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SJC Solicits Feedback Before Ruling On Legality Of Foreclosure Ordinances

Individual Ordinances Will Create Patchwork Of Enforcement Issues

BY ALISON KINCHLA
SPECIAL TO BANKER & TRADESMAN

Since 2011, several Massachusetts cities, including Springfield, Lawrence, Worcester and Lynn, have enacted ordinances intended to regulate and avoid residential property foreclosures. Although not entirely uniform, these ordinances all impose property preservation requirements on the lender and require in-person, pre-foreclosure mediation between the lender and borrower.

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In *Easthampton Savings Bank v. City of Springfield*, a case of keen interest to the mortgage and banking industry, the Massachusetts Supreme Judicial Court (SJC) is soliciting amicus briefs to address whether the Springfield city foreclosure ordinance is pre-empted by state laws and regulations and whether it imposes an unlawful tax on mortgagees. Six banks have challenged this ordinance, focusing on three particularly troubling aspects.

First, the Springfield ordinance requires "owners" of vacant or foreclosing properties to satisfy certain maintenance conditions, including removing hazardous materials, securing the property and complying with the state sanitary code. While the blight frequently associated with vacant properties should be avoided, the ordinance's broad definition of "owners" shifts responsibility for maintenance of the property from the borrower to the lender before the foreclosure is completed – while the homeowners are still in possession. The banks argue that this requirement irreconcilably conflicts with Massachusetts trespass law and subjects lenders to civil and criminal penalties by requiring lenders to perform repairs before they have a legal right to enter the property.

Second, the ordinance requires banks to provide a $10,000 cash bond on each property in foreclosure, without regard to its present condition or whether the bank is actually in possession. The city may draw down from the bond for any maintenance it conducts on a property. Even if the mortgagee properly maintains the property, the city will retain "a portion" of the bond as an administrative fee presumably to cover expenses incurred by the city in repairing other properties. The banks argue that this bond constitutes an unlawful tax on lenders because those lenders who comply will not receive any benefit for the indiscriminate charge.

Third, the ordinance mandates that both lenders and borrowers participate in mediation prior to foreclosure, where the lender is required to consider all alternatives to foreclosure, including modification of the loan and reducing or forgiving some of the indebtedness. The banks claim this aspect of the ordinance is both overly burdensome and duplicative of pre-existing laws. As an example, M.G.L. c. 244 § 35B already mandates that lenders review certain mortgage loans for modification before foreclosing, and loss mitigation options are regulated by a multitude of federal agencies, including the Consumer Financial Protection Bureau, Fannie Mae, Freddie Mac and the Department of Treasury. The ordinance does not account for these pre-existing requirements, effectively requires lenders to start the loss mitigation review anew, and, the banks argue, should be rejected as pre-empted by pre-existing law.

Court's Decision Has Far-Reaching Effects

The banks also challenge the bond and pre-foreclosure mediation requirements as violative of the Contract Clause of the Constitution. The ordinance imposes obligations on mortgagees in conflict with the terms of most mortgages, such as assigning responsibility for maintenance to the lender while the borrower is still in possession of a property and reducing or forgiving a portion of the mortgage debt – a mandate that undermines the very foundation of the mortgage loan.

Notwithstanding the arguments presented, the United States District Court upheld the Springfield ordinance, which has emboldened other cities to draft ordinances that further intrude on the borrower/lender relationship. The city of Lynn's ordinance is particularly far-reaching, as it allows foreclosed borrowers to pay rent to remain in possession of their home until the lender sells the property to a third party, and prohibits eviction of the borrowers if the new owner does not use the property as a principal residence.

Upholding these ordinances will create a patchwork of non-uniform rules and regulations concerning the management of defaulted loans, and effectively undermine the Legislature's ongoing attempts to standardize foreclosure laws and protections. Despite good intentions, these ordinances may also have unintended consequences. For example, any restraint on a third party's subsequent use may make borrowers less likely to purchase foreclosed homes at market value, further depressing the local real estate market and delaying repairs and improvements. Or lenders may reassess the risk of investing in these communities and tighten lending standards, causing a credit contraction to the general municipal population.

Full enforcement of these city ordinances have all been suspended until the pending case has been resolved. The SJC's decision on these issues will either pave the way for further, conflicting, city ordinances, or hopefully prohibit further encroachment by municipalities into this area. In either event, members of the financial industry who have a stake in the matter are encouraged to provide their perspective before the SJC issues its decision. ■

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