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FAILURE TO COMMUNICATE

State Sanitary Code Receivership: A Trap for the Unwary Lender

Security In Certain Mortgages At Risk

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SPECIAL TO BANKER & TRADESMAN

A little-known power of the court is causing large headaches for lenders by wiping-out their security in certain mortgages. The Attorney General's office has partnered with local officials in its Abandoned Housing Initiative ("AHI"), which uses the enforcement authority of the State Sanitary Code to appoint a Receiver to address and repair property conditions allegedly creating safety or health hazards to the public and first responders in cases where property owners have ignored prior violation notices.



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See M.G.L. c. 111, Section 127I. Violations commonly cited, such as overgrowth of the property and lack of security, may seem innocuous and minor.

The danger, though, is that once a receiver is appointed, it assumes control of the property, and the budget frequently includes thousands of dollars for repairs not previously noted, as well as additional soft costs for things like management fees and interest, the total of which may rival the construction budget. Upon completing its work, the receiver is entitled to a super-lien on the property and, to recoup its expenses, may either rent or foreclose on the property. While a receiver may only collect its own costs and fees from the proceeds of any foreclosure sale, it is not required to consider the amount of any other lien on the property when setting the auction price.

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From a lender's perspective, these actions are oddly postured because, while the properties in question are vacant, they typically have not yet been foreclosed upon. Thus, the mortgagors, who are unwilling or unable to conduct any repairs, remain legally responsible for the property. But, if the repairs cited extend beyond the scope of normal pre-foreclosure property preservation tasks, the mortgagee may not have authority to conduct the repairs. This creates a situation where the servicer's responsibility to protect the mortgagee's investment is in direct odds with the investor's own servicing guidelines and, perhaps, even state trespass law and the terms of the mortgage.

To appoint a receiver, the petitioner must demonstrate to the court that "violations of the sanitary code will not be promptly remedied unless a receiver is appointed," which is generally established by providing copies of prior code violation notices and an affidavit from an official attesting that compliance has not occurred.

Here, an ounce of prevention is worth a pound of cure. To reduce exposure, mortgagees should identify a specific department responsible for addressing and re-

sponding to notices of code violations in their nascent stages. If the notices identify violations beyond the purview of normal servicing guidelines, servicers should seek authority from the investor to conduct the repairs and/or attempt to negotiate an agreement with the mortgagor wherein the mortgagor conducts the repairs, rather than risk appointment of a Receiver. The key is to communicate with the citing authority and make a prompt decision as to what, if anything, the mortgagee may do before the receiver is appointed because, at that stage, the mortgagee loses control over both the extent of any repairs and the foreclosure sale and process.

Early intervention may well be imperative, as receiver actions appear poised to increase: several million dollars from the proceeds of the National Mortgage Settlement have been set aside to fund grants under the AHI. Any funds not expended by June 24, 2015 must be returned to the Commonwealth; therefore, distressed municipalities have an incentive to ratchet-up their compliance actions, and delaying response to these violations may result in one very expensive landscaping bill. ■

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