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A legal update from Dechert LLP

## City Councils Impose Greater Liability on Mortgagees and Securitization Trustees

The city council of Springfield, Massachusetts recently approved ordinances relating to (i) mortgagee and securitization trustee liability for the maintenance of vacant residential real property or real property in foreclosure (the “Springfield Liability Ordinance”)<sup>1</sup> and (ii) mandatory mediation programs between “creditors” and borrowers (the “Springfield Mediation Ordinance”).<sup>2</sup> Similarly, the city council of Chicago, Illinois also passed a substitute ordinance relating to mortgagee and trustee duties for the maintenance of vacant properties (the “Chicago Ordinance”)<sup>3</sup> and has recently referred two additional substitute ordinances relating to the maintenance of vacant properties to its Committee on Housing and Real Estate for consideration to alleviate compliance concerns raised by the Chicago Ordinance.<sup>4</sup> This *DechertOnPoint* will provide a brief overview of these ordinances and the issues they raise for securitizations.

### Maintenance Liability Ordinances

Both the Springfield Liability Ordinance and the Chicago Ordinance impose obligations on the “owner” of vacant real property or real property in foreclosure. The definition of “owner” in the Springfield Liability Ordinance includes, amongst others, “every person, entity, service company, property manager or real estate Broker, who alone or severally with others . . . is a mortgagee of . . . property . . . or . . . is a trustee who holds, owns or controls mortgage loans for mortgage-backed securities transactions and has initiated the foreclosure process or has recorded a complaint to foreclose with the registry of deeds.”<sup>5</sup> The Springfield Liability Ordinance is unclear on whether a mortgagee or securitization trustee would have these obligations prior to the related property having delinquency or foreclosure status.<sup>6</sup> Each “owner” of residential property under the Springfield Liability Ordinance, amongst

<sup>1</sup> *Rev. Ordinances of the City of Springfield* §7.50.

<sup>2</sup> *Rev. Ordinances of the City of Springfield* §7.60.

<sup>3</sup> *Mun. Code of Chicago* §13-12-125.

<sup>4</sup> *Amendment of Section 13-12-140 of Municipal Code to require daylight watchmen in vacant buildings*, Chicago, IL, File # 02011-8091 (2011), available at <http://chicago.legistar.com/LegislationDetail.aspx?ID=986556&GUID=B329EC3B-9B1D-4942-B4D2-31BBC286262E&Options=Advanced&Search=>; See also *Amendment of Chapter 13-12 of Municipal Code regarding vacant buildings*, available at <http://chicago.legistar.com/LegislationDetail.aspx?ID=986507&GUID=4F651E52-334B-41EB-88CE-177766FE044B&Options=Advanced&Search=>.

<sup>5</sup> *Supra* fn 1.

<sup>6</sup> Assumption of liability prior to taking title could have significant negative implications due to the fact that a mortgagee may be precluded from asserting control over a property by trespass laws or borrower bankruptcy protections or redemption rights prior to completion of foreclosure and conveyance of legal title. American Securitization Forum, *Letter*, dated 07/26/2011 re: *Amendment of Chapter 13-12 of the Chicago Municipal Code Concerning Owner and Minimum Requirements for Vacant Buildings*, available at [http://www.americansecuritization.com/uploadedFiles/ASF\\_Letter\\_re\\_Chicago\\_Ordinance\\_7\\_26\\_11.pdf](http://www.americansecuritization.com/uploadedFiles/ASF_Letter_re_Chicago_Ordinance_7_26_11.pdf).

other requirements, is required to maintain liability insurance on vacant real property or real property in foreclosure and provide a cash bond acceptable to the Springfield Building Commissioner that is not less than \$10,000 to secure the continued maintenance of the property throughout its vacancy and compensate the City of Springfield for any expenses incurred in connection with inspecting, securing, marking or making such building safe. Failure to comply with the Springfield Liability Ordinance subjects the “owner” to a \$300 fine for each day in which the “owner” is not in compliance with the ordinance.

The “owner” definition in the Chicago Ordinance was revised to include “any person, who alone, jointly or severally with others . . . shall have charge, care of, control, of any premises, dwelling or dwelling unit as owner or agent of the owner, or an executor, administrator, trustee, or guardian of the estate of the owner.”<sup>7</sup> As such, the Chicago Ordinance now requires mortgagees and securitization trustees to assume liability for the maintenance and security of properties in their trusts within 30 days of the vacancy of such properties, regardless of delinquency or foreclosure status. The obligations of an “owner” under the Chicago Ordinance include, amongst other requirements, the obligation of the “owner” to maintain liability insurance of at least \$300,000 in the case of residential properties (or at least \$1,000,000 in the case of other properties). Failure to comply with the Chicago Ordinance subjects the “owner” to a fine between \$500 and \$1000 for each day in which the “owner” is not in compliance with the ordinance. Additionally, in what may be a growing trend of local governments attempting to pin liability for all the social ills stemming from the foreclosure crisis on the mortgage banking industry, several city council members recently introduced another substitute ordinance, which would require “owners” of five or more houses in the city of Chicago to post watchmen at vacant properties in order to avoid being subject to daily fines of up to \$1,000 per daytime violation for properties located within 1,000 yards of a public school and \$500 per day for all other violations.<sup>8</sup> Notwithstanding these trends, Chicago legislators have recently referred yet another substitute ordinance to the Committee on Housing and Real Estate, which indicates that they may

<sup>7</sup> *Supra* fn 3.

<sup>8</sup> Dan Hinkel, *New ordinance would force banks to guard vacant homes or face fine*, *Chicago Tribune*, Oct. 2, 2011, available at [http://articles.chicagotribune.com/2011-10-02/news/ct-met-safe-passages-20111003\\_1\\_vacant-properties-vacant-building-safe-passage](http://articles.chicagotribune.com/2011-10-02/news/ct-met-safe-passages-20111003_1_vacant-properties-vacant-building-safe-passage); *Supra* fn 4.

be willing to consider some of the potential implications of the Chicago Ordinance for mortgagees and securitization trustees. The proposed alternative for the Chicago Ordinance would remove mortgagees and securitization trustees from the definition of “owner” and instead would introduce an additional section that describes the maintenance standards for compliance by mortgagees. While many of the same maintenance requirements and penalties remain, the proposed alternative limits compliance requirements to residential property and permits affirmative defenses against non-compliance due to the mortgagee’s inability to take any action with respect to a property in certain enumerated cases such as (i) the existence of bankruptcy proceedings in which an automatic stay is in place; (ii) a receiver was appointed; (iii) foreclosure proceedings have commenced in which the mortgagor has asserted (by motion or pleading) defenses or claims against the mortgagee, (iv) the related mortgage was not in default, and (v) the mortgagee was not the owner of record of the first mortgage lien on the property at the time of the violation.<sup>9</sup>

## Ordinance Requiring Mediation of Foreclosures

The Springfield Mediation Ordinance establishes a mediation program for residential mortgage foreclosures addressing “all issues of foreclosure, including but not limited to reinstatement of the mortgage, modification of the loan and restructuring of the mortgage debt, including the reduction and forgiveness of mortgage debt.”<sup>10</sup> The ordinance requires foreclosure mediation negotiations between a “creditor” and a borrower and defines “creditor” as:

A person or entity that holds or controls, partially, wholly, indirectly, directly, or in a nominee capacity, a mortgage loan securing a residential property, including, without limitation, a **mortgagee**, an originator, holder, investor, assignee, successor, trust, **trustee**, nominee holder, Mortgage Electronic Registration System or mortgage servicer, including the Federal National Mortgage Association or the Federal Home Loan Mortgage Corporation. “Creditor”

<sup>9</sup> *Supra* fn 4.

<sup>10</sup> *Supra* fn 2.

shall also include any servant, employee or agent of a creditor. (*emphasis added*)<sup>11</sup>

As the definition of “creditor” includes mortgagees and securitization trustees, those parties will be required to submit to mediation prior to taking foreclosure action in this jurisdiction. The Springfield Mediation Ordinance also sets the standards that mediation must follow and directs mediators to conduct mediations using guidelines established by:

(i) the Federal Deposit Insurance Corporation and published in the Federal Deposit Insurance Corporation’s Loan Modification Program Guide available on the Federal Deposit Insurance Corporation’s publicly accessible website, (ii) the Home Affordable Modification Program; (iii) any modification program that a lender uses which is based on accepted principles and the safety and soundness of the institution and recognized by the National Credit Union Administration, the Division of Banks or any other instrumentality of the commonwealth; (iv) the Federal Housing Agency; or (v) similar federal programs.<sup>12</sup>

### Potential Implications of the Enactment of the Springfield Liability Ordinance, Springfield Mediation Ordinance and the Chicago Ordinance

Industry participants have indicated that the impact of city ordinances of this nature would ultimately be a reduction in access to credit for prospective borrowers in these cities.<sup>13</sup> The ability to sell mortgage loans in the secondary market has a significant effect on the availability and pricing of mortgage loans. A situation similar to the enactment of these city ordinances instructive of a reduction in access to credit is the anti-predatory lending statute that was enacted in the State of Georgia in 2002, which imposed certain liabilities on mortgagees and assignees. As a result of the enactment of this statute, mortgage loans secured by properties located in Georgia generally became ineligible for inclusion in securitization trusts because nationally-recognized statistical rating organizations could not

assign ratings to the related securities due to the uncertainty regarding potential liability exposure and costs of compliance with the statute.<sup>14</sup> Ultimately, the assignee liability provisions of the Georgia anti-predatory lending statute were repealed under substantial political pressure from Georgia voters who were unable to access the mortgage credit markets.<sup>15</sup> In the same vein, the new obligations and liabilities imposed on mortgagees and securitization trustees by these ordinances could restrict access to credit in these jurisdictions.

### Conclusion

The city ordinances in effect that are discussed herein direct a major shift in responsibility. There is no doubt that there is a real estate blight issue, but the proposed solutions may have a chilling effect on lending. The result of the passage of these city ordinances is the imposition of more onerous obligations on mortgagees and securitization trustees in transactions involving vacant real property or mortgaged property in foreclosure. As a result, in the future, if the trend is not reversed, we may see the cost of such obligations shifted to mortgagors by way of higher fees and interest rates in order to reduce the risks associated with lending against such properties and the absence of a secondary market for mortgage loans originated in those jurisdictions that have such ordinances.

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<sup>14</sup> See e.g., Standard & Poor’s Ratings Services, *Anti-Predatory Lending Law Update*, available at [http://www.alta.org/govt/issues/04/sp\\_1019.pdf](http://www.alta.org/govt/issues/04/sp_1019.pdf).

<sup>15</sup> *Supra* fn 5.

<sup>11</sup> *Id.*

<sup>12</sup> *Id.*

<sup>13</sup> *Supra* fn 5.

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