

How a Residential Foreclosure Law Affects Commercial Lenders

The Fair Foreclosure Act, which becomes effective as to foreclosures commenced from and after Dec. 4, 1995, was enacted in response to the fact that the residential foreclosure process in New Jersey is the most time-consuming in the country. While the act primarily focuses on the residential mortgage foreclosure process, it contains provisions of general application to all foreclosures.

A residential mortgage is defined by the act as a mortgage on a one-to-four-family dwelling occupied by the borrower or a member of the borrower's immediate family. While intended to apply to foreclosures by consumer lenders of residential mortgages, the act makes no distinction between those consumer loan situations and commercial loan situations where a mortgage is granted to a lender on a one-to-four-family dwelling occupied by the borrowing party or the borrowing party's immediate family.

For example, it is quite common for a principal of a corporation to provide a guaranty for that corporation's commercial loan and to secure the guaranty by a mortgage on the principal's personal residence. Such a transaction is clearly for business and commercial purposes and is generally exempted from most consumer-protection legislation. However, under the act, that mortgage may now be foreclosed only pursuant to the act's foreclosure procedures and the guarantor would be afforded significant additional protections above and beyond the terms and conditions of the guarantor's existing loan documentation. The act's protections and procedures are imposed as to all residential mortgages currently in place or hereafter created. It is these implications for commercial lenders which will be the focus of this brief article.

Provisions Applicable to Residential Mortgages

The most significant provision of the act is the "optional foreclosure procedure without sale." If the lender elects this procedure, once judgment of foreclosure is obtained, the need for a sheriff's sale is eliminated and the mortgaged property may be sold and conveyed through an order of the Office of Foreclosure of the Superior Court. The optional foreclosure procedure may *only* be elected by the lender where the borrower has abandoned the mortgaged property, voluntarily surrendered the property through a deed-in-lieu of foreclosure or there is no equity in the property.

If the optional sale procedure is elected, the Office of

Foreclosure may enter an order fixing the amount, time and place for redemption of the mortgaged property, which may be not less than 45 days or more than 60 days after the date of the order. The order must be mailed to the borrower and all other defendants and each is advised of the terms and conditions under which a public sale may be requested. If no request for a public sale is made within 30 days of the date of the order, and upon proof of



mailing of the order of redemption to all defendants, the lender will be entitled to a judgment debarring and foreclosing the equity of redemption of all defendants in the mortgaged property and adjudging the lender to be vested with a valid and indefeasible estate in the mortgaged property.

All of this is accomplished without a public sale. If, however, the borrower requests a public sale, a public sale will be held generally in accordance with the existing sale procedures.

Of great significance, if the optional sale procedure is used, the debt which was secured by the mortgage is deemed satisfied and the lender is not permitted to institute any further or contemporaneous action for the collection of the debt.

Safeguards for Borrowers

The optional sale procedure is intended to shorten significantly the length of time it takes in New Jersey to complete a residential foreclosure. However, this benefit to lenders was not freely granted — the price was additional, important protective rights to homeowners. The act provides that, prior to acceleration of any residential mortgage obligation and the commencement of any foreclosure or other legal action, the lender must give at least 30 days prior written notice of intention to foreclose. The notice of intention to foreclose is quite detailed and must include, among other things, a description of the debt; the nature of the default; the amount necessary to cure the default; the date before which default must be cured (which must be not less than 30 days of the notice); and that if default is not cured the lender may exercise

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remedies.

In addition to the pre-acceleration notice, the act permits reinstatement of any residential mortgage loan by payment of the amount which would have been due in the absence of the default together with court costs and attorneys' fees in an amount not to exceed those permitted by the New Jersey Court Rules. In other words, even though a residential mortgage loan may have been accelerated, the borrower may reinstate the loan by paying only the past due periodic payments, court costs and permitted counsel fees. If this reinstatement right is exercised, the default is nullified as of the date of the cure, and any acceleration of the underlying obligation is rescinded. The cure right may be exercised only once every 18 months as to any particular mortgage. The right to cure by payment exists at any time up to the entry of final judgment or the entry by the Office of Foreclosure of an order of redemption.

Implications for Commercial Lenders

It is uncertain how severely the act will affect commercial lenders. It is clear, however, that the above provisions will apply to purely commercial situations, such as those in which guarantors of corporate commercial obligations grant mortgages on residences occupied by borrowers or members of their families. Even though the mortgagor will be a guarantor under this scenario and not the maker of the note, the definition of "residential mortgage debtor" in the act includes any person who is "obligated to pay the *obligation*" secured by the residential mortgage.

A prior version of the legislation had defined "residential mortgage debtor" to be any person "obligated to pay the *note*." However, an amendment to the legislation changed the word "note" to "obligation," perhaps indicating an intention to expand the scope of the statute to cover situations involving a guaranty of a commercial loan. The act's provisions will afford additional rights to commercial obligors even though the existing loan documentation may specifically detail and limit the rights of the commercial obligor upon a default. Because the act applies to all foreclosures commenced on or after Dec. 4, 1995, by definition it will alter the terms and conditions of literally thousands of residential mortgages, whether those mortgages were given in a purely consumer context or in commercial loan situations.

Therefore, upon a default under a commercial loan, which is guaranteed by an individual and secured by a residential mortgage, before commencing a foreclosure on the residence, the lender must provide the detailed pre-acceleration notice at least 30 days before acceleration. Also, the obligor will be extended the right to reinstate by payment of the past due periodic amounts due. The

payment of these amounts (rather than the accelerated amounts), the right to reinstate, and the other procedural protections provided in the act may *not* be waived in any documentation. Any such waiver will be void as contrary to public policy.

Even though the procedures for recourse to the mortgaged property will be subject to the act, the act does not apply to collection of the obligation by means other than enforcing the lender's lien on the residential property. Thus, the act should not limit the ability of a lender to proceed against other collateral or seek to attempt to obtain judgment against the corporate borrower.

Beneficial Provisions for All Lenders

While the act contains various provisions which would appear to complicate the life of commercial lenders, there are several provisions of general application which appear quite helpful. In particular, the act states that unless there is an express agreement to the contrary by the parties, the debtor may tender, and the lender may accept, partial payment of any sum owing and due without either party waiving any rights. Whether this concept will be applicable solely to mortgage loans or have greater scope is not clear. However, at minimum, it should put to rest long-standing concerns by lenders that acceptance of partial payments on a mortgage loan could be deemed to represent a waiver of defaults or other rights.

The act streamlines the procedure by which the federal and state governments may enter noncontesting answers in foreclosures. Rather than being required to enter a formal answer, a simple appearance letter will be deemed sufficient where the governmental entity does not intend to contest the matter.

As a further means of speeding the foreclosure process, the act requires the sheriff to conduct a foreclosure sale within 120 days of receipt of the writ of execution and, if unable to do so, permits the Office of Foreclosure to appoint a special master. In connection with sales, sheriffs will now be permitted to allow only two 14-day adjournments, rather than two 30-day adjournments as is current practice. The act also contains a standard form of sheriff's deed for all foreclosures and requires the sheriff's deed to issue within two weeks of the sale provided the purchase price is timely paid.

To assist in serving judgment creditors, the act requires all judgment creditors, upon entry of judgment, to provide a current address for service and to update that address. Failing to do so will permit valid service on a judgment creditor named in a foreclosure merely by regular and certified mail without the need for more diligent inquiry or publication of notice. Finally, the act extends the effective date of a *lis pendens* from three to five years.

Whether inadvertent or not, the act creates additional hurdles for commercial lenders in situations where a commercial loan is secured by a mortgage on a residential property. The extent of the problems caused may not be known until the act has been subjected to judicial scrutiny. As a matter of prudence, lenders should assume that the act will apply and, to avoid granting additional defenses to borrowers/guarantors, should adhere to the provisions of the act in any situation where there is doubt. ■