

HOME EQUITY THEFT PREVENTION ACT - AFFECTS FORECLOSURES AND TITLE INSURANCE

To halt the abuses, Banking Law §595-a was amended to add subsection (1)(h) and two new provisions were created: RPL §265-a and RPAPL §1303, all effective as of February 1, 2007. Succinctly, the ameliorative approach was twofold, one branch to provide notice to mortgagors in foreclosure of possible nefarious schemes, the other to impose special, extensive and extraordinary requirements upon contracts to sell property from certain distressed borrowers, provisions including not only a right to rescind the contract after five days, but to rescind the conveyance itself within two years.

While the statute is presumably effective both to alert the naive to danger and afford welcome protection for them, it will at the same time potentially impact deleteriously upon the foreclosure process and create considerable uncertainty as to the insurability of some titles (and mortgages upon those titles) from certain borrower-sellers. So although the Act does not as such focus upon the content of mortgages, it does present major issues about whether a mortgage is to be taken at all, hence its inclusion here in Chapter 1.

MORTGAGE FORECLOSURE ASPECT

The new RPAPL §1303 decreed by the Act mandates a foreclosing party to provide later delineated notice to a mortgagor regarding assistance and information about the foreclosure process.¹ That notice must (among other things) follow verbatim the statutory dictate:²

“Help for Homeowners in Foreclosure

New York State Law requires that we send you this notice about the foreclosure process.
Please read it carefully.

Mortgage foreclosure is a complex process. Some people may approach you about "saving" your home. You should be extremely careful about any such promises.

The State encourages you to become informed about your options in foreclosure. There are government agencies, legal aid entities and other non-profit organizations that you may contact for information about foreclosure while you are working with your lender during this process.

To locate an entity near you, you may call the toll-free helpline maintained by the New York State Banking Department at _____ or visit the Department's website at _____. The State does not guarantee the advice of these agencies."

This notice must be delivered with the summons and complaint. But there are further requirements regarding the notice. It is mandated to be in bold 14 point type, on its own page separate and apart from any pleadings and on colored paper other than the color of the summons and complaint. Even the title itself elicits special attention; it has to be in 24 point bold type.³

PROBLEMS AND ISSUES

New York State is nationally recognized by mortgage lenders and servicers as one of the most difficult states in which to prosecute a foreclosure action. The new requirements of RPAPL §1303 introduced by the Act increase the already cumbersome burdens of the foreclosure process.

In requiring delivery of the notice with the summons and complaint, the Act uses the phrase "to commence a foreclosure action." What precisely this additional verbiage means is ambiguous. An action is of course commenced by filing a summons and complaint, not delivering or serving it. If there is a supplemental summons and amended complaint (not uncommon in foreclosures) it is not clear whether the notice be included. And if the mortgagor cannot be found, thereby necessitating service by publication, what the role will be for the new notice is unstated.

Even assuming no confusion on the noted points, foreclosure practitioners can readily confirm that certain borrowers dedicated to delaying or defeating foreclosures will seize on any possible miscue in the process. Adding yet another layer of procedure arms the disingenuous to

oppose a foreclosure on the eve of sale (or seek to overturn a foreclosure sale), averring that the special notice was never served. Or, conceding it was served, borrowers will be equipped to claim that the notice was not in bold 14 point type, or the heading was not in 24 point bold type, or the paper was not of a different color. Whether a court will accept such assertions as factual is an imponderable and while such errors which do not result in prejudice can be disregarded as mere irregularities incapable of intercepting foreclosure,⁴ it might be perilously optimistic to assume that firm statutory dictates will always be disregarded by courts.

There is more. The language of the notice may very well run afoul of the Fair Debt Collection Practices Act. Should it nonetheless prove benign in the end, its necessity is doubtful at best given the expansive protections presented by the balance of the Act. Opening up yet further avenues to obfuscate in every foreclosure case to as a way to provide aid of dubious necessity for a tiny minority of mortgagors could be characterized by the lending community as ill-conceived.

TITLES, MORTGAGES AND TITLE INSURANCE

From a title perspective, the most compelling concern of the Act is the directive of the new RPL 265-a(8)(a) that any covered transaction in material violation of the contractual requirements enumerated is voidable and can be rescinded by the seller within two years of recording the conveyance. At the same time, a new subdivision added to the Banking Law⁵ as part of the Act prohibits making a mortgage loan to an equity purchaser if the lender had knowledge that the equity purchaser was not complying with the Act (i.e. RPL § 265-a).

Before examining the plethora of do's and don't's attendant to sale of the property in question (a one-to-four family house), note that the focus of the Act is a conveyance from a property owner (called an equity seller) who is either in default on his mortgage or in foreclosure, to an equity purchaser. Some quick definitions then are needed.

A "default" is said to exist if a person (an equity seller) is two months or more behind in his mortgage payments. Because such a circumstance is not a matter of public record, how any prospective title insurer would know a person could fall within the definition is perplexing. (Apparently scam artists have ways to glean such information.)

"Foreclosure" is defined as an active lis pendens (properly, "notice of pendency") filed in court (it is filed with the County Clerk, albeit the clerk of the court) pursuant to RPAPL Article 13 (the notice of pendency is more a creature of CPLR Article 65) against the subject property - or the property is on an active tax lien sale list. A pointedly puzzling aspect of this definition is that the filing of a notice of pendency is not a prerequisite to initiation of a foreclosure action. The notice of pendency must be on file for 20 days in order for a judgment of foreclosure and sale to issue,⁶ but there is no obligation to file it prior to that time.⁷ Thus, a homeowner could fit the statutory definition of "in foreclosure" but that status might not be reflected in a search of title records.

An "equity purchaser" is a person (or his representative) who acquires title to any residence in default or foreclosure.⁸

The Act appropriately early on delineates titles which are an exception to the restrictions. These include title acquired:

- To use as a primary residence. (The possible dilemma for a title insurer, though, is that the purchaser could misrepresent his intention and then just "change his mind.")
- Referee's deed in foreclosure.
- Statutory sale of property.
- Via court order or judgment
- From a spouse (and other delineated relatives).

- As a not-for profit housing organization or public housing agency.
- As a bona fide purchaser for value. (While mortgagees would want to believe that this defines a deed in lieu of foreclosure it is not clear or certain. This suggests that mortgagees will decline to accept deeds in lieu of foreclosure for fear of the need to meticulously structure a contract in accord with the Act's mandates.)

As noted, contracts covered by the Act are confined to the sale of a residence where there is a default or foreclosure, where there is consideration or no consideration or where the sale includes a reconveyance arrangement.⁹ In turn, a reconveyance arrangement is:¹⁰

- Transfer of title either by conveyance or interest or creation of a mortgage, lien or other encumbrance (during the default or foreclosure) which gives the purchaser legal or equitable title to all or part of the property; and
- Subsequent conveyance (or promise thereof) of an interest back to the seller that allows the seller to regain possession (through a purchase agreement, option to purchase or lease).

CONTRACT REQUIREMENTS

The Act is expansive in reciting various mandates and prohibitions for any contract addressed by the statute. It must be on 12 point bold type,¹¹ in English, or in Spanish if the latter is the seller's primary language¹² (although how that could always be known by a title insurer is problematic), the entire agreement¹³ and no conveyance will be effective sooner than midnight of the fifth business day after "execution".¹⁴ (Unless the contract is acknowledged, the correct word is "signing" or "signed".) Two copies are to be provided to the seller.¹⁵ Any provision to limit the purchaser's liability is void and the mere presence of such a provision renders the contract void.¹⁶

The following are required for inclusion in the contract:

- Name, business address and phone number of purchaser;¹⁷
- Address of the property;¹⁸
- Total consideration;¹⁹
- Complete description of terms of payment or other consideration including services purchaser represents he will perform before or after sale;²⁰
- Time physical possession to be transferred to purchaser and when seller must vacate;²¹
- Terms of rental or lease agreement;²²
- Terms of reconveyance arrangement;²³
- Notice of cancellation (within five business days);²⁴
- Cancellation form (12 point bold type; or all capital letters if typed) to be attached;²⁵

PROHIBITIONS AGAINST EQUITY PURCHASER

Before midnight of the fifth day after signing the contract the purchaser shall not:²⁶

- Accept or induce any instrument of conveyance or interest;²⁷
- Record any document signed by seller (including conveyance);²⁸
- Transfer or encumber any interest in the residence;²⁹
- Pay the seller any consideration;³⁰
- Suggest, encourage or provide any form allowing seller to waive the right of cancellation or rescission.³¹

There are yet other prohibitions against the purchaser. While these seem appropriate in the context of avoiding unfair advantage over a careless seller, many of the barred acts cannot be discerned by a prospective insurer of the title or of a mortgage upon that property. On this point, the purchaser shall not:³²

- Make any false or misleading statement as to value of the residence; or
- The amount of proceeds the seller will get after foreclosure sale; or
- Timing of the judicial foreclosure process; or
- Any contract term; or
- Seller's rights or obligations in the transaction; or
- Nature of any document purchaser induces seller to sign; or
- Make any other false or misleading statement concerning the sale or the reconveyance; or
- Enter into contract which takes unconscionable advantage.³³

Nor can the purchaser represent directly or indirectly that:

- Purchaser is acting as advisor or consultant;³⁴ or
- Purchaser represents or is acting on behalf of seller;³⁵ or
- Purchaser has certification or license not possessed;³⁶ or
- Purchaser is not a member of a licensed profession when he is such a member;³⁷ or
- Purchaser is assisting seller to save the "house" unless there is a good faith basis to say so;³⁸ or
- Purchaser is assisting seller in preventing foreclosure, unless he has a good faith basis to say so;³⁹

RESCISSION

If the seller (that homeowner in default or in foreclosure) desires to rescind the conveyance, it must be upon written notice to the purchaser, or the purchaser's successor if not a bona fide purchaser for value. In addition, the notice must be recorded with the county clerk within two years

after the date the conveyance itself was recorded.⁴⁰

Twenty days after delivery of the rescission notice the seller must reconvey the property free of subsequent encumbrances due to the actions of the purchaser and the seller is obliged to return to the purchaser any consideration paid.⁴¹

Failure to reconvey empowers the seller to initiate an action to enforce rescission, cancel the contract and cancel the deed.⁴² The attorney general can enjoin the purchaser from further action⁴³ and there are various criminal penalties which can be imposed upon the purchaser for misdeeds.⁴⁴

In the action to enforce rescission the seller can be entitled to costs and reasonable attorneys' fees,⁴⁵ equitable relief,⁴⁶ actual damages and up to three times actual damages. The statute of limitations applicable to the action is six years from the date of violation.⁴⁷

Fortunately, a bona fide purchaser for value (or an encumbrancer of the BFP's title) will not be effected by the rescission if the title or the encumbrance were recorded prior to the notice of rescission.⁴⁸ Even knowledge that the seller was in default or foreclosure will not impair the status of the bona fide purchaser for value.⁴⁹ Critically, however, there is still a duty of inquiry as to rights or interests of persons in possession of the property which is in default or in foreclosure.⁵⁰

THE RECONVEYANCE ARRANGEMENT

An option to purchase retained by the equity seller (even in a deed) is deemed to be a loan transaction and the deed is considered to be a mortgage.⁵¹ This presumption, though, can be overcome by clear and convincing evidence to the contrary.⁵²

The equity purchaser is barred from entering into a reconveyance arrangement unless certain acts are either done or avoided.⁵³ (If these are not done - or avoided - it becomes unclear how that might affect the insurability of the title back to the equity seller.) In any event, the ban prevails unless:

- The equity purchaser verifies by appropriate documentation that the seller has or will have reasonable ability to pay for conveyance back (this applies also to a lease with an option to purchase);⁵⁴
- There is a rebuttable presumption of lack of verification if the purchaser only obtains documents from the seller as to assets, liabilities and income [the standard to determine ability to pay is found in Banking Law § 6-1(2)(k)];⁵⁵
- An “in-person” closing (for deed or mortgage) is conducted by an attorney not employed by the purchaser or an affiliate of the purchaser.⁵⁶
- The purchaser obtains the seller’s written consent before granting an interest to anyone else while the seller retains any interest, including an option to repurchase;⁵⁷
- The purchaser notifies existing mortgagees and lienors of intent to take the conveyance and complies with all mortgages, including due on sale provisions and meets qualifications for repayment of mortgages.⁵⁸

Moreover, the repurchase or lease (as part of a reconveyance) cannot be unfair or commercially unreasonable and the purchaser cannot engage in any other unfair or unconscionable conduct.⁵⁹

As part of the reconveyance, the equity purchaser (who is conveying back) must ensure that the title is indeed reconveyed⁶⁰ or pay the seller at least 82% of the fair market value of the property- within 120 days of either eviction or the voluntary giving of possession by the equity seller. As part of this, the equity purchaser must give a detailed accounting of the basis for the payment within 120 days.⁶¹ (There are then sundry provisions as to accounting and appraisal.)⁶²

1 The explicit foundation is recited in the new RPL §265-a(1)(a):

“The legislature finds and declares that homeowners who are in default on their mortgages

or in foreclosure may be vulnerable to fraud, deception, and unfair dealing by home equity purchasers. The recent rapid escalation of home values throughout urban and rural areas has resulted in a significant increase in home equity, which constitutes the greatest financial asset held by many homeowners of this state. During the time period between the default on the mortgage and the scheduled foreclosure sale date, homeowners in financial distress, especially poor, elderly, and financially unsophisticated homeowners, are vulnerable to aggressive "equity purchasers" who induce homeowners to sell their homes for a small fraction of their fair market values, or in some cases even sign away their homes, through the use of schemes which often involve oral and written misrepresentations, deceit, intimidation, and other unreasonable commercial practices."

"(b) The legislature declares that it is the express policy of the state to preserve and guard the precious asset of home equity, and the social as well as the economic value of homeownership."

2 RPAPL § 1303(1).

3 RPAPL § 1303(2).

4 See §2.06A, *infra*.

5 Banking Law § 595-a(1)(h).

6 RPAPL § 1331. For a further analysis of this requirement see §15.04 [2][a], *infra*.

7 While there are strategic reasons to file a notice of pendency at the inception of a foreclosure, such is a judgment call by counsel. In any event, there is no assurance that a foreclosure action will elicit a notice of pendency filing until later in the case when the judgment of foreclosure and sale is pursued. It is therefore possible that no readily sought public record would exist as to the "foreclosure" status of the people the statute strives to protect.

8 There are a number of other definitions in the statute which would need to be consulted as part of detailed analysis - not reviewable here as a matter of space.

9 RPL §595-a(2)(c).

10 RPL §595-a(2)(d)(i).

11 RPL §265-a(3).

12 RPL § 265-a(3).

13 RPL §265-a(4).

14 RPL §265-a(3).

15 RPL §265-a(6)(b).
16 RPL §265-a(12).
17 RPL §265-a(4)(a).
18 RPL §265-a(4)(b).
19 RPL §265-a(4)(c).
20 RPL §265-a(4)(d).
21 RPL §265-a(4)(e).
22 RPL §265-a(4)(f).
23 RPL §265-a(4)(g).
24 RPL §265-a(4)(h).
25 RPL §265-a(4)(i).
26 RPL § 265-a(7)(a).
27 RPL § 265-a(7)(a)(i).
28 RPL § 265-a(7)(a)(ii).
29 RPL § 265-a(7)(a)(iii).
30 RPL § 265-a(7)(a)(iv).
31 RPL § 265-a(7)(a)(v).
32 RPL § 265-a(7)(b).
33 RPL § 265-a(7)(d).
34 RPL § 265-a(7)(c)(i).
35 RPL § 265-a(7)(c)(i).
36 RPL § 265-a(7)(c)(ii).
37 RPL § 265-a(7)(c)(ii).
38 RPL § 265-a(7)(c)(iii).
39 RPL § 265-a(7)(c)(iv).

40 RPL § 265-a(8)(b).
41 RPL § 265-a(8)(b).
42 RPL § 265-a(8)(b).
43 RPL § 265-a(13).
44 RPL § 265-a(10)(a)(i) and (ii).
45 RPL § 265-a(8)(d).
46 RPL § 265-a(9).
47 RPL § 265-a(9).
48 RPL § 265-a(8)(c).
49 RPL § 265-a(8)(c).
50 RPL § 265-a(8)(c).
51 RPL § 265-a(11)(a).
52 RPL § 265-a(11)(a).
53 RPL § 265-a(11)(b).
54 RPL § 265-a(11)(b)(i).
55 RPL § 265-a(11)(b)(i).
56 RPL § 265-a(11)(b)(ii).
57 RPL § 265-a(11)(b)(iii).
58 RPL § 265-a(11)(b)(iv).
59 RPL § 265-a(11)(c).
60 RPL § 265-a(11)(d)(i).
61 RPL § 265-a(11)(d)(ii).
62 RPL § 265-a(11)(d)(ii)(A) and (B).