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# The Folly Of Mortgage Legislation: How Far It Has Gone, Part II

Lenders recognize, but proposed statutes in New York City do not acknowledge, that a mortgage is but a lien on property.

by Bruce J. Bergman

There is assuredly more cause for alarm. Part I of this analysis (which appeared in the May 2011 edition of ***Servicing Management***) was not written to be a first installment - new proposed legislation made it so. The initial piece rang the claxon for a statute in the New York legislature that would effectively bar prosecuting any foreclosure where the plaintiff did not actually possess the original notes, mortgages and assignments. As it relates to possible laws in other jurisdictions, part of the underlying problem is that lawmakers typically lack the nuanced knowledge of the foreclosure process, which can thereby lead to the passage of statutes with dangerous consequences.

Now, three laws being considered in New York City merit a like warning, with much room for profound concern. The tenor of these proposals could find favor elsewhere as part of the widespread belief that lenders are the villains in the foreclosure debacle. As contemplated, these new laws would mandate that as a condition of prosecuting a mortgage foreclosure action (anywhere in New York City), the plaintiff must do the following:

• register with the city and supply considerable information (some of it private);

• purchase and post a bond to cover fines against the mortgaged property and the cost of repairs; and

• maintain the property from inception of the action until judgment.

If, in addition to defaulting on a mortgage, a borrower neglects or abandons his responsibilities to the property and the tenants, the resultant decay and distress become a problem. Concerned about this and the impact it may have on communities, the laws seek to transfer remedial responsibilities from the owners to the lenders.

How widespread the circumstances are is unstated. That the lender-borrower relationship should be turned on its head, making lenders liable for the defalcations of borrowers, is an argument that lacks a foundation, but such are the proposals.

## The statutes

**Registration.** Adding yet another step to a process that, in judicial foreclosure jurisdictions, is becoming an untraversable minefield is surely unwelcome. More staff and more time now must be devoted by lenders to the effort. Personal data about the lender's principals or officers is part of the information to be provided, and the thought that the disgruntled borrowers will disturb these people is not so farfetched. Not incidentally, the failure to register within 10 days elicits a fine of $1,000 for each week of tardiness.

Because this requirement will apply to all existing foreclosures in addition to new ones, for some lenders, this mandate will be imposed upon hundreds or even thousands of cases all at once.

**The bond.** Because lenders are to be responsible for any fines that may attach to the property regarding its condition, and because maintenance is to be paid for by the lender, this requirement to post a bond is mandated. It is to be paid for by the lender and will be in the face amount of at least $10,000, although the sum is ultimately to be determined by an unclear formula.

What the bond may cost is also an unknown. While major lenders and servicers will have bonding capacity, smaller lenders may not, which will mean that the full amount of the bond will be the premium. Whatever the cost may be, it is not at all clear that this will be recoverable in the foreclosure action, meaning the cost might become an unreimbursable expense. Regarding the cost, it seems apparent that lenders will need to obtain blanket bonds for all of their mortgage loans, because the premium to be applied only in the case of each foreclosure could become prohibitively expensive.

There is also a dangerous hidden problem here, which is that the bond remains in force until either the judgment stage or discontinuance of the action. If a lender decides that the foreclosure is a waste of resources (which does happen), and if this is prior to the judgment, then the action would need to be discontinued. That sounds like a simple step, except that any other defendant could object to the discontinuance, and that might keep the action in force for an unstated period, with the lender liable for all of the maintenance and with the bond continuing as security for fines and repairs.

**The maintenance obligation.** Once a foreclosure action has begun, any fines or penalties that accrue against the property for violations of various laws and regulations must be paid by the lender.

Being liable for all repairs or maintenance at the premises creates an obligation that simply cannot be measured. These costs for a one- to a four-family home might not be so substantial - although in some situations, it could be surprisingly large - but the sums are likely to be enormous for the foreclosure of an apartment building, for example. Moreover, no lender will know what the duration of a foreclosure is to be. Nowadays, in New York this is measured in years, so any undefinable cost for an immeasurable period creates a risk that is simply unknown.

Being saddled with the obligation to maintain the property, a lender, which has no possessory interest in the property, is forced to take control even if the premises are locked or those in charge would not wish to allow entrance to the lender. This creates obvious difficulties and liabilities. When the lender does gain control - because the statute foists it upon the lender - the lender will have fulfilled the obligation, which makes it liable for any negligence claims at the property. In turn, every resident or visitor who trips and falls and starts a lawsuit will name the lender as a party defendant, and there will be a possibility of liability, sometimes in extraordinary amounts. In turn, this necessitates the obtaining by the lender of liability insurance for each and every property in foreclosure, even though that would never otherwise be required unless a lender became a mortgagee in possession.

And what about the lender holding a second mortgage, particularly when the loan is smaller than the first? If, for some reason, the first mortgage is not in foreclosure, or the senior mortgagee simply declines to prosecute such an action, the only way the junior lender can be protected is to begin the action. Then, the cost of maintenance may be wildly disproportionate to the initiation of a foreclosure. In this scenario, the junior lender just has the problem compounded to a greater extent.

Where a foreclosure might elicit the appointment of a receiver, once the receiver is in charge of the premises, a lender has no right to possession and could not be responsible for repairs. That is solely the obligation of the receiver as an officer of the court. The statute does not take this anomaly into account. Similarly, where a bankruptcy is filed by a borrower - which is hardly an uncommon situation - federal law then preempts any possessory rights by the lender, granting those either to a trustee or to the debtor in possession, depending upon the nature of the bankruptcy.

Lenders recognize, but the proposed statutes do not acknowledge, that a mortgage is but a lien on property. It is neither an ownership nor a possessory interest. Therefore, lenders well understand that controlling the property or being liable for repairs is simply not their responsibility. Then, too, the mortgage contract - the relationship between the lender and borrower - has always been interpreted based upon the noted immutable principles. The world thus changes with this new legislation, should it pass.

It may be that owners have to be subject to more piercing liability when they neglect properties they own or when they fail to supply services to their tenants. But such is not an excuse to impose such obligations on lenders. To the extent that lenders will become so liable - to register, post a bond and pay for all fines and repairs - then some foreclosures would not be worth pursuing at all, and the loan would become an absolute loss. Even for foreclosures that would nonetheless be initiated, the expenses will create losses where they would not have otherwise existed or even greater shortfalls where some loss was otherwise manifest.

Mindful that these responsibilities might soon exist, how any lender could price a loan or even consider a mortgage loan in New York becomes exquisitely problematical. This will do nothing to help citizens or business people who need mortgage financing.

The ultimate problem then is that those seeking a solution to a problem - the legislators - may not have understood the consequences of the legislation. The solution sought creates insurmountable difficulties, and such is a component of the folly of some mortgage legislation. SM

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