

LAW REVIEW

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BUYING A HOME IN FORECLOSURE CAN BE TRICKY

Warning: boring column to follow.

In today's economic market, we are seeing all sorts of schemes reflecting declining property values and upside-down loans, where the loan amount is higher than the value of the property.

Some folks are trying to work with their lender to do so-called "short sales" where the lender agrees to let the owner sell the property for less than the amount of the loan balance. From what I have seen, most lenders are impossible to work with and owners trying to work with lenders on short sales ultimately walk away from the property allowing it to be foreclosed upon.

That is unfortunate because in many cases short sales make sense for the lender as well as the upside-down owner.

Home Equity Purchases

Another common scenario is when an investor buys a residential property from an owner while it is in foreclosure, which is called a home equity purchase. Be careful.

A home equity purchase occurs when an owner-occupied, 1-4 unit residential property in foreclosure (Notice of Default has been recorded) is purchased for rental or investment purposes by a buyer--called an equity

purchase investor. The Legislature assumes that buyer is taking advantage of the unfortunate homeowner who is unable to keep current on the loan.

A home equity purchase contract, which could include a short sale if an investor is buying from a homeowner in foreclosure, must be printed in at least 10-point bold type and contain specified notices to the seller including a 5-day notice of right to cancel. Failure to use the correct form, in particular the notice to cancel, allows the home equity seller to later cancel the contract and subjects the buyer to damages and harsh penalties. Civil Code section 1695.

Homeowner in Foreclosure

Months ago we wrote about a case where the court allowed a homeowner in foreclosure to later rescind a contract to sell to a real estate broker who purchased the property while it was in foreclosure. The real estate broker/buyer neglected to include the notice of right to cancel in the contract.

Another case came down last month with similar facts, *Hoffman v. Lloyd*.

New Case

Lloyd owned and lived in a single-family home in San Francisco. He fell behind on his mortgage payments. Hoffman purchased the property while in foreclosure, closed escrow and leased back the home to Lloyd, who had a two-year option to repurchase the property from Hoffman. Potential win-win. The parties did not use a CAR home equity purchase contract and did not include the mandatory 5-day notice of right to cancel. Fatal mistake.

Lloyd fell behind on his rental payments and was evicted by Hoffman. As part of the eviction proceedings Lloyd and Hoffman entered into a mutual release of all claims, known and unknown.

Lloyd, the original owner—now evicted, filed bankruptcy, then sued to rescind the sale to Hoffman because the contract did not include the notice of right to cancel.

Rescission

The Court of Appeal concluded that notwithstanding the general release, because Lloyd was not notified of his right to cancel when he sold to Hoffman while in foreclosure, he was entitled to get the property back.

Boring Column

This is a certified boring *Law Review*, but I wrote it because I couldn't think of anything else, and to emphasize that if you buy an owner-occupied home as an investment while it is in foreclosure, which is happening these days, make sure you use the correct contract form with the proper notices.

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