redemption period hinder the sale of properties at public auction?

Is it appropriate to remove the time period for a beneficiary to file a civil action for deficiency judgment of balance due?

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