WASTED ON DEL PASO BOULEVARD!

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A new and interesting Court of Appeal case was decided yesterday that involves local parties and a property in North Sacramento.

In February, 2005, New Faze Development, owned by City Council candidate Allen Warren, purchased a building and the underlying property on Del Paso Boulevard which housed a church and a small social services agency. The purchase price was $525,000. New Faze paid $52,500 down (10%), and the Seller carried back a note for the $472,500 balance (90%). The note was secured by a deed of trust recorded against title to the property. New Faze purchased the property with the intent to tear down the existing building and replace it with a new mixed-use development. In fact, in October, 2006, the tenants were evicted and the existing building was torn down by New Faze to prepare the property for redevelopment. At this point, the property (and the Seller's security for the note) was just an empty lot on Del Paso Boulevard (there appeared to have been no personal guarantee of the note).

Prior to beginning any construction of a new building, New Faze defaulted on its note payments, and failed to pay the property tax and insurance payments on the property. By this time, the Seller's note was held by McGeorge Associate Dean Glenn Fait and his sister-in-law, Donna (the "Faits"), who instituted foreclosure proceedings. In May, 2009, the Faits bought the property at the public foreclosure sale for only $14,097.

Shortly thereafter, in July, 2009, the Faits brought a lawsuit in Sacramento Superior Court against New Faze Development, and three individuals, owner Allen Warren, Project Manager Wendy Saunders and Director of Construction Jay Rivinius, for "waste" and "intentional and negligent impairment of security". The Faits' claims were based upon the fact that New Faze had torn down the building on the property, leaving just the empty lot, thus wasting and impairing the Faits' security for their note.

New Faze and the other defendants defended their conduct by claiming that unless they tore down the building in "bad faith," they could not be held liable for either waste or impairment of

security. The defendants stated that they did not commit “bad faith waste” because they did not intend to harm the property, and they did not act maliciously or recklessly by demolishing the building because the “demolition was based on a good faith belief that the property could be developed into a legitimate mixed use commercial project.” The Superior Court Judge agreed, and the case brought by the Faits was dismissed.

On appeal, however, the Appellate Court, like the Faits, disagreed with the trial Judge’s decision, overturned the dismissal and returned the case to the Superior Court for trial.

New Faze and the other defendants were correct that only “bad faith waste” is actionable, but their attorneys had the definition wrong. The Court of Appeal said that all waste is bad faith waste unless it is caused “solely or primarily as a result of economic pressures of a market depression.” In other words, if you can’t afford to keep your property maintained because you lost your job, it is not waste. However, if you have the money to pay your taxes, and you don’t pay them, that is waste for which the lender can sue. Another example stated in the case is that, if you have the money to maintain an orchard on your property which is part of the lender’s security, and you don’t, that is also waste for which a lender can sue.

In this case, New Faze, Warren, Saunders and Rivinius, intentionally tore down the building. The Court said that “in their zeal to develop the property, the defendants demolished the building before they had the financial means to complete the development or pay off the promissory note.” Further, “….. the defendants may have had the best of intentions, but that fact alone does not entitle them to avoid liability for waste.” The Court also said that the Faits should not have to “bear the risk of a property devaluation due to the overexuberance of a developer in an overheated real estate market preceding a recession.” The Court also concluded that New Faze’s failure to pay the delinquent property taxes constituted waste for which the Faits could sue.

The Court then decided that each of the individual defendants could be held liable for intentional or negligent impairment of the Faits’ security if they were aware that the Faits’ deed of trust was recorded against the property. Based on a series of cases, it is not necessary that, in committing the tort of impairment of security, the defendants be the borrower. Individuals having knowledge of the deed of trust on the property was enough for them to be sued by the lender.

The case was a great education on “waste” of property and the tort of “impairment of security” relating to secured property in California, particularly based upon seller financing. This case may be appealed to the California Supreme Court. If it is not, it will return to the Superior Court for a trial regarding liability and damages. Please note that this case relates to commercial property, not a residence, for which the rules can be somewhat different.