

Commercial Foreclosures (Judicial) (CA)

by Marc A. Liverant, Paul M. Williams, and Jung W. Han, Morgan, Lewis & Bockius LLP, with Practical Law Real Estate

Status: **Maintained** | Jurisdiction: **California**

This document is published by Practical Law and can be found at: us.practicallaw.tr.com/w-031-1516

Request a free trial and demonstration at: us.practicallaw.tr.com/about/freetrial

A Practice Note discussing commercial foreclosure procedures and proceedings under California law. This Note outlines the primary considerations, requirements, and processes for judicial foreclosures of commercial real property secured by deeds of trust and mortgages. This Note also addresses the appointment of receivers, deficiency judgments, the borrower's right to reinstate the loan, and the borrower's right of redemption for commercial real property. Real estate and construction transactions are currently being impacted by emergency measures enacted in response to the 2019 novel coronavirus disease (COVID-19). For current updates on certain state and local laws impacted by COVID-19, including eviction and foreclosure moratoriums, business closures, electronic signatures, recordings and notarization laws, and general crisis management guidance in handling real estate and construction matters, see [Real Estate Global Coronavirus Toolkit](#).

Foreclosure is the legal process by which a lender (beneficiary or mortgagee) liquidates secured real property to obtain payment following the borrower's (trustor's or mortgagor's) default on the underlying debt.

This Note outlines California law governing judicial commercial foreclosure proceedings including:

- Redemption rights.
- Deficiency judgments.

This Note also provides step-by-step guidance for conducting judicial commercial foreclosures under California law.

Available Methods of Foreclosure in California

Lenders in California use the following instruments to secure loans against real property:

- Deeds of trust.
- Mortgages.

Deeds of trust are the most common security instruments in California. California recognizes mortgages, but lenders

rarely use them. For more information, see [State Q&A, Real Estate Finance: California: Question 1](#).

Under California law, a lender may foreclose a loan secured by commercial real property by either:

- **Non-judicial foreclosure.** Foreclosure is authorized under a deed of trust or other contract containing a power of sale clause and is conducted at a public auction without judicial assistance. Non-judicial foreclosures are the most commonly used form of foreclosure in California and are governed by the California Civil Code (Cal. Civ. Code §§ 2923.3 to 2944.10).
- **Judicial foreclosure.** Foreclosure of a mortgage or other contract by court order after a judgment in a lawsuit. Judicial foreclosure is rarely used with deeds of trust due to its lengthy and expensive nature and is governed by the California Code of Civil Procedure (Cal. Civ. Proc. Code §§ 725a to 730.5).

A lender may also initially choose to pursue both foreclosure processes simultaneously. This gives the lender some time to weigh the pros and cons of both processes before ultimately choosing one.

For information on non-judicial foreclosures, see [Practice Note, Commercial Foreclosures \(Non-Judicial\) \(CA\)](#).



Pre-Foreclosure Requirements and Considerations

Counsel for the lender should review the terms of the note and deed of trust or mortgage, as applicable, for any contractually required notification requirements before beginning the foreclosure process.

Most California lenders provide defaulting borrowers with a demand letter. The demand letter should include:

- The terms of the loan.
- A description of the default.
- A statement that the lender intends to strictly enforce the loan documents if the borrower does not cure the default.

Order a Title Search

Before beginning foreclosure, the lender must conduct a title search to identify liens and other encumbrances that affect title to the real property. The title search may also reveal parties that have recorded a request for notice of foreclosure.

Liens for property taxes and certain other super priority liens should be paid to protect the lender's interest in the real property.

The lender should also conduct a search of the bankruptcy court records to determine whether the borrower has filed for bankruptcy protection. If the search reveals that the borrower has filed a bankruptcy petition, the foreclosure action must stop until the lender applies for and is granted relief from the automatic stay (11 U.S.C. § 362).

Consider Appointing a Receiver

To the extent a property is in danger of waste or deterioration, a lender may move for the appointment of a receiver to protect and preserve the property. Seeking the appointment of a receiver does not constitute an action under California's "one-action" rule (Cal. Civ. Proc. Code § 564(d)). For more information on California's one-action rule see [Practice Note, Navigating the One-Action Rule in California: Overview](#).

Lenders may seek a receiver to:

- Collect rents under an assignment of leases and rents.
- Protect and preserve the property.

A receiver is responsible for paying the real estate property taxes when due and insurance premiums for the real property.

The California Code of Civil Procedure and Rules of Court govern receiverships (Cal. Civ. Proc. Code §§ 564 to 570; Cal. Rules of Court, rule 3.1175 to 3.1184). For more information on receiverships in California, see [State Q&A, Provisional Remedies: California](#).

Receiverships are an important tool to consider when the property is abandoned or is otherwise at risk if left in the hands of the borrower.

Judicial Foreclosure

Although rarely pursued for deeds of trust, California law authorizes judicial foreclosures. Judicial foreclosure is the appropriate method when the lender holds:

- A mortgage that lacks a power of sale rather than a deed of trust.
- A non-standard deed of trust, such as a deed of trust lacking a power of sale clause.

A lender (mortgagee) in California pursuing judicial foreclosure does not have the option of choosing between foreclosing on the security interest in the real property and suing the borrower directly on the debt (suit for breach of contract for failure to pay).

California's "security first rule" (which is part of the one-action rule) requires the lender to exhaust its security interest in the real property collateral before pursuing the borrower directly. The lender must foreclose its security interest first and may only pursue the debtor directly for a deficiency judgment. (Cal. Civ. Proc. Code § 726(a); see [Practice Note, Navigating the One-Action Rule in California: Overview](#).)

File a Foreclosure Complaint

To begin a judicial foreclosure, the lender must file a complaint with the superior court for the county where the real property is located. The complaint must name all persons with a recorded interest in the property at the time of filing and the rights of which may be impacted by the foreclosure (Cal. Civ. Proc. Code § 726(c)). These may include:

- The borrower (mortgagor).
- The borrower's successor and assigns, if any.
- The owner of the property, if different from the borrower (for example, a guarantor that pledged the property as collateral for a loan).
- Junior lien holders, such as:
 - subordinate lenders;
 - judgment lien holders; and

Commercial Foreclosures (Judicial) (CA)

- mechanic's lien holders.
- Guarantors.
- Parties who have recorded a request for notice of foreclosure.

Counsel for the lender should consider obtaining a litigation guarantee from a reputable title company to provide the lender with all information regarding the necessary and indispensable parties to the judicial foreclosure.

The foreclosing party must serve a copy of the complaint on the other named parties to the action (see [State Q&A, Commencing an Action: California: Question 13](#)).

After filing the foreclosure complaint, the lender should immediately record a notice of pendency of action (also called a notice of lis pendens) with the recorder's office in the county where the real property is located. Recording the notice of lis pendens gives constructive notice to third parties that there is a pending legal action affecting the title or rights to certain real property. (Cal. Civ. Proc. Code § 405.24 and *Kirkeby v. Superior Court of Orange Cty.*, 33 Cal. 4th 642, 647 (2004).)

Minimum Facts for the Foreclosure Complaint

At a minimum, the foreclosure complaint must include a description of:

- The parties.
- Each party's interest in the real property.
- The mortgage or deed of trust and the secured obligation (promissory note).
- The property.
- The default.
- The interests of all other parties in the property.
- Any facts establishing the lender's compliance with statutory or contractual pre-foreclosure requirements, if any.
- Facts supporting any requests for special relief. For example, to:
 - reform or amend the loan documents;
 - subrogate another lien or to determine priority; or
 - obtain a deficiency judgment against the borrower.

The foreclosure complaint must also:

- Establish the lender's ownership of the note and deed of trust or mortgage.

- Request foreclosure of the mortgage or deed of trust, as applicable.
- Request attorneys' fees and other expenses if provided for under the mortgage or deed of trust.

Attach Exhibits to the Foreclosure Complaint

The lender should attach legible copies of the following instruments as exhibits to the foreclosure complaint:

- The signed promissory note.
- The recorded deed of trust or mortgage, as applicable.
- A true and correct copy of the notice of default or demand letter.
- Any recorded assignments of mortgage or deed of trust (or substitution of trustee), if applicable, showing the chain of title for the lender's interest, vesting in the foreclosing lender.
- Any other recorded liens or interests in the real property.

These documents help establish the prima facie case for foreclosure.

Judgment

The lender often prevails without a trial:

- If the defendant borrower does not respond to the foreclosure complaint within 30 days of service, the lender should seek judgment using an entry of default (Cal. Rules of Court, rule 3.110(d), (g)-(h), Cal. Civ. Proc. Code § 585(a)-(c), (e) and see [Practice Note, Default Judgment: Drafting the Application \(CA\)](#)).
- If the defendant borrower files a response to the complaint, the lender may be able to prevail by moving for summary judgment. If no material facts are contested, the court issues summary judgment in favor of lender. (Cal. Civ. Proc. Code § 437c and see [Practice Note, Summary Judgment: Overview \(CA\)](#)).

Judgment in favor of lender:

- Includes an order for the entire amount due to plaintiff lender, including costs and disbursements.
- Directs the sale of the real property to satisfy the amounts due.
- Directs the sheriff to sell the property at a public auction.
- Determines the priority among liens, if applicable.
- Determines the amount of attorneys' fees owed.
- Indicates whether a deficiency judgment is permitted.

Borrower's Right to Reinstate the Loan

The borrower has the right to reinstate (also known as a right to cure) the loan at any time before entry of the decree of foreclosure. To reinstate the loan, the borrower must pay:

- The entire amount then due, other than the accelerated portion of the principal due and owing after default (all installments past due regardless of acceleration of the loan balance).
- The costs and expenses incurred by the lender resulting from enforcing its rights under the mortgage or deed of trust, including:
 - insurance premiums paid by the lender, if any;
 - delinquent taxes paid by the lender, if any;
 - interest to the date of reinstatement;
 - costs of recording and publication;
 - costs of service;
 - attorneys' fees; and
 - any other expenses necessarily paid by the lender.

(Cal. Civ. Code § 2924c.)

Counsel for the lender should ensure that there is a contact person available to provide the reinstatement amount if the borrower indicates a desire and ability to reinstate.

Executing on the Foreclosure Sale

The foreclosing lender enforces its judgment by a writ of sale (writ). The writ directs the sheriff to levy on and sell the real property.

After receiving the writ, the sheriff must:

- Prepare a notice of levy.
- Prepare a notice of sale.
- 20 days before the sale date, publish the notice of sale for three consecutive weeks in a newspaper of general circulation in the county where the real property is located.
- Serve the notice of sale at least 20 days before the sale date on:
 - the trustor or the trustor's successor in interest;
 - all persons with a lien on the property; and
 - all parties that filed a request for notice with the clerk of the court.

- Serve the notice of levy before or at the same time as the notice of sale.
- Record the notice of sale in the office of the county recorder for the county where the real property is located at least 20 days before the sale date.

The sheriff's notice of sale must include:

- The details of the foreclosure judgment, including:
 - the parties;
 - the amount awarded the plaintiff; and
 - the court in which the judgment was granted.
- A description of the property to be sold, including the legal description and the street address or other identifiable location of the real property.
- The details of the sale, including:
 - the date, time, and place of sale; and
 - if the real property has no street address, a statement that directions to its location may be obtained from the levying officer on request.
- A statement that the sale is made subject to the borrower's right of redemption.
- The following statement:

"Prospective bidders should refer to Sections 701.510 to 701.680, inclusive, of the Code of Civil Procedure for provisions governing the terms, conditions, and effect of the sale and the liability of defaulting bidders."

(Cal. Civ. Proc. Code §§ 701.540 and 701.547.)

Disbursement of Sale Proceeds

After the judicial foreclosure sale concludes, the sheriff disburses the proceeds as ordered in the foreclosure judgment. Typically, the sheriff disburses the proceeds in the following order of priority:

- To reimburse the costs incurred in conducting the sale.
- To the foreclosing lender until its award in the court judgment is satisfied.
- To the junior lienholders in order of priority.
- The rest to the debtor.

Right of Redemption

A right of redemption allows a borrower (or the borrower's successor in interest) to retain the property after a foreclosure sale.

Commercial Foreclosures (Judicial) (CA)

If the lender has not waived the deficiency, or if it is not otherwise prohibited, the borrower (or the borrower's successor-in-interest) may redeem the real property following a judicial foreclosure sale within:

- Three months from the sale date, if the sale proceeds satisfy the debt, with interest and costs.
- One year from the sale date, if the sale proceeds do not satisfy the debt, including interest and costs.

(Cal. Civ. Proc. Code § 729.030.)

To redeem, the borrower must pay:

- The purchase price.
- The amount of any assessments or taxes and reasonable amounts for fire insurance, maintenance, upkeep, and repairs paid by the purchaser.
- Any amount paid by the purchaser towards a superior interest to protect the purchaser's interest.
- Interest on the total amount paid, including post-sale items, at the rate of interest on money judgments.
- The amount of the purchaser's liens that are subordinate to the foreclosed lien, plus interest.

(Cal. Civ. Proc. Code § 729.060(b).)

The redemption amount may be offset against any rents or profits paid to the purchaser after the sale (Cal. Civ. Proc. Code § 729.060(c)).

Counsel should be aware that the IRS has a 120-day redemption period on properties subject to a federal tax lien.

Sheriff's Certificate of Sale and Deed of Sale

If the lender has waived the right to a deficiency judgment or the deficiency is otherwise prohibited by law, after

payment of the purchase price, the sheriff must execute a certificate of sale in favor of the purchaser. The sheriff:

- Delivers the certificate of sale to the purchaser.
- Records a duplicate certificate of sale with the county recorder for the county where the real property is located.

(Cal. Civ. Proc. Code § 729.040.)

If the borrower does not redeem the property or the property is not subject to redemption following the foreclosure sale, after payment of the purchase price the sheriff must execute and deliver a deed of sale in favor of the purchaser (Cal. Civ. Proc. Code §§ 701.660 and 729.080).

The deed of sale conveys the fee title to the purchaser.

Taking Possession of the Property

If the property is abandoned at the time of the sale, the purchaser may take possession immediately. If the property remains occupied, the purchaser may take possession only after successfully completing a forcible entry and detainer action (eviction) (see [Practice Note, Landlord's Rights and Remedies \(Commercial Lease\) \(CA\): Eviction](#)).

Deficiency Judgments

Deficiency judgments are generally available following a judicial foreclosure in California.

The foreclosing lender must apply to the court within three months after the judicial foreclosure sale to obtain a deficiency judgment. The court holds a hearing to determine the fair value of the property. The deficiency is limited to the difference between the balance owing on the loan and the fair market value of the property. (Cal. Civ. Proc. Code §§ 580a and 726(b).)

Foreclosure Comparison

	Non-Judicial Foreclosure	Judicial Foreclosure
Costs	Typically, less expensive.	Typically, more expensive.
Timeline	Minimum of approximately four months.	18 months or more, but typically several years.
Any notice requirements before commencing foreclosure	There is no statutory requirement for a pre-foreclosure demand letter. The lender must comply with any notice requirements contained within the loan documents.	There is no statutory requirement for a pre-foreclosure demand letter. The lender must comply with any notice requirements contained within the loan documents.

Commercial Foreclosures (Judicial) (CA)

	Non-Judicial Foreclosure	Judicial Foreclosure
Publication requirements	The trustee must publish the notice of sale once each week for three consecutive weeks in a newspaper of general circulation in the public notice district or county where the real property is located. The first date of publication must occur at least twenty days before the sale date. (Cal. Civ. Code § 2924f(b)(1), (b)(2).)	Counsel for the lender must publish the summons and complaint only if alternative service is needed to provide notice of the lawsuit to a defendant (see State Q&A, Commencing an Action: California: Question 12). The sheriff must publish the notice of sale following judgment according to the same requirements for a non-judicial sale (Cal. Civ. Proc. Code § 701.540).
Declaratory judgment for loan or title defects	N/A.	The lender may include a count for a declaratory judgment to clear a title defect in a foreclosure complaint.
Deficiency judgment	No. The lender cannot sue the borrower for a deficiency after foreclosing nonjudicially (Cal. Civ. Proc. Code § 580b). A junior lienholder may sue the borrower on the debt unless the junior lien is a purchase money mortgage.	A lender may include a count for a deficiency judgment in the foreclosure complaint for non-purchase money mortgages (Cal. Civ. Proc. Code § 726(b)).
Redemption period	N/A.	The redemption period is: <ul style="list-style-type: none"> • Three months after the sale date if the proceeds satisfy the debt. • One year after the sale date if the proceeds do not satisfy the debt. (Cal. Civ. Proc. Code § 729.030.)
Requirement to confirm foreclosure sale	N/A.	N/A.
One-action rule	A beneficiary (lender) under a deed of trust may only pursue one form of recovery of any debt secured by a mortgage or deed of trust (Cal. Civ. Proc. Code § 726(a)).	A beneficiary (lender) under a deed of trust may only pursue one form of recovery of any debt secured by a mortgage or deed of trust (Cal. Civ. Proc. Code § 726(a)).

About Practical Law

Practical Law provides legal know-how that gives lawyers a better starting point. Our expert team of attorney editors creates and maintains thousands of up-to-date, practical resources across all major practice areas. We go beyond primary law and traditional legal research to give you the resources needed to practice more efficiently, improve client service and add more value.

If you are not currently a subscriber, we invite you to take a trial of our online services at legalsolutions.com/practical-law. For more information or to schedule training, call 1-800-733-2889 or e-mail referenceattorneys@tr.com.