

Prudent Bidding on Real Estate at a Foreclosure Sale

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A Binding Contract

In a traditional real estate purchase transaction, a willing buyer and a willing seller enter into a negotiated contract which customarily provides that the buyer may terminate the contract if the results of a property inspection or title examination are not satisfactory. At a foreclosure sale, the final highest bid creates a binding "as is" contract on the terms set forth in the Notice of Sale regardless of whatever defects there may be in the physical condition of the property or its title. The high bidder has no right to terminate the contract after the bid becomes final. If the high bidder refuses to close due to the physical condition of the property or the status of its title, the foreclosure trustee has the right to hold the bidder to the contract and seek to recover all damages incurred due to the bidder's default. Consequently, before making a bid that ultimately could create a binding contract with no exit options, a prudent bidder will consider several issues.

Title Issues

Although a foreclosure sale may generate enough money to satisfy certain liens against the property, the proceeds may not necessarily pay off all such liens and will not cure other preexisting liens or title defects. Property at a foreclosure sale is sold subject to all prior or superior liens and encumbrances. If, for example, the deed of trust being foreclosed is a second-lien deed of trust, the high bidder will take title to the property subject to the first-lien deed of trust. Also, if a property owner has defaulted on a mortgage, there is great probability that the owner has defaulted on other obligations, giving rise to the possibility of judgment liens against the owner which may take priority over the deed of trust being foreclosed. Further, even if the deed of trust being foreclosed was recorded prior to other liens, the other liens may be superior and will survive the foreclosure if the deed of trust being foreclosed was subordinated to the later lien, or if the later lien has "super" priority status (such as a tax lien). Additionally, the lender whose deed of trust is being foreclosed may not have searched title to the property carefully when making the loan, and the title may be subject to a serious, or even fatal, title defect. In that case, the foreclosure will not cure the defect, and the bidder will take title subject to the defect. Finally, as mentioned above, the foreclosed property will be sold subject to unpaid taxes, so any title search also should include a detailed review of the property tax records. Prior to bidding, therefore, a prudent bidder will examine title to the property to determine what liens and encumbrances exist against the property and will survive the foreclosure.

Procedural Issues

Foreclosure sales must be conducted in strict compliance with detailed sale procedures imposed by North Carolina law. If the proper procedures are not followed, the winning bidder may become embroiled in litigation with the former owner claiming ownership of the property or with a lienholder claiming its lien was not extinguished due to the failure of the foreclosing trustee to follow one or more of the required procedures. Any title examination, therefore, should include an investigation into the foreclosure trustee's

compliance with the complicated procedures mandated by statute. The winning bidder should monitor the trustee's actions closely and require strict adherence to use of the correct procedures.

Environmental Issues

Beyond the title and readily observable physical condition of the property being foreclosed, a prudent bidder will be concerned about the environmental condition of the property, something not generally ascertainable by a brief visit to the property prior to the sale. The law generally exempts an "innocent owner" from clean-up liability for certain types of contamination, but, to qualify as an "innocent owner," the owner must have made "all appropriate inquiries" by having a qualified person investigate the property for the possible existence of contamination prior to purchase. Some of this investigation will involve a review of the public records, but an on-site examination also is required. This may not be possible when purchasing at a foreclosure sale due to the lack of legal access to the property and its structures prior to closing. An interested bidder, therefore, should consult an attorney to evaluate the steps that may be taken and what environmental risks are involved.

The Holdover Owner

Once the high bidder has closed on the purchase, it's not always smooth sailing. Often, owners who have been the subject of a foreclosure, having essentially nothing to lose, no desire to leave "their" property, and no reason to take care of it, will not vacate willingly. If the previous owner rented the property to tenants prior to the foreclosure, the tenants also may have no motivation to vacate or maintain the property. Since self-help eviction is not permissible in North Carolina for residential properties and not wise with respect to commercial properties, the purchaser at foreclosure is left with the unenviable task of evicting the occupants through legal proceedings. This can be costly and time-consuming, thereby delaying the purchaser's ability to access the property to inspect its physical condition and begin desired renovations, while giving the disgruntled occupant more time in which to damage the property. Quick and decisive legal action is required to gain exclusive possession of the property.

Conclusion

The recession and the current commercial refinance situation have resulted in the possibility of purchasing desirable commercial and residential properties for "fire-sale" prices at foreclosure sales. In order to protect against the risks discussed above, a prudent bidder interested in buying property at a foreclosure sale will, prior to making a bid, spend the time and money necessary to conduct, to the extent possible, the same investigations conducted by buyers in traditional real estate purchase transactions. Otherwise, the bidder may not get the bargain envisioned.

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For further information regarding the issues described above, please contact Clifford P. Parson.

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