Credit Bidding and Obtaining Confirmation of Sheriff's Sales of Mortgaged Real Estate

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Practice Area: Restructuring and Insolvency & Banking and Commercial Finance & Real Estate

There are three phases to every Wisconsin foreclosure action—Judgment, Sheriff's Sale, and Confirmation. Once the foreclosing lender has obtained a judgment of foreclosure, a redemption period begins to run. A redemption period may last anywhere from five weeks to twelve months. Upon the expiration of the redemption period, the lender is entitled to direct the Sheriff to conduct a public auction to sell the property to the highest bidder. Once the sale has concluded, the lender is required to seek court approval of the sale by filing a motion for confirmation.

Lenders commonly have a lot of questions for their counsel about the sale and confirmation process. Using a hypothetical foreclosure case in which a judgment has been entered and the redemption period has expired, this article will summarize those phases of a foreclosure case and highlight strategies for obtaining confirmation of bids.

The Hypothetical Case – *Main Street Bank v. Acme Development*
Main Street Bank ("Bank") loaned $1,000,000 to Acme Development ("Acme") for the acquisition of a 12-unit apartment complex (the "Property") in Milwaukee. Acme defaulted on its loan and, on the direction of Sally Banker (the commercial lender responsible for this loan), Bank's counsel commenced an action in Milwaukee County Circuit Court for a monetary judgment on the underlying note and a foreclosure judgment directing that the Property be sold by the Sheriff. Both judgments were entered in favor of Bank. Bank did not waive its right to recover the deficiency from Acme, thereby setting the redemption period at 6 months, even though further collection action after the foreclosure is unlikely because Acme is insolvent and the guarantor has filed bankruptcy. Earlier in the case, Bank also obtained a receiver over the Property to collect the rents, which were collaterally assigned to it by Acme as further security for the loan.

Bank's counsel caused a Notice of Sheriff's sale to be published as the six month redemption period was ending. Sally Banker and counsel must now discuss the upcoming sale and consider an appropriate opening bid with an eye toward the confirmation process that will follow soon after the sale.

The Sale
Wisconsin's lengthy and multi-step foreclosure process is somewhat foreign to Sally Banker as none of her loans have ever ended up in foreclosure. Now that the Sheriff's sale is approaching, Bank's counsel will explain to her that:

- At the Sheriff's sale, anyone may make a bid for the Property regardless of whether that person or entity was a party to the foreclosure case. Frequently, however, the foreclosing lender is the only bidder.
- Generally, the foreclosing lender (here, Bank) will make the opening bid. Others who wish to acquire the Property must make a higher bid. Sometimes the Sheriff will have rules governing the amount of incremental bid increases (i.e. competing higher bids must be made in a minimum of $100 increments) to keep the sales moving.
- Bank's bid is a "credit bid" of up to the amount of the current balance owed. This means that Bank can bid up to $1,000,000 for the Property and not pay anything out of pocket to acquire the Property if that is the highest bid.
- There is no legal requirement that the Bank bid the full amount of its debt at the sale, whether by the opening bid or any subsequent higher bids it may wish to make.
- Winning bidders other than the Bank must be prepared to pay the Sheriff not less than 10% of the bid in cash or certified funds at the conclusion of the sale. The remaining 90% of the bid must be paid to the clerk of court within 10 days after the sale is confirmed by the court.
- One strategy that counsel will suggest to Sally Banker in order to ascertain the extent of interest by third parties is to start bidding lower than the ultimate stopping point, and increase the Bank's bid as others increase their bids.

Now that Sally Banker is familiar with the sale process she must now decide on an opening bid and related strategy. Four factors generally impact this decision. The first factor is the value of the foreclosed property as compared to the debt owed. Second is the potential holding costs of the Property for an anticipated re-sale period. The third factor is the extent, if any, to which Bank hopes to avoid acquiring ownership of the property through the sale and whether there are or may be other interested bidders known to Bank. The fourth factor incorporates the legal standard by which the winning bid will be considered for confirmation.

In light of these factors, Bank's counsel will explain to the Sally Banker that:

1. A buyer will take the Property subject to existing liens (like unpaid property taxes) that are prior to the liens being foreclosed. Those prior liens should be subtracted from any valuation amount as the bid is being considered.
2. If the Property is fully leased and not in need of extensive repair, the Bank may not be too concerned about holding the Property as REO while it is marketed for sale, and therefore be willing to bid to win because the rental income will offset the holding costs.
3. The highest bid made at a Sheriff's sale will be viewed by the court under the "fair value" standard. Fair value in this context does not mean market value because the distress and involuntary nature of Sheriff's sales is recognized by the courts as having a downward impact on price. But the court has wide discretion to determine what constitutes "fair value" and the facts always vary from case to case. For example, the amount of a non-contingent offer that could close soon after confirmation would likely be compelling evidence for or against confirming a sale (depending on the amount of the offer) because it is a real-time indicator of market value.
4. Courts will give closer scrutiny to the bid if the Bank's right to a deficiency is not waived. This is because the higher the bid, the lower Acme's deficiency liability will be after the foreclosure sale is confirmed.
5. An inexact but useful rule of thumb in calculating a confirmable opening bid under these circumstances is to use 70% to 80% of the market value of the Property. But what is the value? Bank obtained an appraisal showing the value of the Property to be $900,000. Although the appraisal is over a year old (and Bank wanted to avoid the cost of ordering a new appraisal if possible), Sally Banker believes $900,000 to be a fairly accurate indicator of value. The current tax assessed value of the Property is $950,000, which the court will likely look to as one indicator of value.
6. With all of this in mind, Sally Banker suggests an opening bid of $720,000. This constitutes 80% of the last appraised value and about 75% of the tax assessed value. She also instructs counsel that if anyone is present at the sale to bid higher, they can have the Property. Counsel advises Sally that this bid is very likely to be confirmed if no higher bids are made.

The sale date has arrived. Bank's counsel is present and announces an opening bid of $720,000. No other bids are offered and the Property is therefore sold to Bank for $720,000. Bank's counsel calls Sally Banker after the sale to give her the news and discuss the final phase of the foreclosure process—confirmation.

Confirmation
Title to the Property will not pass to Bank until the sale is confirmed by the court. In fact, Acme may still exercise its redemption rights—or file bankruptcy to upset the sale—until the court orders confirmation of the sale.

To obtain confirmation, counsel will file a motion requesting that the court find that the Bank's credit bid of $720,000 constitutes fair value. The motion will also request a) that the $1,000,000 monetary judgment be amended to reflect the addition of accrued interest and attorneys' fees and costs related to the action, and the subtraction of the confirmed credit bid (Bank can then proceed to collect the remaining deficiency judgment), b) the turnover of any rents collected but not used by the receiver to pay maintenance or taxes, which would be further credited against the judgment, and c) the discharge of the receiver. The motion must be served on Acme and all other parties that were named in the foreclosure action. Since there are no excess proceeds from the sale, subordinate lienholders will not receive anything from the sale and their liens will be extinguished.

Acme's objection to the motion, if any, must be premised on evidence that the Bank's bid is so inadequate as to "shock the conscience" of the court. Bank would then need to present its own evidence (likely in the form of a new appraisal) and argue that the bid is confirmable notwithstanding the challenge. At the confirmation hearing, each side would present its valuation witnesses and the court would then weigh the competing values and rule on the motion.

Counsel advises Bank that due to the amount of the bid and the lack of any motivation for Acme to contest confirmation (Acme is not operating and the guarantor has no liability for the deficiency due to the bankruptcy), a fight is not likely. Counsel files the motion and, true to her prediction, Acme does not oppose the motion. At the hearing, the court notes the proximity of the bid to the appraised and tax assessed values of the Property and the lack of any objection to the motion. Because the bid does not shock the conscience of the court under these circumstances, the sale is confirmed and title to the Property transfers to Bank. Sally Banker can now start marketing the Property for sale.

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