

# FORECLOSURE AND DEFICIENCY JUDGMENT

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## **FORECLOSURE.**

Foreclosure is a proceeding in equity whereby a mortgagee either takes title to or forces the sale of a mortgagor's property in satisfaction of a debt. A foreclosure results in a termination of all rights of a mortgagor or his grantee in the property conveyed by the mortgage (Deed of Trust). The following is an overview of the foreclosure process in North Carolina.

**1. Default.** After default of a promissory note, the first step in the foreclosure process is a pre-foreclosure demand/notice letter by the note-holder or servicer to the homeowner, informing them of the default; providing a summary of the outstanding balance, description of the charges, and calculating interest accruing on a daily basis; indicating that foreclosure will/may begin in 45 days, and providing other notices required under Chapter 45 including all fees and expenses (such as that attorney's fees may be incurred which the homeowner will be responsible for paying) and opportunity to cure. The pre-foreclosure demand/notice letter must be sent to the last known address of the borrower. The servicer or note holder must also file all loans with the Commissioner of Banks ("COB") within 3 business days of mailing the pre-foreclosure notice, such filing to include: i) the name and address of the borrower; ii) the due of the last scheduled payment made by borrower; iii) the date the pre-foreclosure notice was mailed to borrower; iv) and payment of \$75.00 to the State Home Foreclosure Prevention Trust Fund managed by COB.

In addition to the 45 day pre-foreclosure notice, each party entitled to receive a notice of hearing of the foreclosure action must also receive a written statement within 30 days of the date of the notice of hearing addressed to the borrower's last known address setting out the amount of principal and interest that the noteholder claims is owed as of the date of the written statement, a daily interest charge based on the contract rate, and other expenses that the noteholder contends is due.

**2. Notice of Foreclosure Hearing.** After 45 days expires from the time of the pre-foreclosure notice, the foreclosure may be commenced by filing of a Notice of Foreclosure Hearing, noticing a hearing at which the Trustee or Substitute Trustee will seek an order permitting the sale of the property to satisfy the underlying deed of trust. The Notice of Hearing must be served upon any person to whom the Deed of Trust directs that notice be given, any person obligated to pay the debt, any person whom the holder intends to assert liability, and every record owner of the real property encumbered by the deed of trust. You theoretically could have the foreclosure hearing 20 days after the Notice of Foreclosure Hearing was filed (if you could serve it on the day of filing), but given service issues and the like, the foreclosure hearing is usually noticed for a day 45-60 days after filing of the Notice.

**3. Foreclosure Hearing.** At the Foreclosure Hearing, the Trustee must show that the existence of a valid debt, a default of payment of the debt, a security interest in the property, notice to those entitled to notice of the foreclosure hearing, and agreement that the security interest can be foreclosed, upon which the Court will give an Order permitting the sale of the property to satisfy the Deed of Trust. The Trustee does not have to be an attorney and it is permissible for an attorney to represent both the Trustee and the noteholder provided the attorney is not the trustee.

The Clerk's decision may be appealed to Superior Court and is then heard de novo at the next succeeding term of Court ten days or more from the hearing and such hearing will take precedence over all other trials. If the appealing party posts a bond then the Clerk must stay the foreclosure pending the appeal. If no bond is posted and assuming the Trustee obtains an order

authorizing the sale then in that event the Trustee can proceed with the sale even though the borrower had filed an appeal. The bond amount is one percent (1%) of the principal balance due on the note or less in the Clerk's discretion upon a finding of hardship or good cause so long as the appealing party owns and occupies the property.

**4. Notice of Sale.** After entry of the Foreclosure Order, the Trustee will normally notice the sale of the Property, on a date which must be at least 20 days later. The Notice of Sale will include, among other things: i) the date, time and place of sale; ii) description of property to be sold; iii) terms of the sale including cash deposits; and iv) that the property will be subject to taxes and special if it is sold. The notice of sale must also be published in a newspaper once a week for at least 2 successive weeks.

[You can file the Notice of Sale of the property before you get the foreclosure order, but that is not how it is usually done. In that regard, there are often service or other issues that cause foreclosures to be continued, and if you noticed the sale of the property before the original hearing and it is continued, you will have wasted time and money with respect to the proposed sale].

**5. Sale.** The Trustee will conduct the sale on the date noticed, or a date to which the Trustee thereafter postpones the sale, and file a Report of Foreclosure Sale/Resale. The homeowner may redeem the property at any time within ten (10) days of the sale. After the tenth day, if no upset bid is filed, the foreclosure sale is final.

**6. Trustee's Deed.** The Trustee will convey the property by Trustee's Deed, after the ten (10) days, and after tender of the purchase price, to the highest bidder. The highest bidder has a reasonable time to tender the remainder of the purchase price.

**7. Final Report.** The Trustee will file a Final Report and Account, and the Clerk will approve (hopefully). That process is taking some time these days because of a large backlog, although it could be done the day after the Trustee's Deed is recorded.

**8. Application For Order.** The owner can file an Application for Order, and a Notice of Application, giving the prior owner notice that in ten (10) days the owner will apply for an order to evict the prior owner. After the tenth day, the new owner can petition the court and have an order entered providing for the eviction of the old owner.

**9. Eviction.** After the order is entered giving the new owner possession, the Sheriff will evict, usually within two (2) weeks of entry of the order.

**10. Restrictions On Foreclosure For Military Service.** On January 1, 2011, G.S. §45-21.12A entitled "Power of Sale Barred During Periods of Military Service" became effective and applies to all foreclosures filed on or after January 1, 2011. The legislature's stated intent was to supplement and complement the provisions of the Service Member's Civil Relief Act, 50 USC app. Sec. 501, et seq. and to provide greater peace of mind and security for persons in federal active duty (see G.S. §45-21.12A(c)). A power of sale foreclosure is barred during or within ninety days after a borrower's, trustor's or debtor's period of military service. A foreclosure hearing pursuant to G.S. §45-21.16(d) cannot be conducted by the clerk unless a certification provided by a mortgagee, trustee or other creditor seeking foreclosure is filed with the clerk certifying that the hearing will not take place during or within ninety days after a period of military service for the mortgagor, trustor or debtor. This statute only applies to mortgages or deeds of trust that originated before the mortgagor's period of military service.

**11. Tenants of Foreclosed Properties.** The Protecting Tenants at Foreclosure Act (PTFA) went into effect and applies to foreclosures on residential properties occurring after May 20, 2009. This is a federal statute, and trumps state law. As stated in its title, the purpose of the act is to protect bona fide tenants from foreclosures by requiring a minimum 90 day notice to vacate. A tenant is considered a bona fide tenant if (1) the tenant is not the mortgagor or the child, spouse, or parent of the mortgagor under the contract (2) the lease or tenancy was the result of an arms-length transaction; and (3) the lease or tenancy requires the receipt of rent that is not substantially less than fair market rent for the property or the unit's rent is reduced or subsidized due to a Federal, State, or local subsidy. Any immediate successor in interest in such property pursuant to the foreclosure takes title to such property subject to sending a notice to vacate to any bona fide tenant at least ninety days before the effective date of such notice; and subject to the rights of any bona fide tenant, as of the date of such notice of foreclosure. Under a bona fide lease entered into prior to the notice of foreclosure, the bona fide tenant may remain occupying the premises until the end of the remaining term of the lease, assuming the tenant is abiding by the terms of the lease. Provided, a successor in interest may terminate a lease effective on the date of sale of the unit to a purchaser who will occupy the unit as a *primary residence*, subject to the receipt by the tenant of the ninety day notice to vacate. It does not matter if the lease is not recorded or if the lease is not in writing. A bona fide tenant is still entitled to a ninety day notice to vacate. If the occupant is not a bona fide tenant, then the occupant is only entitled to a ten day notice to vacate pursuant to North Carolina law.

## **DEFICIENCY JUDGMENTS AND EXCLUSIONS**

A deficiency is established, if at all, by the bid at the time of the sale. Thus, if the debt at the time of the sale was One Hundred and 00/100 Dollars (\$100,000.00) and the foreclosure sale generated Ninety Thousand and 00/100 Dollars (\$90,000.00) after costs and fees then the deficiency is determined at that time to be Ten Thousand and 00/100 Dollars (\$10,000.00). In order to collect on a deficiency, the lender is required to file a new civil action against the borrowers to collect the deficiency as established by the foreclosure sale. However, there are two circumstances where a noteholder may not obtain a deficiency judgment. First, if the note is a purchase money note where the seller financed the purchase of the property for the buyer by a purchase money promissory note and deed of trust. Second, a noteholder cannot obtain a deficiency judgment against a borrower on any deed of trust recorded after January 1, 2010, whether by power of sale or judicial action so long as the property encumbered by the deed of trust was occupied by the borrower as her principal residence at the time the foreclosure action is commenced, and such loan is a “*nontraditional mortgage loan*” as defined in N.C.G.S.A. § 45-21.38A.

### **N.C.G.S.A. § 45-21.36**

#### **Chapter 45. Mortgages and Deeds of Trust**

##### **☞ Article 2B. Injunctions; Deficiency Judgments**

##### **➡ § 45-21.36. Right of mortgagor to prove in deficiency suits reasonable value of property by way of defense**

When any sale of real estate has been made by a mortgagee, trustee, or other person authorized to make the same, at which the mortgagee, payee or other holder of the obligation thereby secured becomes the purchaser and takes title either directly or indirectly, and thereafter such mortgagee, payee or other holder of the secured obligation, as aforesaid, shall sue for and undertake to recover a deficiency judgment against the mortgagor, trustor or other maker of any such obligation whose property has been so purchased, it shall be competent and lawful for the defendant against whom such deficiency judgment is sought to allege and show as matter of defense and offset, but not by way of counterclaim, that the property sold was fairly worth the amount of the debt secured by it at the time and place of sale or that the amount bid was substantially less than its true value, and, upon such showing, to defeat or offset any deficiency judgment against him, either in whole or in part: Provided, this section shall not affect nor apply to the rights of other purchasers or of innocent third parties, nor shall it be held to affect or defeat the negotiability of any note, bond or other obligation secured by such mortgage, deed of trust or other instrument: Provided, further, this section shall not apply to foreclosure sales made pursuant to an order or decree of court nor to any judgment sought or rendered in any foreclosure suit nor to any sale made and confirmed prior to April 18, 1933.

### **N.C.G.S.A. § 45-21.38**

#### **Chapter 45. Mortgages and Deeds of Trust**

##### **☞ Article 2B. Injunctions; Deficiency Judgments**

##### **➡ § 45-21.38. Deficiency judgments abolished where mortgage represents part of purchase price**

In all sales of real property by mortgagees and/or trustees under powers of sale contained in any mortgage or deed of trust executed after February 6, 1933, or where judgment or decree is given for the foreclosure of any mortgage executed after February 6, 1933, to secure to the seller the

payment of the balance of the purchase price of real property, the mortgagee or trustee or holder of the notes secured by such mortgage or deed of trust shall not be entitled to a deficiency judgment on account of such mortgage, deed of trust or obligation secured by the same: Provided, said evidence of indebtedness shows upon the face that it is for balance of purchase money for real estate: Provided, further, that when said note or notes are prepared under the direction and supervision of the seller or sellers, he, it, or they shall cause a provision to be inserted in said note disclosing that it is for purchase money of real estate; in default of which the seller or sellers shall be liable to purchaser for any loss which he might sustain by reason of the failure to insert said provisions as herein set out.

**N.C.G.S.A. § 45-21.38A**

**Chapter 45. Mortgages and Deeds of Trust**

**Article 2B. Injunctions; Deficiency Judgments**

**§ 45-21.38A. Deficiency judgments abolished where mortgage secured by primary residence**

(a) As used in this section, the term “*nontraditional mortgage loan*” means a loan in which all of the following apply:

- (1) The borrower is a natural person.
- (2) The debt is incurred by the borrower primarily for personal, family, or household purposes.
- (3) The principal amount of the loan does not exceed the conforming loan size for a single family dwelling as established from time to time by Fannie Mae.
- (4) The loan is secured by: (i) a security interest in a manufactured home, as defined in [G.S. 143-145](#), in the State that is or will be occupied by the borrower as the borrower's principal dwelling; (ii) a mortgage or deed of trust on real property in the State upon which there is located an existing structure designed principally for occupancy of from one to four families that is or will be occupied by the borrower as the borrower's principal dwelling; or (iii) a mortgage or deed of trust on real property in the State upon which there is to be constructed using the loan proceeds a structure or structures designed principally for occupancy of from one to four families that, when completed, will be occupied by the borrower as the borrower's principal dwelling.
- (5) The terms of the loan: (i) *permit the borrower as a matter of right to defer payment of principal or interest; and (ii) allow or provide for the negative amortization of the loan balance.*

(b) Except as provided in subdivision (6) of subsection (c) of this section, this section applies only to the following loans:

- (1) A loan originated on or after January 1, 2005, that was at the time the loan was originated a rate spread home loan as defined in [G.S. 24-1](#). 1F.
- (2) A loan secured by the borrower's principal dwelling, which loan was modified after January 1, 2005, and became at the time of such modification and as a consequence of such modification a rate spread home loan.
- (3) A loan that was a nontraditional mortgage loan at the time the loan was originated.
- (4) A loan secured by the borrower's principal dwelling, which loan was modified and became at the time of such modification and as a consequence of such modification a nontraditional mortgage loan.

(c) This section does **not** apply to any of the following:

- (1) A home equity line of credit as defined in [G.S. 45-81\(a\)](#).
- (2) A construction loan as defined in [G.S. 24-10\(c\)](#).
- (3) A reverse mortgage as defined in [G.S. 53-257](#) that complies with the provisions of Article 21 of Chapter 53 of the General Statutes.
- (4) A bridge loan with a term of 12 months or less, such as a loan to purchase a new dwelling where the borrower plans to sell his or her current dwelling within 12 months.
- (5) A loan made by a natural person who makes no more than one loan in a 12-month period and is not in the business of lending.
- (6) A loan secured by a subordinate lien on the borrower's principal dwelling, unless the loan was made contemporaneously with a rate spread home loan or a nontraditional mortgage loan that is subject to the provisions of this section.

(d) In addition to any statutory or common law prohibition against deficiency judgments, the following shall apply to the foreclosure of mortgages and deeds of trust that secure loans subject to this section:

(1) For mortgages and deeds of trust recorded before January 1, 2010, the holder of the obligation secured by the foreclosed mortgage or deed of trust shall not be entitled to any deficiency judgment against the borrower for any balance owing on such obligation if: (i) the real property encumbered by the lien of the mortgage or deed of trust being foreclosed was sold by a mortgagee or trustee under a power of sale contained in the mortgage or deed of trust; and (ii) the real property sold was, at the time the foreclosure proceeding was commenced, occupied by the borrower as the borrower's principal dwelling.

(2) For mortgages and deeds of trust recorded on or after January 1, 2010, the holder of the obligation secured by the foreclosed mortgage or deed of trust shall not be entitled to any deficiency judgment against the borrower for any balance owing on such obligation if: (i) the real property encumbered by the lien of the mortgage or deed of trust being foreclosed was sold as a consequence of a judicial proceeding or by a mortgagee or trustee under a power of sale contained in the mortgage or deed of trust; and (ii) the real property sold was, at the time the judicial or foreclosure proceeding was commenced, occupied by the borrower as the borrower's principal dwelling.

(e) The court may, in its discretion, award to the borrower the reasonable attorneys' fees actually incurred by the borrower in the defense of an action for deficiency if: (i) the borrower prevails in an action brought by the holder of the obligation secured by the foreclosed mortgage or deed of trust to recover a deficiency judgment following the foreclosure of a loan to which this section applies; and (ii) the court rules that the holder of the obligation secured by the foreclosed mortgage or deed of trust is not entitled to a deficiency judgment under the provisions of this section. The amount of attorneys' fees to be awarded shall be determined without regard to the provisions of the loan documents, the provisions of [G.S. 6-21.2](#), or any statutory presumption as to the amount of such attorneys' fees.