BURR ALERT

SALT IN A LENDER'S WOUND:

What Actions Should a Lender Take Under the Newest Version of the 'Protecting Tenants at Foreclosure Act'?

By Meredith Minkus **February 2013**

In the context of residential foreclosures, one of the biggest issues facing foreclosing lenders is handling non-borrower tenants and occupants of the subject property. Tenant and occupant issues have, until recently, been adjudicated under state substantive property law and procedural foreclosure rules. The "Protecting Tenants at Foreclosure Act of 2009" Pub. L. No. 111-22 §701-703, 123 Stat. 1632 (2009)(the "Act"), however, imposed a top-down national scheme relating to occupants of foreclosed properties. The Act gives no consideration to variations in state foreclosure laws and procedures, and has only served to create confusion and injustice. In addition to Congress's heavy-hand, courts have improperly applied the Act to grant generous benefits to property occupants, and to prejudice the rights of foreclosing lenders. The Act and case law, indefensible as they may be, will obviously play a role in developing strategy and tactics when the lender seeks to remove an occupant who is not the borrower. With the extension of the Act to 2014 with the passage of the Dodd-Frank Financial Reform Act, it is now even more crucial for lenders to implement a strategy for handling non-borrower tenant situations.

What is the Act?

In very general terms, the intent of the Act is to offer protections to a tenant in the event of foreclosure by honoring the tenant's lease or providing the tenant with additional time to vacate the property. On its face, this is an innocent motive; application of the poorly worded one-size-fits-all law, however, presents numerous problems. At the very outset, confusion exists as to the scope of the Act, with some courts claiming the Act applies only to "federally-related mortgage loans," but this misperception simply reflects a careless reading of the statute. *See e.g.* Curtis v. US Bank National Association, 427 Md. 526, 530 (2012) ("There are several qualifications to the applicability of [the Act]…First, the foreclosure must involve a 'federally-related mortgage'…). Contrary to such misreading, the Act expressly applies to *all* residential foreclosures, regardless of whether the loan is a "federally-related mortgage." Section 702 states that the Act applies to "any foreclosure on a federally-related mortgage loan **or on any dwelling or residential real property**..." (emphasis added). *Thus, the Act therefore applies anytime any lender is foreclosing a mortgage on any residential property.* The scope of the Act is likely unconstitutional, but the language is black and white.

Application

The Act states that in the case of any foreclosure on a residential property, "any immediate successor in interest in such property pursuant to the foreclosure" assumes its interest subject to two restrictions relating to tenants in the property. The first is relatively straightforward: The "provision" of a "notice to vacate" must be given at least 90 days before the effective date of the notice. Second, the successor in interest takes the property subject to the rights of any "bona fide tenant" under an existing "bona fide lease entered into before the notice of foreclosure" until the end of the remaining term of the lease.[1] If the tenant has no lease, the 90 day notice period applies unless state law provides a longer notice period, in which case the state law notice period applies.

Who are Bona Fide Tenants?

Only "bona fide tenants" receive protection under the Act, whether their interests arise under a "bona fide lease" or tenancy pre-dating the "notice of foreclosure." Two questions naturally arise: 1) What is a "bona fide tenant" or "bona fide lease"? and 2) What constitutes "notice of foreclosure"? Paragraph (b) of the Act provides that a tenancy or lease is "bona fide" only if:

1. The tenant is not the mortgagor or the mortgagor's child, spouse or parent;
2. The lease or tenancy is the result of an arms-length transaction;
3. The lease or tenancy requires rent that is not substantially less than fair market rent, or the rent is reduced or subsidized under state or federal law.

These criteria obviously create many potential factual and legal issues. For example, what constitutes an "arms-length transaction"? What is "fair market rent"? How much less than that amount constitutes "substantially" less?[2]

The "Notice of Foreclosure" and its recent, crucial clarification

Perhaps the most important change under the extension of the Act occurs in section 1484 of the Dodd-Frank Act which was amended to define "notice of foreclosure" as "the date on which complete title to a property is transferred to a successor entity or person as a result of an order of a court or pursuant to provisions in a mortgage, deed of trust, or security deed." Any lease entered

[1] Under paragraph 2(A), the immediate successor in interest does not have to honor the lease term if the successor in interest will occupy the property as a primary residence. Even if the purchaser will occupy the property as a primary residence, however, he is nonetheless required to provide the 90-day notice under paragraph (1). It is an open question whether a second purchaser, versus the immediate successor in interest, is bound by the notice requirement or the terms of the pre-existing lease. The plain language of the Act speaks only to the "immediate successor in interest", but there would be a question whether the immediate successor in interest could sell the property free of the restrictions by which it was bound upon taking title. This article focuses on the interests of lenders taking title through foreclosure. Issues relating to a later REO sale of the property are beyond the scope of this discussion.

[2] In Harper v. J.P. Morgan, 305 Ga. App. 536 (2010), a Georgia court held 30% under fair market rent to be "substantially less", but this result cannot be extrapolated to every jurisdiction for obvious reasons.

into before title vests in the foreclosing lender, even the day prior, therefore entitles the tenant to occupy the property for a minimum of 90 days under the Act. To understand just how senseless this provision is, consider that in 2012, the average residential foreclosure case in Florida took 861 days—almost two and a half years—to complete.[3] Prior to the recent definition of the 'notice of foreclosure' it could be reasonably argued that the filing of the Lis Pendens constituted sufficient notice. Further, in Florida, all tenants are personally served with the foreclosure lawsuit. It is nonsensical that a tenant who has been served and has resided in the property throughout the lengthy span of the litigation - and who has received notice of each court action - can then invoke additional time at the end of the litigation when the Certificate of Title is issued. In what would be a lender's nightmare, a tenant could conceivably enter into a multi-year lease on the very last day of such a foreclosure case (with the lender having received no payments since months before the case began), and under the Act, the foreclosing lender would be forced to honor the lease. Further, while we are discussing unpleasant scenarios, the Act falls silent on the tenant's obligation to pay rent to the lender. Meaning, should the tenant fail to pay rent, the Act does not provide language permitting the lender to go forward with an immediate eviction. And, even worse, the Act forces lenders into the landlord business by subjecting them to potential insurance related liability issues.

In short, the acquiring party through foreclosure must give any bona fide tenant at least 90 days' notice before the tenant can be removed from the property. If the tenant has a lease in place, and the lease term runs for more than 90 days, the acquiring purchaser is stuck with the lease term.

Strategy for Lenders

With all this in mind, what should a lender do when foreclosing a residential mortgage where there is a tenant in the property? *Primarily, the foreclosing lender should send the 90-day notice at the earliest possible opportunity.* The day title transfers to the lender (in Florida, the transfer occurs upon issuance of a certificate of title by the county clerk of court), the lender should send the 90 days' notice. *The notice, furthermore, should very specifically state that it is the statutory 90 days' notice.* In one case, a lender sent a 5-day notice to vacate under state eviction law, then sued for possession after 90 days. The court ruled against the lender because the notice did not have a 90-day effective date.[4] This case was a state court case, but illustrates the advisability of strictly adhering to the Act's notice requirements.

Beyond sending the specific statutory notice, there are a few options a lender may pursue which may defeat a tenant's defenses under the Act. *One such tactic is to conduct discovery relating to the tenant's alleged lease.* If the tenant cannot prove the existence or terms of the alleged lease agreement, the lender may be able to successfully argue there is no bona fide tenancy, and obtain an order removing the occupant. This strategy should be employed as soon as the lender discovers the alleged tenancy. If the lender can defeat the claim of a bona fide lease prior to concluding the

[3] http://articles.orlandosentinel.com/2012-04-12/business/os-foreclosures-orlando-20120412_1_foreclosure-activity-foreclosure-related-filings-daren-blomquist

[4] Bank of NY Mellon v. de Meo, 607 Ariz. Adv. Rep. 33 (2011).

foreclosure, it will have a better opportunity to seek an immediate order removing the occupant upon taking title.

Additionally, requesting a copy of the lease at the earliest opportunity may initiate a dialogue with the tenants. Being able to address their concerns or advise them to seek counsel prior to the posting of the writ works to the benefit of all parties involved. It is possible that an agreement can be reached whereby the tenant agrees to peacefully leave the property or the lender offers an incentive, such as cash for keys, for the tenant to maintain the property and leave it in good condition upon their departure.

Another option lenders may pursue, which is admittedly not entirely in keeping with the Act, is to simply file a motion and have the Judge enter an order to issue a writ of possession in favor of the lender as soon as the lender gets possession of the property. While the author of this article is not advocating violating federal law, it is the author's experience that most courts are simply not aware – or perhaps unwilling - to extend the overreaching and paternalistic application Act in all circumstances. Scheduling and noticing a hearing for possession affords the tenant the chance to come forward and prove a bona fide tenancy does exist.[5]

No Private Cause of Action?

Further, there is little risk to the lender in putting pressure on the alleged tenant to come forward and prove a bona fide tenancy. *Courts have ruled that the Act does not provide a private cause of action to the tenant. The Act is a defensive measure only.*[6] In Nativi v. Deutsche Bank National Trust Co., 2010 WL 2179885 (N.D. Cal. 2010), the Northern District of California held that:

> On its face, the statute does not explicitly state whether Congress intended FPTFA to include private rights of action. The statute states that tenants would be granted a right to remain in their homes for "at least 90 days." (citation omitted) Review f the Congressional Record indicates that Congress intended tenants to have protection to deal with the foreclosure crisis…Although the framers of the statute indicated granting rights to tenants, they did not indicate an intent to create a remedy. In fact, the Congressional Record emphasizes that the remedy should not come from the federal court but rather from the state court…Because Congress intended the PTFA to be used for protection in state court, a private right of action is not found to exist under PTFA.

[5] Although, see Bank of America v. Owens, 28 Misc. 3d 328, 903 NYS2d 677 (City Court of New York, 2010). In this case a New York court held that under the Act, the new owner has the burden of proof showing that a tenant is not bona fide. Further, Bank of America was not allowed to shift the 'burden of proof' by sending out a questionnaire to the tenants stating that a failure to respond would mean an assumption that bona fide status did not exist.

[6] *See* Logan v. U.S. Bank, N.A., U.S. Dist. LEXIS 46314 (C.D. Cal. 2010) ("…section 702 does not create either an express or implied private right of action for tenants to seek damages against successors in interest to foreclosed property for violating the ninety-day notice requirement.")

Because there is no remedy for a tenant under the Act, it often behooves the lender to seek removal of the occupant, and to put the burden on the occupant to defend the lender's claim for possession. In the event the lender prevails, and is later determined not to have complied with the Act, there is no remedy for the tenant under the Act. State law may provide some claim, and it is imperative that counsel be aware of any such potential claim, but the Act poses no risk under these circumstances.

Conclusion

Although likely formed with benevolent intentions of assisting tenants by preventing a forced, quick departure from the property, the Protecting Tenants at Foreclosure Act's application is problematic for lenders. The difficulty primarily lies in implementing a general federal law and the expectation that such law will seamlessly integrate with various state laws, which apply both judicial and non-judicial foreclosure procedures. It is vital, given the Act's extension, that lenders develop a strategy of how to best handle potential tenant issues before the foreclosure is completed.

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