

Date of Hearing: April 15, 2024

ASSEMBLY COMMITTEE ON BANKING AND FINANCE

Timothy Grayson, Chair

AB 2424 (Schiavo) – As Amended March 21, 2024

**SUBJECT:** Mortgages: foreclosure

**SUMMARY:** Establishes new notification requirements for mortgage servicers and minimum standards for bids made at the foreclosure sale.

Specifically, **this bill:**

- 1) Requires a mortgage servicer to include the following information about a third party, such as a family member, HUD-certified housing counselor, or attorney, in specified communications a borrower:
  - a) As part of a required initial contact with a borrower who has defaulted on their mortgage regarding options to avoid foreclosure, a notice that the third party may record a request to receive copies of default and notice of sale.
  - b) As part of its due diligence requirement to send a letter to the affected borrower, to notify the borrower that a third party may record a request to receive copies of any notice of the default and notice of sale.
- 2) Prohibits a sale from being conducted until 60 days after the recording of the notice of sale if the mortgagor or trustor provides the trustee and beneficiary with a listing agreement placed in a publicly available multiple listings service for the sale of the property.
- 3) Requires a trustee, after receiving a copy of a purchase agreement for the sale of the property, to postpone a date of sale by at least 45 days after the day on which the purchase agreement was entered into by the borrower.
- 4) Prohibits a trustee from selling a property at the initially scheduled date of sale for less than 75% of the fair market value, as defined, of the property, and establishes the following rules for this initial trustee's sale:
  - a) The trustee must accept the highest noncontingent bid even if there is a contingent bid with a higher purchase price.
  - b) While a prospective bidder may make an offer contingent on inspection and the ability to obtain third-party financing, the contingent bid can only be accepted if there are no noncontingent bids, and the bidder has 20 days for the date of the auction to notify the trustee in writing that all contingencies are satisfied, or else the bid fails.

**EXISTING LAW:**

- 1) Requires notice of a foreclosure sale to be given using the methods prescribed in statute, including by posting the notice in a conspicuous place on the property to be sold at least 20 days before the date of sale. Specifies that if the property is a single-family residence, the

notice must be posted on the door of the residence, if that is possible. (Civil Code Section 2924f (b)(3). All further statutory references are to this code, unless otherwise indicated.)

- 2) Establishes comprehensive procedures for conducting a foreclosure sale in the form of an auction. (Sections 2924g and 2924h.)
- 3) Establishes that each bid made by a bidder at a foreclosure sale shall be deemed an irrevocable offer by that bidder to purchase the property for the amount of the bid. (Section 2924h (a).)
- 4) Establishes that, so long as the trustee's deed upon sale is recorded within 15 calendar days of the foreclosure sale, it shall be deemed perfected as of 8 a.m. on the date the foreclosure sale was held. (Section 2924h (c).)

**FISCAL EFFECT:** Unknown. This bill is keyed Nonfiscal by Legislative Counsel.

**COMMENTS:**

1) **Purpose.**

According to the author:

Sadly, in too many real world situations, 120 days of failure to make a mortgage payment is not enough time to correct the situation. For example, in instances of a divorce, or the passing of an owner, four months just isn't sufficient for the marital, or deceased estate to make arrangements to either bring the loan current, or to otherwise sell the property for fair market value.

Under the current system, even if the home is listed for sale, the mortgage holder is within their rights and in fact frequently does move, shortly after 120 days has elapsed, to schedule a foreclosure auction. If a foreclosure auction occurs, the mortgage holder is not obligated to sell the property for fair market value. In many instances the home is sold for substantially less than FMV; selling for at, or slightly more than the outstanding mortgage. In those instances, the estate loses substantial equity in the home.

AB 2424 doesn't seek to prevent the mortgage holder from getting repaid, it only seeks to balance the equities, so that both the bank and the owner(s) of the property get their fair share of their interest in the value of the home.

For some families, a home is their only substantial asset. AB 2424 will reform the rules somewhat when payments have fallen behind due to unforeseen circumstances. AB 2424 seeks to preserve a minimal amount of equity in the property, while assuring the banks also get repaid.

2) **How do foreclosure sales work?**

Broadly speaking, foreclosure is the process by which a lender (the mortgagee) forces the sale of a home after the borrower (the mortgagor) fails to make housing payments. A deed of trust contains a power of sale clause allowing the lender to sell the home without going to

court. This nonjudicial foreclosure process, while occurring outside of the court system, nevertheless requires lenders and the foreclosure trustee (the third party managing the foreclosure process) to comply with a number of timeline and notification requirements meant to create an orderly process for all parties.

Generally, the nonjudicial foreclosure process works like this: A lender records a Notice of Default with the county registrar, and this notice tells the borrower the amount owed. Once the Notice of Default is recorded, the borrower has 90 days to pay what is owed. If the borrower is unable to pay that amount, the next step is the recording of a Notice of Trustee Sale, which establishes the date and location where the auction will occur. The Notice of Trustee Sale also starts new timelines for the borrower to pay off the loan or reach an agreement with the lender. If no agreement is made, the auction will take place and bids will be collected and the home will be sold to a third party. The homeowner receives any surplus balance that exists, if there is any, once the foreclosure trustee, the lender, or any other creditors with priority liens on the property are paid.

California's three-stepped non-judicial foreclosure process (Notice of Default, Notice of Trustee Sale, and Auction) added a fourth step in 2021 with the passage of SB 1079 (Skinner), Chapter 202, Statutes of 2020. SB 1079 establishes a post-auction sale that gives eligible bidders, including nonprofits or potential owner-occupants, an opportunity to match or exceed the last and highest bid made on single-family homes. This process, which must happen within 45 days of the foreclosure sale, is intended to increase owner occupancy of single-family homes, safeguard against tenant displacement, and protect communities from corporate investors buying up large quantities of foreclosed homes.

AB 2424, which is described in greater detail in Staff Comment #4, proposes new rules around the foreclosure sale process to lock in the best possible bid for both the homeowner and the lender.

### 3) **Homeowner Bill of Rights (HBOR).**

The California HBOR protects homeowners facing foreclosure by establishing notification requirements. When the HBOR first went into effect in 2013 following the passage of SB 900 (Leno), Chapter 87, Statutes of 2012, the effects of the 2008 mortgage crisis still lingered, and distressed homeowners were still plagued by a number of procedural and administrative challenges that stacked the deck against them in the foreclosure process. Borrowers complained about what was called "dual tracking," which occurred when the foreclosure process proceeded even while the borrower was separately discussing loan modification options with their servicer, the entity handling the day-to-day tasks of managing the loan. Other notable problems were the lack of a single person they could talk to about their specific situation, lost paperwork, and a lack of written commitments from servicers despite verbal promises made over the phone. While in theory borrowers may have had access to interventions such as loan medications or loan forbearance that could help keep them in their homes, in practice homeowners experienced a maze of procedural hurdles that made success extraordinarily difficult.

The HBOR, revised and extended by SB 818 (Beall), Chapter 404, Statutes of 2018, contains a number of important procedural protections, including:

- **Restrictions on dual tracking:** A mortgage servicer must generally pause the foreclosure process while it is making a decision on a loan modification application and until after a period during which the homeowner can appeal a denial. Moreover, HBOR prohibits foreclosure while the borrower remains compliant with the terms of a loan modification or another foreclosure-prevention option.
- **Notification of foreclosure-prevention options:** HBOR requires a loan servicer to try to contact a borrower at least 30 days before starting the foreclosure process to discuss options to avoid foreclosure.
- **Rules related to customer service.** HBOR also contains rules meant to prevent servicers from evading or misleading distressed homeowners. For example, a servicer must assign the borrower a single point of contact when the borrower requests a loan modification or other foreclosure prevention option. Also, the servicer must notify the applicant if there is missing or incorrect information in the application.

#### 4) What problem does AB 2424 address?

AB 2424 addresses a situation when a homeowner unnecessarily loses substantial equity in their home following a foreclosure sale. Because the borrower receives any excess equity once the mortgage loan is paid off, the financial impact of an excessively low sale price can be devastating for the distressed homeowner, especially one who has lived in the home for a long time. For example, in one case highlighted by AB 2424's sponsor, a homeowner's \$800,000 home was sold by the lender for just \$52,000, a loss of almost \$750,000 in potential home equity.

It is unclear how widespread the above-described problem is, but undoubtedly the foreclosure sale process does not concern itself with securing the best financial outcome for the borrower. The borrower is the last in line to receive the proceeds of a foreclosure sale, which is held first and foremost to make the lender and trustee whole. And, while HBOR provides borrowers vital protections, it was not enacted with the purpose of helping a borrower preserve home equity.

AB 2424 attempts to address this through new processes to maximize the opportunity for bids that are more favorable for the borrower. Specifically, AB 2424 would:

- **Allow for one more opportunity for the owner to sell the home.** The foreclosure sale is delayed by 60 days if the borrower provides the lender or the trustee with a listing agreement placed in a multiple listing service for the sale of the property, like a typical home would be sold. This listing must occur at least 5 days prior to the scheduled foreclosure sale, and this delay is only allowed one time. Moreover, if the borrower provides the trustee or the lender with a copy of the purchase agreement of the sale of the property, the trustee must delay the foreclosure sale another 45 days in order to give time for that sale to close.
- **Establish a minimum bid price for the first foreclosure sale.** A trustee cannot sell the property for less than 75% of the fair market value of the property. This minimum bid threshold follows a similar approach as Ohio to ensure the best outcome for the borrower.

Specifically, under Ohio law, the foreclosed home cannot be sold for less than two-thirds of the appraised market value.<sup>1</sup>

- ***Allows contingent bids, but prioritizes noncontingent bids.*** AB 2424 creates a separate mechanism for auction bids that are contingent on inspection outcomes and third-party financing. Specifically, contingent offers would now be allowed, but these bids would prevail only if they are above the 75% threshold and there are no noncontingent offers. This means that at this first sale, the trustee must accept a noncontingent offer that meets the bid price threshold, if there is one, even if there is a contingent bid that is higher.

The sponsors argue that the permissibility of contingencies will allow bidders who are not sophisticated investors or corporations to make a bid on a foreclosure sale, but the bill also puts parameters around those bids to protect against possible negative consequences for the person facing foreclosure. In effect, AB 2424 accepts the possibility of a lower sale price in exchange for more certainty that the first auction sale will be successful.

- ***Allows for more flexibility in the second foreclosure sale.*** In the event that there are no successful bids consistent with the rules for the first auction, or an accepted contingent bid falls through, then the trustee may conduct a second sale at least seven days after the first and accept the highest bid, no matter the bid price.

## 5) Policy considerations

The provision in AB 2424 that has generated the most debate and conversation is the allowance for contingent bids in the foreclosure sale process. As the sponsors argue, this will enable individual investors to be more competitive by allowing them an opportunity to inspect the home or organize financing, which reduces their risk in making a bid.

It is also possible that AB 2424's proposed contingent bid process could help guard against bid collusion or similar efforts to keep bids artificially low. One can imagine a group of five all-cash investors agreeing to keep their bids below the 75% threshold, thereby activating the second auction sale where the highest bidder prevails, regardless of price. In this scenario, allowing someone to compete against an all-cash buyer with a contingent bid could compel the cash buyer to increase their offer above the 75% threshold, a good outcome for the homeowner facing foreclosure.

But there are potential drawbacks, as well. Contingent bids introduce complexity and more opportunities for a failed outcome. And it could invite other manipulation opportunities from other investors. For example, a bidder could make a contingent bid with contingencies that are unlikely to be met, thereby automatically kicking the foreclosure sale into a second auction where they can offer a lower cash-only price. Moreover, a foreclosure sale can be risky for the buyer, which is one reason why this process attracts certain types of well-funded or corporate investors. AB 2424, by reducing – but not eliminating entirely – the risk for normal home buyers to participate, could end up exposing them to a variety of risks that do not exist in the normal home market.

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<sup>1</sup> Ohio Rev. Code § 2329.20

The contingent bid process is also the source of angst for AB 2424's opponents, including the California Bankers Association, the California Chamber of Commerce, and the California Land Title Association. Opponents to AB 2424 argue these provisions are impractical and counter to how foreclosure sales are typically managed. These groups' coalition letter points to a number of practical issues and concerns associated with introducing contingent bids, such as the impact on title insurance and how inspections would happen when the person losing their home remains on the property.

## 6) Proposed amendments.

The committee recommends amendments to remove the contingent bidding process. While such a bidding process could possibly help secure a good outcome for homeowners, the procedural uncertainties and possible unintended negative consequences for bidders or those facing foreclosure means that additional caution is warranted. Specifically, the committee recommends striking out the following provisions in Civil Code Section 2924f(e):

~~(e) (1) With respect to residential real property containing no more than four dwelling units that is subject to a first lien power of sale contained in a first lien deed of trust or mortgage, the mortgagee, beneficiary, or authorized agent shall provide to the trustee a fair market value of the property at least 10 days prior to the initially scheduled date of sale, and the trustee shall not sell the property at the initially scheduled date of sale for less than 75 percent of that fair market value of the property. All of the following requirements apply to the initial trustee's sale pursuant to this paragraph:~~

~~(A) A prospective bidder may make an offer contingent on their satisfactory inspection of the property and ability to obtain third party financing.~~

~~(B) The trustee shall accept the highest noncontingent bid even if there is a contingent bid with a higher purchase price.~~

~~(C) If all bids are contingent bids, the trustee shall accept the highest contingent bid.~~

~~(D) If the trustee accepts a contingent bid, the bidder shall have 20 days from the date of the auction to notify the trustee in writing that all contingencies are satisfied. The trustee shall not set a second sale date pursuant to paragraph (2) until the expiration of this 20-day period or the termination of the contingent bid, whichever is earlier.~~

~~(E) If the bidder of the accepted contingent bid fails to notify the trustee in writing that all contingencies are satisfied within 20 days from the date of the auction, the contingent bid is terminated and the trustee shall schedule a second trustee's sale pursuant to paragraph (2).~~

~~(F) If the mortgagor or trustor sells the property before the trustee receives written notification from the bidder that the contingencies have been satisfied, the contingent bid is terminated.~~

~~(G) Subject to subparagraph (F), the trustee shall finalize the sale when the trustee receives written notification that all contingencies have been satisfied.~~

~~(H) If a contingent bid fails to close following the first auction, the trustee shall schedule a second trustee's sale pursuant to paragraph (2).~~

(2) (A) If the property remains unsold after the initial trustee's sale pursuant to paragraph (1), then the trustee shall hold a second trustee's sale and the property may be sold to the highest bidder.

(B) The trustee shall not hold the second trustee's sale until at least seven days after the initial trustee's sale.

(3) For purposes of this subdivision, "fair market value of the property" means an estimate of the fair market value of the property determined by an opinion of a licensed real estate broker, an appraisal from a licensed appraiser, a value from a commercially utilized automated valuation model, or a value from a computerized property valuation system that is used to derive a real property value.

#### 7) **Previous legislation.**

AB 2424 is a follow-up to SB 1323 (Archuleta), of the 2021-22 Legislative Session, which aimed to tackle the same problem. However, SB 1323 took a much different approach, instead requiring the trustee to contract with a real estate broker to sell the property and allowing for an auction sale only after certain conditions are met following the attempt to sell through a broker.

#### 8) **Support**

AB 2424 is sponsored by the Consumer Federation of California and supported by consumer groups, housing rights advocates, and legal aid groups, including Housing and Economics Rights Advocates, California Elder Justice Coalition, and the National Housing Law Project. CFC writes the following in support:

California's foreclosure process has directly contributed to the large-scale extraction of billions of dollars of wealth from low-income communities, which has perpetuated and exacerbated the racial wealth gap in our state. When a mortgagor can't pay their mortgage loan, the lender is authorized to sell the secured property at an auction; the lender takes back the loan's remaining balance, and the homeowner is supposed to receive any surplus funds from the sale. The defaulted homeowner often unnecessarily loses tens or hundreds of thousands of dollars of accrued home equity because of the auction process. At the same time cash investors benefit from these below-market value sales by acquiring properties at bargain rates. For every dollar the investor/purchaser saves in buying the property, the homeowner loses that dollar in equity.

#### 9) **Oppose**

As noted in **Comment #5**, a coalition of groups representing banks, mortgage bankers, trustees, and those in the land title industry oppose AB 2424, unless amended to remove the proposed contingent bid process. With regards to those provisions, opponents argue:

The second portion of your bill introduces an entirely new concept into foreclosure sales, allowing bidders at public auctions to place bids "contingent on their satisfactory inspection of the property and ability to obtain third-party financing". We believe that such a contingent bid process would pose a host of

legal and practical problems, and it is this portion of AB 2424 which forms the basis of our “oppose unless amended” position.

**REGISTERED SUPPORT / OPPOSITION:**

**Support**

Consumer Federation of California (Sponsor)  
California Advocates for Nursing Home Reform  
California Elder Justice Coalition (CEJC)  
East Bay Community Law Center  
Elder Law & Advocacy  
Housing and Economic Rights Advocates (HERA)  
Justice in Aging  
National Association of Consumer Advocates (NACA)  
National Housing Law Project  
Public Law Center

**Oppose Unless Amended**

California Bankers Association  
California Chamber of Commerce  
California Community Banking Network  
California Credit Union League  
California Land Title Association  
California Mortgage Association  
California Mortgage Bankers Association  
United Trustees Association

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