Foreclosures: A Non-Traditional Approach

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ABSTRACT

Foreclosures are at a record high, causing families to be displaced, blighted neighborhoods and the reduction of home values. This paper examines a few unusual cases recently determined, whereby the Court exercises its equity powers to find a just result.

Keywords: Foreclosures; forbearance agreement; equity; modification agreement; deed in lieu of foreclosure

INTRODUCTION

Foreclosures are becoming a part of the American way of life. At one time, everyone strived to own their own home. Now, everyone is attempting to hold onto their homes. Every homeowner has witnessed a decline in the value of their home, but even worse for some, many saw their homes taken from them in foreclosure proceedings. This year the United States will probably have over one million homes foreclosed on. Nearly 528,000 homes have been taken back by lenders during the first six months of this year. As of June, 2010, 2,065,027 homes have been foreclosed on. Foreclosures are inevitable, but what is unpredictable are the results being obtained in the foreclosure proceedings. If the Courts simply enforced the terms of the mortgages and notes pursuant to strict contract law, the homeowners would have little hope to save their homes. The result would be a real estate market that would take many years to recover from its present place. Simply put, this would mean rock bottom home prices, with the banks being owners of a surplus of homes. The banks would have to pay taxes on abandoned homes, many of which would have to be boarded up and otherwise maintained. This would destroy neighborhoods and seriously bring down other property owners values. "The single most important determinants of future home prices are the local foreclosure and delinquency rates".

On March 4, 2009, the Department of the Treasury announced a plan to aid the homeowner, the Home Affordable Modification Program (HAMP), which can be implemented by the Court systems. This program is authorized to accept new borrowers until December 31, 2012. Many of the Courts have compelled the parties in a foreclosure proceeding to act in good faith in attempting to resolve the matter with a goal of keeping the homeowner in his or her home and the bank receiving monies for its loan. The President's give away (entitlement programs) did not work and were short-sighted. While a countless number of homeowners are losing their homes is and was a poor response to the foreclosure epidemic destroying our economy, some Courts are not just using their legal powers, but are also using their equitable powers. In all fairness to the President, when the program ended, home sales did decline. This paper looks at two recent Court decisions by Justice Jeffrey Arlen Spinner of the New York Supreme Court for the County of Suffolk. The Supreme Court, in the New York Court system, has original jurisdiction and is the trial Court. The Judge's decisions at first blush appear to be outrageous, but in reading the Judge's decisions, it actually shows the Judicial system's commitment to help resolve the current mortgage crisis. First, a brief description of a foreclosure proceeding is required.

When needing funds to purchase a home or to refinance an already owned home, the homeowner (debtor) borrows money from a lender (creditor). At the closing, the debtor signs numerous documents, but the major two are the mortgage and the note. The note is a promise to pay back the monies borrowed and the mortgage acts as a lien recorded against the property and protecting the lender's investment. By virtue of the mortgage, the creditor becomes secured (protected), which means that if the debtor fails to pay the mortgage when due (default), the secured creditor is in the first position to take back the property to the extent of what it is owed.

Once the foreclosure proceeding has been commenced, the debtor has many options: 1) usually not refinancing because the debtor's credit has been ruined by the foreclosure and qualifying for loans has been made more difficult by virtue of higher underwriting standards; 2) a deed in lieu of foreclosure (simply turn back the property to the creditor and the debtor would be released from any deficiency monies owed); 3) bankruptcy; 4) a short sale (where the debtor sells the house for the creditor. However, in utilizing a short sale, the debtor cannot receive any proceeds from the sale, but his/her debt would be fully discharged); and 5) the loan modification agreement granted in conjunction with HAMP. During the HAMP trial period, or while the borrowers are being considered for eligibility, the foreclosure action is suspended. HAMP affords protection for first lien mortgages, which were originated on or before January 1, 2009. The mortgage loans must be owned, guaranteed, or securitized by Freddie Mac and be single family 1-to-4 unit primary residences, including condos and cooperatives. To be considered for a modification under HAMP, the borrowers are current or less than 60 days delinquent and determined to be in imminent default, or be more than 60 days delinquent. The borrowers must assert a financial hardship and currently be a party to a foreclosure proceeding, pending litigation or bankruptcy. Borrowers must have a monthly housing expense-to-income ratio greater than 31 percent of their verified gross monthly income. If the borrowers qualify for this program, the Department of Treasury will partner with the lender to reduce the homeowners' monthly mortgage payments. Typically, the delinquent amount (arrears and costs) would be made current on the loan by adding them to the back of the loan (back-ending), known as recapitalizing arrears. Before diving into the cases that follow, a very brief description of a typical foreclosure part of the Judicial system should be set forth. Once a foreclosure action is commenced, the matter gets assigned to a special part, with referees (attorneys) appointed by the Court, to help resolve the matter. Should one of the parties be unreceptive or the matter legitimately be unable to be resolved, than the matter would be assigned to one of the Judge's parts for disposition.

In the case of Indy Bank vs. Yano-Horosky (New York Supreme Court for the County of Suffolk, Index No. 2005-17926), this matter was decided by Justice Spinner on November 19, 2009. Justice Spinner is assigned to a special foreclosure part of the Court in Suffolk County, which happens to have the highest ratio in the State of New York for the amount of foreclosures to the number of homes and this Justice has seen the filing for the foreclosures rise from 2,862 in 2006; to 4,679 in 2007; to 7,111 in 2008 with no abatement in sight.

The Yano-Horosky matter was a foreclosure proceeding wherein the defendant-debtor borrowed $292,500.00 from the plaintiff's predecessor on August 4, 2004.

The mortgage secured an adjustable rate mortgage (ARM), which had an initial interest rate of 10.375 percent. The Summons, Complaint and Notice of Pendency were filed within less than one year from the making of the loan, on July 27, 2005, with the Judgment of foreclosure and sale being granted on January 12, 2009, three and one-half years after the commencement of the proceeding. Because this loan was considered "subprime" or "high cost", the debtor was entitled to and requested a settlement conference (HAMP).

The first conference was scheduled for February 24, 2009 and thereafter continued five times. The Judge noted that at each conference the bank was totally uncooperative in attempting to amicably resolve the matter. The Court either becoming frustrated or irate, or a combination of both, directed that an officer of the plaintiff bank appear for the next conference, which took place of September 22, 2009. The bank officer was not cooperative in trying to resolve the matter and made it clear to the Court that the bank officer wanted the property back from the debtor and would not be agreeable to anything short of that.

At the conference, the bank claimed that it was owed over $525,000.00 and conceded that the property being foreclosed on was not worth more than $275,000.00. The bank, in its defense, stated that it attempted to resolve the matter by virtue of a "forbearance agreement". A forbearance agreement provides that a lender will not commence or pursue a foreclosure proceeding in exchange for the debtor fulfilling his/her promises. The debtor's promises could be to consent to the amount owed, a deed in lieu of foreclosure, a refinance, a new agreement to pay, etc. In this case, the debtor was to make payments, which the bank claimed she failed to do. Upon scrutiny by the Court, it found out that the bank did not send out the forbearance agreement with the dates to be paid, etc. until after those payment dates had passed, making the debtor in default before she even received the agreement.

Further, the bank rejected the defendant's daughter's offer to purchase the house at the fair market value (short sale). The bank also stated that it would not consider the income of the debtor's husband and daughter in any type of modification agreement because they were not obligors on the note and could not be bound. However, HAMP and other programs do allow and consider third party contributions upon the submission of financials by such persons. The husband and daughter stated that they would sign any and all documents to be bound and did in fact have a stake in the matter since they both resided in the home. The bank rejected this offer. Finally, in a last ditch effort of desperation, the debtor offered the bank a deed in lieu of foreclosure, which too was rejected by the bank. The deed in lieu of foreclosure would have given the property back to the bank immediately, but the bank, in turn, was requested to have forgiven any deficiency monies owed by the debtor upon the resale of the property, which it refused to do.

Being unable to have any meaningful settlement discussions with the bank, the Court ordered a hearing on November 8, 2009 to explore the issues in the case. At the hearing, the bank claimed that it was owed $527,437.73 as of November 22, 2009. The debtor was able to produce two letters from the bank which showed $285,381.70 was due on February 9, 2009 and the other letter showed that $283,997.48 was due on August 10, 2009. Clearly, the credibility of the bank was called into question by the Court. The bank responded that the discrepancies were probably because the debtor made payments. However, it was already conceded by all the parties that no payments had been made. The Court-appointed Referee computed the amount to be $393,983.42 through January 1, 2009. Even using this amount and adding interest, etc. to it, the Court determined that the bank was over $80,000.00 off in its demand. The Courts generally require payment histories, which clearly would have clarified any discrepancies. Foreclosure is an equitable remedy, and equity declares that "he who seeks equity must have clean hands". The Court felt that the bank never negotiated in good faith and was not credible in its testimony. Typically, the Court could do one of two things: 1) sanction the bank with a monetary penalty, which they would probably have paid, and continued to pursue the claim against the debtor, or 2) dismiss the case. However, here again, the bank would have simply commenced a new foreclosure proceeding and pursued its claims against the debtor. The Court instead invoked its equitable powers and ordered the promissory note cancelled, the mortgage discharged, the judgment vacated, and set aside all fees involved to be paid by the bank. When the decision first hit the newspapers, it was with a minimum amount of the facts and the legal community thought that the Judge was a loose cannon and his decision would easily be reversed on appeal. But, in reading the facts which revealed the consistent bad faith of the bank, the decision may have been the only viable and just result to be had.

In the proceeding Emigrant Mortgage Company, Inc. vs. Corcione, (NewYork Supreme Court for the County of Suffolk, Index No. 2009-28917), Justice Spinner was assigned to resolve this matter. This proceeding was commenced by the filing of the Summons, Complaint and Notice of Pendency on July 23, 2009. The underlying mortgage sued on was given on July 5, 2007, in the amount of $302,500.00. It was an adjustable rate mortgage with the initial rate being 11.625 percent. With the mortgage documentation documents, the debtors also signed a default rider providing that should the debtors default, the debtors would be obligated to pay interest at the rate of 18 percent. On or about May 1, 2008, the debtors defaulted, with one of them having lost his job, causing them to be unable to make the payments. The debtors alleged that they attempted to obtain a modification of the loan, but the bank in response, stated that they only did so after the proceeding was commenced. On another note, the bank had no explanation as to why it took no action for 14 months after the default to the commencement of the proceeding. During this time, interest was accumulating at the rate of 16 percent (not the default rate of 18 percent), which to the date of the decision, the Court was perplexed as to why this lower rate was being charged.

On October 1, 2009, the Plaintiff made a motion for summary judgment and for the appointment of a referee to compute. This loan qualified for a modification conference and the initial conference was held on October 18, 2009 and adjourned thereafter no less than five times. As a result, the conference was than scheduled with Justice Spinner on March 16, 2010. The Court, in examining the loan documentation, felt that the parties entering into the loan agreement were not of equal bargaining power and that the contract was an adhesion contract (take it or leave it). At the loan modification agreement conference, the bank claimed the arrears to be $119,330.89. The bank also proposed that if the debtors could keep up with a payment schedule for 12 months, it would reduce approximately $30,000.00 of the default interest. The Plaintiff claimed that the amount of principal currently owed was $301,721.58 with interest in the amount of $95,154.65 accumulated from the date of the default until March 1, 2010. The Plaintiff claimed other monies due, which the Judge reviewed and found most of which were without merit. The Court than proceeded to review the terms of the proposed Loan Modification Agreement and found them to be deplorable with one section even depriving the debtors from utilizing protection under the United States Bankruptcy Code. The automatic stay granted debtors in bankruptcy would be waived, the Judge finding that if this were enforceable, the Plaintiff would be able to pre-empt the federal insolvency statutes. The Court found such clause to be unconscionable and against public policy and therefore void. The Court proceeded to State that New York law required the parties to loan modification conference to act in good faith. The Court stated that the Plaintiff's actions were pre-meditated and calculated, so that the Plaintiff would be free of liability and the debtors would be irreparably harmed. The Court found the conduct of the Plaintiff to be shocking and/or egregious, and so exercised its powers to award exemplary damages to punish the Plaintiff. In this case, unlike the previous one, the Court did not cancel the debt, but instead, Justice Spinner took a different approach. He denied the Plaintiff's motion for summary judgment, he disallowed all interest from the date of the default to the Court's decision, he barred all legal fees and miscellaneous expenses, he determined the amount owed to be $301,721.58, and lastly, he awarded the debtors $100,000.00 in exemplary damages.

In March of 2010, this same Judge awarded a homeowner $155,000.00 against a bank that entered the house of the debtor without permission and changed the locks. In the July 15, 2010 issue of the New York Law Journal, there is an article on Justice Spinner and how he has gotten the attention of the banks, attorneys, press, media and homeowners by his unusual decisions using equity and not basic contract law.

CONCLUSION

Foreclosure seeks equity in that the bank does not simply desire a monetary award, but instead wants the mortgaged premises to be awarded to it. Justice Spinner uses equity in his decisions. The plaintiff who seeks equity must do equity, it must have clean hands. The Court determined that certain banks were not acting in good faith in resolving the matters, as required by statute. This type of conduct should no longer be rubber-stamped by the Courts, but instead, each foreclosure proceeding reviewed to see if both parties are acting in good faith with the ultimate goal of keeping the homeowner in the home and giving the bank a fair return for its investment. Most modification agreements could achieve this objective by lowering the current payments and adding to the back end of the mortgage the monies rightfully owed the banks.

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