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PERSPECTIVE

New homestead exemptions, personal guaranties: Time to negotiate?

By Catherine E. Bauer

As of Jan. 1, the California homestead exemptions have changed significantly. Section 704.730 of the Code of Civil Procedure increased the homestead exemption to at least \$300,000, and to as much as \$600,000 (depending on a county's median home prices).

In Los Angeles and Orange Counties, no surprise, the homestead exemption is at the maximum \$600,000 level, which is a significant change. In 2020, the largest exemption available was \$175,000 (and that required certain qualifying factors be met). Most folks could only claim a \$75,000 or \$100,000 exemption.

This increase in homestead exemption amounts will significantly impact creditors, judgment debtors, bankruptcy debtors and bankruptcy trustees. Homeowners can protect much more of the equity in their homes (or, in some instances, their boats, life estates or leasehold interests) from creditors. We will see how this plays out. At a minimum, homeowners in financial trouble can feel more secure that their homes will not be sold by judgment creditors or by bankruptcy trustees.

The impact of the increased exemption will be of particular significance to a certain group of obligors impacted by the pandemic: homeowners who executed unsecured personal guaranties on now-shuttered businesses. With the changes to the law, it is much more likely that guarantors with significant home equity can avoid losing their homes because

of their failure to pay on their personal guaranties.

Combined with the pandemic, these increased exemptions should lead parties to seriously consider the advantages of entering into negotiations. Resolving these debts via settlement can be advantageous to both sides.

Why? For lenders, obviously, they are now at greater risk of receiving no repayment. Guarantors can now shield substantially more of the equity in their homes. Add to this the fact that state courts have been heavily impacted by the pandemic. With civil cases taking a backseat to criminal matters, it is even more likely than in the past that lenders will need to spend years and years chasing guarantors. This, of course, is costly. And, in the end, these guarantors may choose to file bankruptcy.

Once there is a bankruptcy filing, even if armed with a judicial lien, a creditor may see its lien substantially impacted by a bankruptcy filing. Section 522(f) of the Bankruptcy Code allows a debtor to avoid judicial liens to the extent they impair a debtor's exemption. So, for example, if a debtor's home in Los Angeles County is worth \$2 million, and mortgages total \$1,400,000, a judicial lien of \$400,000 could be stripped off the property in its entirety because it impairs the debtor's \$600,000 homestead exemption. In the same scenario, but with mortgages totaling \$1,200,000, the same judicial lien would remain viable under § 522(f) in the amount of \$200,000 (the amount of equity the debtor would not be able to protect via the homestead exemption).

Why would guarantors choose to negotiate settlements of their personal guaranty debts? Why not roll the dice and see what the creditor does? Well, certainty is one thing. Do you really want to spend your life waiting to see what the creditor does? Do you want to spend your life litigating rather than building back your business? Do you want to risk a foreclosure?

Would filing bankruptcy be easier? Maybe, but there are people who are morally opposed to filing bankruptcy. For instance, a guarantor whose business (let's say a restaurant) was a victim of the pandemic, may be mortified by the prospect of a personal bankruptcy filing. This sort of guarantor may also be concerned that, even with the increase in the homestead exemption amount, they could lose their home or other assets. Additionally, the public nature of a bankruptcy filing lays bare one's financial life: a real negative to some.

Something more for guarantors and their attorneys to consider: Lenders can take great offense at California's high cost of living and home values. "What do you mean you live in a \$2 million house, but you can't or won't pay anything on your personal guaranty?" Emotions can run high. And, you never know when someone's job is on the line because of a defaulted debt.

While the adversarial system is fabulous, it often makes for intractable lines in the sand. Negotiated settlements help parties uncover paths that are win-wins for everyone. For instance, a guarantor may just need some time to

get a new business going. A lender may agree that obtaining a consensual lien to secure a personal guaranty is optimal. These are not outcomes that would come from full blown litigation.

Giving parties a safe place to meet (via Zoom or other means), to tell their stories, and to develop workable solutions, is going to be even more necessary and desirable in the post-pandemic world.

Of course, parties should consult with their counsel and determine the best path for resolving personal guaranty debts given their particular situations. Hopefully, the underlying loan default was a 'one off' caused by the pandemic and the guarantor can get back on their feet and be successful. Every case is fact specific. When considering options, please throw into the mix the possible benefits of a negotiated settlement. Recovering fast and getting back to business is more important than ever. ■

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