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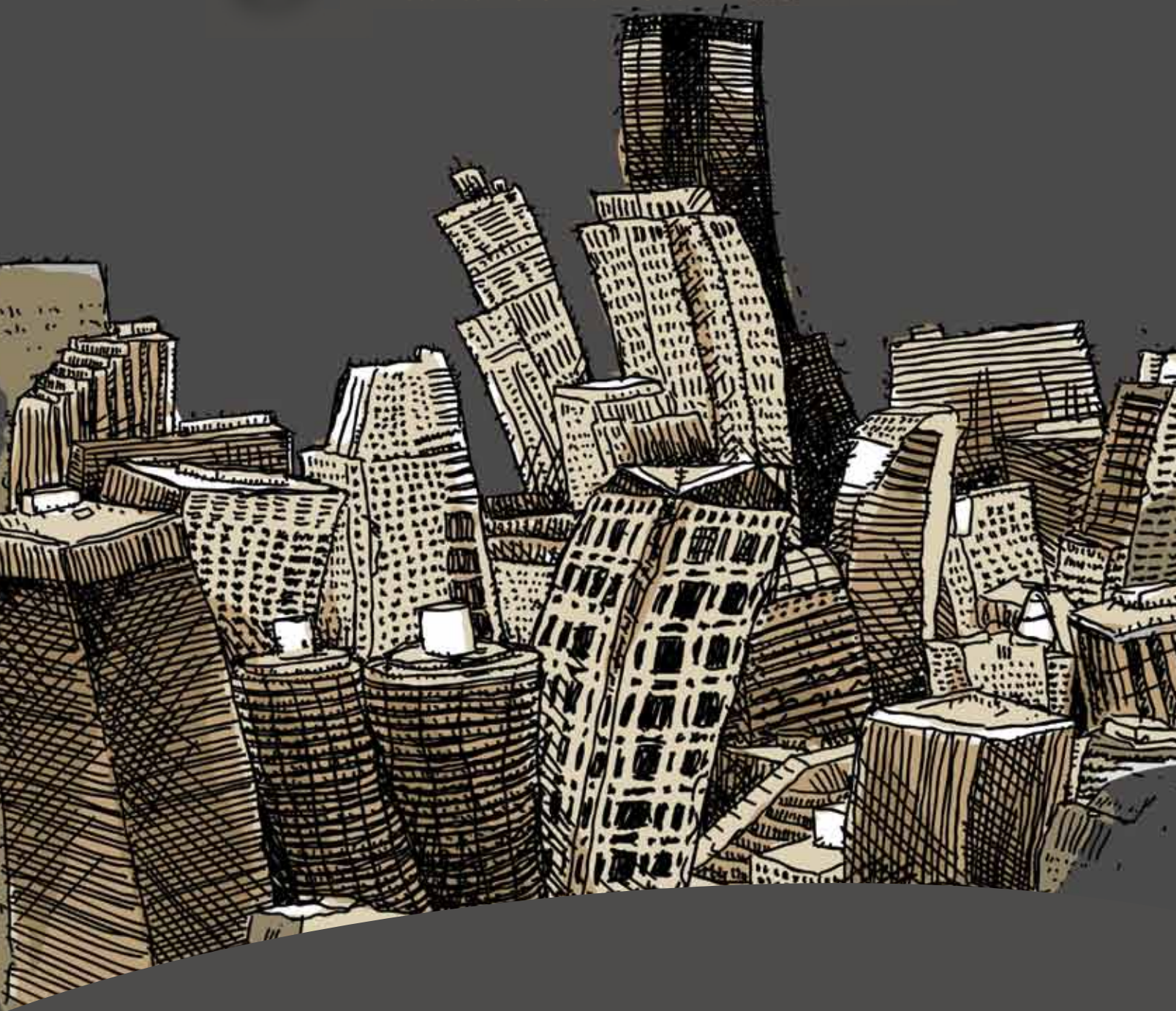

Dealing with Distressed Real Estate in Today's Uncertain Times

Georgia Foreclosure Confirmation Proceedings in Today's Recessionary Real Estate World:

Back to the Future

by Craig Pendergrast and Sara LeClerc

As commercial property owners face declining cash flows and commercial mortgage-backed security pools limit lender flexibility to modify and extend loan terms, foreclosures and foreclosure confirmation practice are taking front and center among lawyers for lenders, borrowers and guarantors of loans secured by commercial real property. Appraisers are in high demand, not so much for the purpose of providing valuations for underwriting of new loans, but instead for the purpose of assisting lenders in deciding how much to bid at foreclosure and participating in the inevitable battle of appraisers at the subsequent foreclosure confirmation hearing.

This article will address the law applicable to real property foreclosure confirmation proceedings in Georgia and alert secured creditors, debtors and their counsel to potential strategies relating to foreclosure.

The Georgia Foreclosure Confirmation Statute: Then and Now

The Georgia real property foreclosure confirmation statute is found at O.C.G.A. § 44-14-161. Among its provisions is one that requires a foreclosing lender to obtain the "true market value" of the property at foreclosure or else be faced with the prospect of losing any right to pursue a deficiency judgment against the borrower or guarantor of the secured debt.[1] This provision was adopted in 1935 during the Great Depression and was intended to protect debtors against unscrupulous lenders who sought to take advantage of the fire sale nature of a foreclosure sale in a tremendously depressed market by bidding in a low price to maximize the amount of a deficiency judgment that the lender might then obtain and seek to recover against the debtor.[2] Although the present real estate market is not generally considered to be as depressed as was the market in the 1930s, and real estate prices in some sectors were

arguably inflated above realistic values in the period preceding the recent meltdown, the present economic circumstances facing the real estate markets in parts of Georgia harken back to the days and concerns that gave birth to the Georgia foreclosure confirmation statute.

Pre-Foreclosure Considerations

To foreclose following default on a loan secured by real estate, the lender must provide the borrower with written notice of foreclosure and must publish a notice of the upcoming foreclosure for four consecutive weeks in the legal organ of the county in which the real property lies.[3] As the foreclosure sale date approaches, the lender must decide whether it wants to pursue a deficiency judgment against the borrower or any guarantors if the lender believes that the value of the property is less than the amount of the debt. If so, then the lender should retain a well-qualified appraiser, preferably with substantial testimonial experience, to provide an opinion of the value of the property on or about the date of the foreclosure.

The Appraiser's Dilemma in Today's Market

In today's real estate market, the meltdown in the financial markets in the fall of 2008, has made new loans on reasonable terms hard to obtain, with buyers looking for bargain basement pricing and sellers trying to hold on to their properties until a more rational and functional market exists. Appraisers often are faced with the problem of having few, if any, reliable modern comparable sales to rely upon in developing an opinion of value. Moreover, in attempting to determine the "true market value" of a property for purposes of anticipated testimony at a foreclosure confirmation hearing, the appraiser is faced with a dilemma: the appraiser must determine whether the few recent sales that may be located are representative of sales in which a "typically" motivated buyer and seller have been participants,[4] or if instead the comparable sales are atypical of a normally functioning market, with only distressed sellers, asset liquidating lenders and bargain hunting buyers occupying the field in a dysfunctional market. And if only older comparable sales can be found, then the appraiser must seek to determine whether those sales were representative of a rational market or if instead they were the product of an irrational bubble with respect to that particular sector of the real estate market.

One response of some appraisers has been to recognize the atypical nature of current markets and to perform a prospective appraisal, projecting into the future when the markets return to functionality and then discounting the anticipated pricing of that future day back to the present. Other appraisers criticize this methodology as being dependent upon too many assumptions of future conditions, including the date that the markets will return to normality and the prices, interest rates, rent terms and capitalization rates that will exist at such time. Yet even those appraisers who note the potential flaws in this approach still recognize that it is an accepted appraisal methodology,[5] and Georgia courts have also recognized the potential viability of this approach.[6]

The lawyer who is in communication with a secured lender client in advance of foreclosure should ideally be involved in the selection of a well-qualified appraiser with good testimonial demeanor and experience and should also confer with the appraiser to assure that the appraiser's data, approach and analysis are as reliable as possible. Otherwise, when it comes time for the appraiser to defend the appraisal in the face of cross-examination at a foreclosure confirmation proceeding, embarrassment and a poor outcome very well may follow.

The Lender's Dilemmas

Once the lender has its appraisal in hand, it must then decide how much to bid at the foreclosure sale. Best practice is to bid an amount that is higher than the appraised value to account for a margin of error and to demonstrate optimum good faith on the part of the lender. In other words, the lender should show that it is not trying to take advantage of the borrower by attempting to maximize the amount of a deficiency that it will pursue later. But how much of a buffer over the appraised value is enough? Should the lender attempt to anticipate the highest possible opinion of value that an opposing appraiser may reach, thereby minimizing the possibility of being barred from pursuit of a deficiency judgment, while minimizing the amount of a potential deficiency judgment? Or should the lender rely primarily upon its selected appraiser's competence and opinion and select a somewhat arbitrary amount by which to increase its bid, thereby cushioning the possibility of an adversarial attack on the appraiser's opinion, while demonstrating good faith to the judge in the upcoming foreclosure confirmation proceeding? There is obviously no "right" answer to these questions, and the exercise of reasoned discretion under the circumstances will be required.

If the lender wishes to pursue a deficiency judgment following the foreclosure sale, the lender is faced with another dilemma. Should it resell the property as quickly as possible prior to the foreclosure confirmation hearing, which may not take place for many months, or should it wait until after the hearing and the ruling thereon? If the former approach is taken, the property is sold to a third party prior to the confirmation hearing, and the court denies confirmation due to an inadequacy of the foreclosure price or on other grounds, then the option of asking the court to allow a new foreclosure sale[7] at a higher price is obviously lost, along with

the potential to salvage the right to pursue a deficiency for a lower amount based on the new foreclosure sale. If the lender chooses the latter approach and holds the property pending the completion of the foreclosure confirmation process, then its holding period will increase before it can realize upon the value of the property, and it will also have a longer period of dealing with the expenses and other burdens and risks of property ownership.

The Foreclosure Confirmation Proceeding

The foreclosure confirmation statute, O.C.G.A. § 44-14-161, requires that the foreclosure sale be reported to a judge of the superior court in which the land lies within 30 days of the foreclosure date. At that same time, the lender should file a petition to the court requesting that the foreclosure sale be confirmed and seek a rule nisi to set the date of the foreclosure confirmation hearing. That hearing is a special statutory proceeding in which the only issues to be tried are the legality of the advance notice of the foreclosure sale, the regularity of the sale and the issue of whether the foreclosure sale price represented at least the true market value of the property.[8] The confirmation statute requires that written notice of the confirmation hearing be provided at least five days in advance of the hearing to any debtor (including borrowers and guarantors) against whom the lender later elects to pursue a deficiency judgment.[9] That said, the court's calendar typically does not allow for such quick scheduling of the hearing, and case law holds that the Georgia Civil Practice Act nevertheless applies to a confirmation hearing, at least to the extent of discovery.[10] The respondent borrower(s) and guarantor(s) need not file an answer, as would be required in an ordinary civil action.

Since discovery is allowed, it is recommended that both petitioner and respondent promptly initiate written discovery to gain relevant information, including pertinent facts, witness identities and documents (particularly appraisals) that the other party possesses. Either party may then depose the other's appraiser or any other persons who are reasonably likely to testify at the hearing or who possess information upon which an appraiser or other expert witness may rely.

The confirmation hearing, if contested, is a full-fledged evidentiary hearing, most often involving a battle of appraisers, with the primary issue usually being the determination of the true market value of the property as of the date of the foreclosure sale. Given the somewhat subjective nature of many of the assumptions, selections, adjustments and opinions of even the most accomplished appraisers, the cross-examination of an opposing appraiser represents a golden opportunity for exposing the often imprecise nature of the appraiser's ultimate opinion of value.

The lender as the petitioner carries the burden of proof.[11] The

judge is the finder of fact; there is no right to jury trial.[12] The judge is required to determine only whether the foreclosure price was equal to or greater than true market value. The court need not state what it believes to have been the actual value as of the foreclosure date,[13] and although the court on request of a party prior to ruling must set forth findings of fact and conclusions of law in its order, it may not be necessary for the court to set forth much in the way of its analysis of the market value evidence in the order.[14] As finder of fact in a setting involving competing expert opinions, the court's findings on true market value will in most cases be difficult to reverse on appeal so long as there is any evidence (i.e., an appraiser's opinion that does not amount to sheer speculation) to support such finding in the absence of harmful error on an evidentiary admissibility ruling with respect to facts underlying such opinion.[15]

The Impact of an Unconfirmed Foreclosure Sale

If the court concludes that the foreclosure price was less than the true market value of the property (including gross inadequacy of price) and therefore declines to confirm the foreclosure sale, then the validity of the foreclosure sale is not affected, and the foreclosing lender's title remains intact in the absence of "fraud, mistake, misapprehension, surprise or other circumstances which might authorize a finding that such circumstances contributed to bringing about the inadequacy of price" so as to warrant setting aside the sale.[16] However, a finding of inadequacy of the foreclosure price results in an absolute bar to the lender for purposes of pursuing a deficiency judgment against the borrower or guarantor of the loan.[17] This is an unusually harsh result to the lender in comparison to the law of many other states, many of which would call upon the court to make a finding as to the true market value of the property and then allow the lender to pursue a deficiency judgment for the amount that is the difference between the amount of the debt and the value of the property as determined by the court.

This result is also at odds with Georgia law under its version of the Uniform Commercial Code (UCC) with respect to a secured lender's disposition of secured personal property. Under the UCC, the lender is required to make a "commercially reasonable" disposition of the property, and if the method of such disposition to an unrelated third party is deemed to be commercially reasonable, then the price received from disposition generally establishes the amount to which the debt is compared for purposes of calculating a deficiency.[18] If the borrower challenges the commercial reasonableness of the sale, then the lender carries the burden of proof to demonstrate commercial reasonableness.[19] If the lender or related party acquires the secured personal property, then the acquisition price establishes the basis for calculating a deficiency, unless the debtor carries the burden of proving that the disposition price was significantly below the range of prices that would have been received from a commercially reasonable disposition to an unrelated third party. If successful on such challenge, the borrower is not relieved of liability for a deficiency. Instead, the deficiency simply is reduced by the difference between the price received by the lender at its sale and the amount the court determined would have resulted from a commercially reasonable sale to an unrelated third party.[20]

Potential Order Allowing Lender to Conduct a New Foreclosure Sale

In the Georgia real property foreclosure confirmation process, the harsh result of a finding by the court that the foreclosure price was less than true market value is potentially mitigated by the court's authority under O.C.G.A. § 44-14-161(c) to allow the lender to conduct a new foreclosure sale for good cause shown, with the lender presumably bidding in a higher price at such sale. If the court has declined to state its opinion as to a particular amount that constitutes true market value, then the lender may be faced with yet another dilemma in setting a new foreclosure bid amount that will satisfy the court. Of course, the lender could choose to bid the amount that the borrower's appraiser opined to be the true value. But it is also possible that the value of the property will have moved upward between the time of the original foreclosure sale and the new foreclosure sale, making even that approach potentially problematic.

The court is not necessarily required to order a new foreclosure sale. The confirmation statute gives the court discretion to order a resale on a finding of "good cause."[21] What constitutes good cause for a resale is not defined by the statute and is not well-developed in case law. Lenders should argue that their good faith reliance upon a competent appraiser in determining their original foreclosure bid amount constitutes good cause for a resale,[22] but if the court nevertheless declines to order a resale, then such refusal may be within the bounds of its discretion.[23] Georgia appellate courts have yet to issue an opinion that addresses the parameters of the trial court's discretion (or abuse of discretion) in this setting. Moreover, as noted above, if the lender already has sold the property to a third party prior to the confirmation hearing, then a resale will not be possible. Further, if the value of the property has declined since the time of the original foreclosure sale, then the debtor may argue that allowing a new foreclosure sale would be unfair by reason of a possible increase in the amount of the deficiency to which it would be exposed.

Lender Strategies to Avoid the Absolute Bar of a Failed Confirmation Proceeding

As discussed above, the Georgia foreclosure confirmation statute arose from concerns regarding unscrupulous foreclosure practices by lenders. But what is the scrupulous lender to do when faced with the risk of being absolutely barred from recovering any deficiency if a court were to determine that its foreclosure bid was just marginally low as compared to the true market value of the property?

One approach is to bring a suit on the note and/or guaranty at the outset and defer exercising the lender's security interest through foreclosure, levy and sale until after judgment for the debt has been entered.[24] A lender that follows this strategy will not be required to incur the expense and risk of a foreclosure confirmation proceeding. However, the lender must await the entry of judgment on its action on the debt before foreclosing on the property.[25]

Another approach mentioned above is to bid in an amount substantially in excess of the lender's appraiser's opinion of value. But even that buffer may be deemed insufficient by a court given the wide range of valuation opinions that may exist between a lender's appraiser and a borrower's or guarantor's appraiser. The somewhat subjective judgments made by appraisers in their adjustments of comparable sales and in their selection of an appropriate capitalization rate using the income capitalization approach can yield tremendous differences in opinions of value, even if appraisers are otherwise in agreement as to the selection of comparable sales.

Other lender approaches to avoid this harsh result must be taken at the time the loan is made or modified. One option would be to include a choice of law clause in the loan agreement and/or guarantee calling for another state's more lender-friendly law to govern actions arising under those loan documents. This choice of law clause could be combined with a forum selection clause pursuant to which such actions were to be brought in the same forum as the selected law.[26] Some nexus of the loan transaction to the chosen state preferably should exist, and such nexus will exist logically where the lender has a connection to that state.

For both Georgia and out-of-state lenders making loans to Georgia borrowers or secured by Georgia properties, another option would be to include provisions in the loan documents pursuant to which the borrower and/or guarantor waives the benefit of or otherwise modifies the Georgia foreclosure confirmation statute's strict anti-deficiency judgment pursuit provisions. One potential modification that would be fair to both lender and borrower/guarantor would be to call upon the court to make a specific finding as to the true market value of the property and to limit any deficiency to the difference between that value and the amount of the debt. Contractual waivers or modifications of statutory protections are generally enforceable in Georgia, so long as they do not run afoul of fundamental Georgia public policy.[27] The provisions of most Georgia statutes do not arise to such level of non-waivability[28] and Georgia courts generally have required that such statutes contain an express provision precluding contractual waiver to enjoy such protected status.[29]

Although there are a number of Georgia appellate opinions that have addressed the enforceability of contractual waiver of various statutory provisions, no Georgia appellate court has addressed directly the waiver of the debtor deficiency protection provisions found in the Georgia foreclosure confirmation statute. An argument may be made that because that statutory section contains no express non-waiver language and establishes economic protections for the benefit of individual debtors, it should not be deemed to rise to the level of non-waivable public policy[30] so that individual debtors through loan document provisions may waive or modify those protections. By contrast, the nearby code section that sets the requirements for public notice of a foreclosure sale contains a provision that expressly precludes any waiver of such notice requirement.[31]

If the provisions of the Georgia foreclosure confirmation statute are subject to contractual waiver, issues may arise still as to whether the language in a particular loan document amounts to such waiver. For example, would contractual language generally waiving a guarantor's defenses at law and in equity be sufficient to waive its defenses based on the foreclosure confirmation statute? Or would language in which a guarantor absolutely guarantees full and prompt payment of the underlying debt, including any deficiency remaining after a foreclosure sale, serve to waive the anti-deficiency judgment pursuit provisions of the foreclosure confirmation statute? These are questions that must be answered on a case by case basis.[32]

By contrast, should a borrower or guarantor be presented with loan documents that contain non-Georgia choice of law or forum selection provisions, they would be well-advised to attempt to negotiate terms that call for application of Georgia law in a Georgia forum. Counsel for a borrower or guarantor should review draft loan document language carefully and attempt to avoid language that might serve to waive the protections of the Georgia foreclosure confirmation statute.

Conclusion

Counsel for lenders, borrowers and guarantors should be aware of the Georgia foreclosure confirmation statute at all steps of the loan relationship. In entering the loan, consideration should be given to the ramifications of the statute and

to the possibility of language that may serve to waive or modify the statute's provisions. Similar consideration should be given at the time any loan modification or forbearance agreement is negotiated. As a foreclosure sale is approaching, all parties should consider strategies that take into account the possibility of a deficiency.

On the borrower's side, this may include cooperation with the lender in connection with a friendly foreclosure or deed in lieu of foreclosure to avoid any risk of the lender pursuing a deficiency judgment. Or the borrower may consider a bankruptcy filing to attempt to buy time to find a buyer or new lender for a transaction that could avoid or minimize a deficiency.

If a foreclosure is imminent or after a foreclosure has taken place that gives rise to deficiency exposure, all parties should review the contract documents carefully to determine how their terms might serve to waive or modify the confirmation statute's provisions. In the heat of a contested foreclosure confirmation proceeding, counsel should consider discovery and other investigation and understand the pros and cons of various appraisal methodologies to be prepared to represent their clients in the best manner possible.

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Endnotes

1. O.C.G.A. § 44-14-161(b) (2002).
2. *Taylor v. Thompson*, 158 Ga. App. 671, 671-72, 282 S.E.2d 157, 158 (1981).
3. O.C.G.A. § 44-14-161(c), 162(a), 162.2, 162.3 (2002).
4. Fair market value is generally defined as the most probable price that a specified interest in real property is likely to bring where the buyer and seller are each acting prudently and knowledgeably, the seller is under no compulsion to sell and is typically motivated, the buyer is under no compulsion to buy and is typically motivated, both parties are acting in their best interests, and an adequate marketing effort is made prior to completion of a contract and sale. THE DICTIONARY OF REAL ESTATE APPRAISAL, Fourth Edition, Appraisal Institute, Chicago, Illinois (2002)
5. Uniform Standards of Professional Appraisal Practice, Statements 4 (recognizing use, limitations, and considerations relating to prospective value opinions) and 2 (recognizing use, limitations, and considerations relating to discounted cash flow valuations).

6. *Blue Marlin Development, LLC v. Branch Banking & Trust Co.*, 302 Ga. App. 120, 690 S.E.2d 252 (2010); *Greenwood Homes, Inc. v. Regions Bank*, 302 Ga. App. 591, 692 S.E.2d 42 (2010).
7. O.C.G.A. § 44-14-161(c)(2002)(court may order foreclosure resale for good cause shown).
8. *Vlass v. Sec. Pac. Nat'l Bank*, 263 Ga. 296, 297, 430 S.E.2d 732, 734 (1993); *see also Friedman v. Regions Bank*, 288 Ga. App. 57, 58, 653 S.E.2d 507, 509 (2007).
9. O.C.G.A. § 44-14-161(c) (2002); *Vlass v. Sec. Pac. Nat'l Bank*, 263 Ga. 296, 297-98, 430 S.E.2d 732, 734 (1993).
10. *Alliance Partners v. Harris Trust & Sav. Bank*, 266 Ga. 514, 515, 467 S.E.2d 531, 532 (1996).
11. *Gutherie v. Ford Equip. Leasing Co.*, 206 Ga. App. 258, 259, 424 S.E.2d 889, 890-91 (1992); *Echols v. Edwards*, 185 Ga. App. 688, 689-90, 365 S.E.2d 844, 845 (1988).
12. *Peachtree Mortgage Corp. v. First Nat'l Bank of Atlanta*, 143 Ga. App. 17, 18, 237 S.E.2d 416, 417-18 (1977).
13. *Echols v. Edwards*, 185 Ga. App. 688, 690, 365 S.E.2d 844, 846 (1988); *American Century Mortgage Investors v. Strickland*, 138 Ga. App. 657, 659-60, 227 S.E.2d 460, 462 (1976).
14. Compare, *PSI Pneumatic Structures, Inc. v. Citizens & Southern Newnan Bank*, 159 Ga. App. 766, 285 S.E.2d 576 (1981) (appellate court vacated for failure to set forth findings of fact other than conclusory statement that foreclosure price represented true market value); *American Century Mortgage Investors v. Strickland*, 138 Ga. App. 657, 227 S.E.2d 460 (1976) (order setting for evidence of conflicting appraisal values and conclusion that foreclosure price was less than true market value held to be sufficient).
15. *Mid-Roc, LLC v. First Southern National Bank*, 2010 Ga. App. LEXIS 851 (September 10, 2010); *Chamblee Hotels, LLC v. Chesterfield Mortgage Investors, Inc.*, 287 Ga. App. 342, 343, 651 S.E.2d 447, 448 (2007); *McCain v. Galloway*, 267 Ga. App. 505, 505, 600 S.E.2d 449, 450 (2004); *Echols v. Edwards*, 185 Ga. App. 688, 690, 365 S.E.2d 844, 846 (1988)
16. *Giordano v. Stubbs*, 228 Ga. 75, 79, 184 S.E.2d 165, 168-69 (1971).
17. O.C.G.A. § 44-14-161(a) (2002); *Powers v. Wren*, 198 Ga. 316, 321, 31 S.E.2d 713, 716 (1944); *Turpin v. N. Amer. Acceptance Corp.*, 119 Ga. App. 212, 217, 166 S.E.2d 588, 592 (1969).
18. O.C.G.A. § 11-9-610(b) (2002).
19. *Id.* § 11-9-626.
20. *Id.* § 11-9-626(3).
21. *Id.* § 44-14-161(c).
22. *Gutherie v. Ford Equip. Leasing Co.*, 206 Ga. App. 258, 261-62 424 S.E.2d 889, 892 (1992); *Adams v. Gwinnett Commercial Bank*, 140 Ga. App. 233, 234-35, 230 S.E.2d 324, 325-26 (1976), aff'd, 238 Ga. 722, 235 S.E.2d 476 (1977).
23. *Thompson v. Maslia*, 127 Ga. App. 758, 762, 195 S.E.2d 238, 241-42 (1972).
24. *Reese Developers, Inc. v. First State Bank*, No. A10A1512, 2010 Ga. App. LEXIS 848 (September 10, 2010).
25. *Vaughan v. Moore*, 202 Ga. App. 592, 415 S.E.2d 47 (1992).
26. *See, e.g., TruServ Corp. v. Flegles, Inc.*, 419 F.3d 584, 589 (7th Cir. 2005).
27. O.C.G.A. § 1-3-7 (2000)
28. *Id.* § 13-8-2 (2010)
29. *Porubiansky v. Emory Univ.*, 156 Ga. App. 602, 603-04, 275 S.E.2d 163, 165 (1980).
30. *See Wachovia Bank v. ASF Enterprises, LLC*, No. 1:09-CV-03571-JOF, 2010 U.S.Dist. LEXIS 63619 (N.D.Ga. June 25, 2010), citing to *Trust Investment & Development Co. v. First Georgia Bank*, 238 Ga. 309, 309-10, 232 S.E.2d 828 (1977), and *Taylor v. Thompson*, 158 Ga. App. 671, 672, 282 S.E.2d 157 (1981) for the proposition that the foreclosure confirmation statute does not rise to the level of public policy, which would preclude a lender from contractually reserving in loan documents the right to pursue non-foreclosure remedies prior to foreclosure.
31. O.C.G.A. § 44-14-162.3(b) (2002 & Supp. 2010).
32. For judicial analysis of contractual waiver language, consider: *United States v. Yates*, 774 F. Supp. 1368 (M.D. Ga. 1991); *Casgar v. Citizens & S. Nat'l Bank*, 188 Ga. App. 234, 372 S.E.2d 815 (1988); *Jones v. Dixie O'Brien Div.*, 174 Ga. App. 67, 329 S.E.2d 256 (1985); *Vickers v. Chrysler Credit Corp.*, 158 Ga. App. 434, 280 S.E.2d 842 (1981) (subsequently overruled with respect to personal property dispositions).