

ISSUES AND OBSERVATIONS ON FORECLOSURES IN TENNESSEE

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Many people have asked me to write an article on foreclosures and issues and concerns I may have about deed of trust foreclosures and the process followed in this State. Please take note what I will deal with tax sales in a later article and this article deals only with deed of trust foreclosures which are also called power of sale foreclosures. In attempting to do this at this time it is important to make sure the readers understand some of the basic terminology about foreclosures. The standard mortgage security document used in Tennessee real estate loan transactions is called a deed of trust. It is not the same as a warranty deed but is rather a security document in which the borrower conveys his or her interest in real property to a trustee to and for the benefit of a lender. In this manner the real estate is pledged to secure the loan of money to a borrower. The trustee is normally appointed by the lender and they serve as the equitable title holder of the property until the debt is paid at which time a release is recorded in the Register of Deeds office. If default by the borrower occurs, they serve until they conduct a foreclosure sale or until they are replaced by a substitute or successor trustee appointed by the lender. In the majority of cases, a substitute or successor trustee is appointed by the lender to contract the actual foreclosure sale and a notice of appointment of this person will be recorded in the Register of Deeds office a few weeks before a notice of sale appears in a local newspaper. For the purposes of this article, I will refer to a trustee and any successor or substitute trustee as the trustee.

The term “power of sale” refers to the process employed to sell the real estate when a default occurs per the note or deed of trust. This process, which is used in a minority of states in

the U.S., allows the trustee to sell the collateral upon notice of default from the lender without any court intervention or process. In the majority of states in the U.S, the process of judicial foreclosure is the process used and it normally results in a sheriff's sale after a lawsuit to foreclose is ended. In Tennessee, through power of sale, which right is created in the deed of trust, the sale time and date is set by the trustee (or the substitute to successor trustee) in a notice of foreclosure or notice of sale published in a newspaper of general circulation in the county where the real estate subject to the lien of the deed of trust is located. Tennessee statutes set forth requirements that the notice must be published at least three times in some newspaper published in a county where the property is located and that the first publication must be at least 20 days previous to the sale (T.C.A 35-5-101). The trustee conducting the sale chooses the time and place of the sale and this must be reflected in the notice of sale (T.C.A. 35-5-104). The location of the sale is normally held at the local courthouse or the seat of the local government but this appears to be a gray area of the law in that the trustees in this area have selected other locations like the Gaylord Arena. In addition, this same statute now requires that every claimed lien of the U.S. and the State of Tennessee be identified in the notice and that the notice shall indicate that proper notice has been given to the U.S. Government and the State. The trustee is free to conduct the sale in any commercially reasonable manner as long as she or he conducts the sale in compliance with state law and the language contained in the deed of trust.

One of the main reasons that I feel that this article is timely is that since 9-11 many real estate investors have viewed foreclosure sales as a way to add property to their portfolios or to purchase property for re-sale. It also seems now to be ancient history but for most of the twenty years I have been in law practice, foreclosure sales were sparsely attended and very few people actually were serious bidders at foreclosures sales. That has changed and many of the persons

who now attend these sales have questions about the process, the sale itself, and the status of title a buyer obtains at sale. I probably could and should write a book on this but the issues and observations listed below are an attempt to answer the most common questions I receive about power of sale foreclosures:

1. Do I need to sign a purchase contract if I am the highest bidder? The older custom of requiring the high bidder to sign a written purchase agreement seems to have faded out of practice, at least in the Nashville area. However, the law seems to still be that foreclosure sales are sales of real estate and are subject to the statute of frauds and that a written contract is needed if the seller intends to enforce the sale in the courts. This was determined in the U.S. 6th Circuit Court of Appeals case of Watson v. McCabe in 1975. However, most trustees do not require a written contract and it appears that they are willing to fall back on the next high bidder to purchase the property if the high bidder does not complete the purchase.

2. How long to I have to obtain financing if I am the high bidder? The simple answer is you need to have your financing lined up when you bid if you really want to acquire the property. The trustee sets the time for payment usually by announcement at sale and you are bound by the timeframe they set. This timeframe may be from a few hours to 72 hours as determined by the trustee.

3. Does the notice in the paper cover all the terms of sale? No. The terms of sale are governed by the deed of trust, the notice and announcements made at sale by the trustee. If you fail to listen to the announcements made at sale you will be making a serious mistake. The

announcements can cover a variety of matters including whether a property has been withdrawn from sale ,bidding procedures, problems with title, etc.

4. Why are many properties that are advertised for sale not actually sold? This happens for a variety of reasons. The most common reasons are the arrearage is paid by the borrower or the borrower had filed for bankruptcy protection. Also, sometimes the lender discovers title problems that need to be cured before sale. The trustee and lender can call off the sale at any time before actual sale occurs and they are not required to appear and give notice of the cancellation of the sale although some do.

5. Does the trustee guarantee clear title to the property sold? No. The title conveyed by the trustee is by trustee deed which is similar to a quitclaim deed. They are conveying whatever interest they have as a result of serving as trustee at the request of the lender. Title to these properties may have clear title but just as often there can be some flaws. Problems can result from missed IRS and state liens, the existence of prior deeds of trust that have not been paid, ownership issues arising out of estates or divorces, bankruptcy issues and faulty deeds of trust. It is important for investors who want to bid at these sales to learn how to review title records first to avoid problems. The trustee is there to sell the property not to protect you as your attorney. At a minimum, bidders should know whether any tax liens affect the title and whether or not the deed of trust being foreclosed upon is in first position. If not, you will take title subject to all prior liens. A simple rule of thumb is that priority is king. A foreclosure based upon a lien or deed of trust recorded prior to later liens or deeds of trust has priority and generally will result in the extinguishing of liens with later priority. Likewise, foreclosure on a lien or deed of trust with a later priority will not extinguish liens or deeds of trust with priority.

6. How much do I have to bid initially at a sale? This is set by the trustee who normally makes an initial bid on behalf of the lender. Before the bidding starts, the trustee will usually announce the increments that each bid can be raised. For example, a trustee might announce that bids must be in \$1000 increments or he/she can disqualify your bid.

7. What if I buy a property and the house or building is occupied? You probably have tenants at sufferance. This is a status for persons who obtained access to the property legally but no longer have legal rights to the property. This can be the former owner or tenants of the former owner or maybe unknown persons. You will have to file an action for unlawful detainer in the General Sessions Court to begin the eviction process.

8. Can groups of investors get together to attempt to control or influence bidding? This is a growing hot topic. The sale must be commercially reasonable to be viable sale. It must meet the statutes we have discussed and be consistent with the deed of trust. The trustee or person calling the sale must not be in collusion with any bidder nor can there be “hidden” deals between the trustee and any bidder. Otherwise, my research indicates that it is pure capitalism at work. Bidders are allowed to discuss bid strategy and work together to purchase property. Although this is somewhat controversial, I have found no law to prohibit one bidder from requesting that another bidder not bid at a particular sale, even if compensation is involved. What really seems to be in effect is that as a bidder, you need to be aware that other bidders may be working together and that even if you are the next high bidder you may still end up with the property if the high bidder does not perform. You also need to realize that some bidders may be working together and that two or more bidders may really be part of the same “team.”

9. If the property has IRS or State tax liens, how long do I have to wait to have title clear from these liens? If proper notice is sent to the IRS or the state as required by law, the lien will

expire 120 days after the sale. If proper notice is not given the property will remain subject to the lien. Proper notice to the IRS or state is extremely important and a copy of the letter from the appropriate government agency acknowledging receipt of notice from the trustee should be attached and recorded with your deed. If not, make sure the trustee provides a copy of this letter to you.

10. What do I do if the property is in bad condition or is not what I expected? These sales are “as-is” sales and you will have to take the property as it is.

I hope this information proves helpful to you in your investment career. Foreclosure purchases can be profitable but as experienced buyers will confirm there can also be expensive pitfalls and losses. Knowledge of the property and the process is essential . For any questions or information, please do not hesitate to contact me at bnotestine@hotmail.com or bob@bellemeadetitle.com.

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