

**Basics of Mortgage Foreclosure and Contract-for-Deed Cancellation
for Tenants**

by

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[1] Simplified Definitions

- a) Mortgage = Agreement between mortgagee (lender²) and mortgagor (borrower) whereby real estate (land plus buildings) is pledged as collateral for a loan (a “note”)
- b) Foreclosure = Procedure by which the lender gets the property back after borrower defaults on the loan
- c) Foreclosure by Action = Foreclosure through the court system
- d) Foreclosure by Advertisement = Foreclosure without a lawsuit
- e) Contract for Deed = Contract for sale of real estate. Typically, the vendee (buyer) agrees to pay vendor (seller) an agreed set of payments over time. If all payments are made, the deed is then transferred to the vendee and the vendee becomes the owner. If payment(s) is/are missed, the vendor can cancel the contract and take back the land. From an economist’s perspective, this functions in many ways like an alternative form of “mortgage” although the legal rules are different.

[2] Foreclosure by Advertisement³

- a) The procedure starts with lender advertising the sale in a legal newspaper at least 6 weeks before the sheriff’s sale.
- b) At least 4 weeks before the sheriff’s sale, the lender’s process server personally serves the occupant/s with notice of the sale.

¹Minnesota statutes are available at <http://www.leg.state.mn.us/leg/statutes.asp> .

²For reading ease, throughout the rest of this outline, I’m going to use the word “lender” for mortgagee and “borrower” for mortgagor. Of course, some loans do not involve mortgages, so some lenders are not mortgagees and some borrowers are not mortgagors. However, this outline is about loans with mortgages.

³See Minn. Stat. § 580.03

[3] Foreclosure by Action

- a) The procedure starts with lender serving the borrower with a lawsuit seeking foreclosure. The lender also serves the occupants.
- b) The defendant/borrower has 20 days to answer. After that (or by default if no answer), assuming the lender wins the case, the court will order a sheriff's sale.
- c) This process is more cumbersome but does have one advantage over foreclosure by advertisement: the court has the power to issue a deficiency judgment (entering judgment for the money still owed if the bank eventually sells the property at a loss).

[4] Sheriff's Sale

Officially this is an auction. Usually, the lender is the only bidder. The lender starts the bidding at the full amount of principal + accrued interest owing. (Since the lender eventually gets this amount, this bid effectively involves the lender paying itself and thus risking nothing.) Others, including the tenants, who attend are free to bid more.

The winner of the auction receives a Certificate of Sale. For the rest of this outline, I'm going to assume that the winner of the auction is the lender.

[5] Redemption Period

- a) After the sale, the lender does not possess the property. Instead, it has to wait for the redemption period to pass.
- b) During the redemption period, the borrower remains in possession. This is a legal term. If the borrower is a landlord, he will continue to be the landlord just as before the sale. The tenants still pay him the rent and he still owes them the usual duties (e.g. doing repairs).⁴
- c) During the redemption period, the borrower also has the right to redeem. This means paying off the entire winning bid (not just the unpaid monthly mortgage payments) + certain court costs. If the borrower redeems, he is fully restored to his prior position minus the mortgage. It is as if he had paid off the mortgage without all the unpleasantness.

⁴Occasionally, the lender will get a court order creating a receiver to run the building during the six months. If so, the tenant will be served with the court order and should obey it.

[6] How Long is the Redemption Period?

a) In most cases, the redemption period is 6 months.⁵

b) Rarely, the redemption period is longer or shorter. For example:

- * Most agricultural land has a 12-month redemption period.⁶
- * Mortgages signed prior to July 1967 have a 12-month redemption period.⁷
- * If the borrower has paid off 1/3 of the principal, the redemption period is 12 months.⁸
- * Upon proper motion to the court, the lender can reduce the redemption period to 5 weeks for *abandoned* residential property smaller than five units.⁹
- * The lender and borrower can make a certain kind of written agreement to reduce the redemption period to 2 months.¹⁰

[7] Cancellation of Contracts for Deed¹¹

A Contract for Deed is not foreclosed. Instead, after a default the vendor serves a special notice on the vendee giving the vendee a choice of curing the breach (typically, catching up on payments plus paying certain costs) or having the contract terminated. The vendee has 60 days to cure (similar to redeeming a mortgage). If the vendee does not cure or get a court order to stop the process, after the 60 days the ownership reverts to the vendor (similar to the mortgagee getting full ownership after the redemption period with a mortgage sheriff's sale). Just like the mortgage redemption period (usually 6 months), during the 60 days the vendee is still the landlord and the tenant is still the tenant of the vendee.

⁵See Minn. Stat. §§ 581.10, 580.23.

⁶See Minn. Stat. §580.23.

⁷See Minn. Stat. § 580.23.

⁸See Minn. Stat. § 580.23.

⁹See Minn. Stat. § 582.032.

¹⁰See Minn. Stat. § 582.32.

¹¹See Minn. Stat. § 559.21.

[8] What Happens After the Redemption or Cancellation Period Ends?

a) A statute now governs most situations where the lender or vendor takes over after the redemption or cancellation period ends.¹² The lender or vendor has to give the tenants one-month notice.¹³ The notice can be given during the redemption/cancellation period so long as the notice is at least a month and so long as the notice period ends no earlier than the end of the redemption/cancellation period.¹⁴

b) One appellate case¹⁵ has modified the statute (the court would say “interpreted the statute”) just discussed. If the tenant signed the lease during the redemption period, the one-month rule does not apply. The tenant’s rights simply end on the last day of the redemption period after which the tenant is a “trespasser” (who it appears still has the right to stay until evicted in an Eviction Action [“UD”]).

[9] What Happens If the Owner Sells the Building?

An owner in financial straits will often sell the building, or “give it away” in return for not being sued for money, or otherwise transfer the building voluntarily. Unless the voluntary redemption procedure (see footnote 10) or something like it is used, the buyer (“grantee” in legalese) simply steps into the shoes of the seller. In other words, the buyer is now the landlord

¹²See Minn. Stat. § 504B.285, subd. 1(1)(ii-iii). At common law, after the redemption period the lender simply took over, the lease was cancelled, and the tenant became a tenant at sufferance (like a trespasser). The one exception to this common-law rule is that if the lease was signed before the mortgage and the lender knew of the lease, then the lease is not cancelled. The theory behind this rule is that if the lender had nothing to do with a lease signed after the mortgage, the lender should not be burdened with something done completely out of his control. See Schrunk v. Andres, 221 Minn. 465, 470 22 N.W.2d 548, 551 (1946).

¹³In this situation, the word “month” really means “month” and not “rental period”. For example, a lender’s notice given on January 17 to vacate by February 17 is a month’s notice. See Minn. Stat. § 645.14.

¹⁴If the tenant holds a Section-8 voucher, the mortgage foreclosure might not terminate the Section 8 contract and thus the lease might survive the foreclosure. This is the holding in a set of cases from New England. See Bristol Savings Bank v. Savinelli, CV-95-0377478-S, 1996 Conn. Super Lexis 742 (Conn. Super. Ct. Mar. 21, 1996); Webster Bank v. Occhipinti, No. CV-970059147S, 1998 WL 846105 (Conn. Sup. Ct. Nov. 20, 1998); EMC Mortgage Corp. v. Smith, Civ. No. 95-04794, Housing Court Dept, City of Boston, MA (Jan. 5, 1996).

¹⁵Broszko, v. Principal Mutual Life Ins. Co., 533 N.W.2d 656 (Minn. Ct. App. 1995).

of the tenant whether either likes it or not.¹⁶

[10] Limit on Renting a Unit in Foreclosure or Cancellation.

An owner in foreclosure or cancellation is not lawfully allowed to sign a new lease for more than the redemption or cancellation period. If this statute¹⁷ is violated, it doesn't do the tenant much good in fighting with the bank or vendor, but it could help in suing the landlord for money.

[11] Security Deposits

a) The security deposit is held by the landlord until 21 days after the end of the tenancy.¹⁸ Thus, the security deposit is not actually in play while the tenant is still in the unit.

b) The successor in interest to the original landlord, even the lender taking back the property, probably is liable for the deposit.¹⁹

c) The original landlord is also liable for the deposit unless he transfers the deposit to the successor, tells the tenant the amount transferred, and the tenant is given 20 days to object to the amount as well as a stamped envelope in which to send the objection.²⁰

d) A careful reading of the security deposit statute indicates that the security-deposit penalties for not paying the last month rent are relatively mild, even if the landlord takes the right steps.²¹ In most cases, the filing of an Eviction Action is the biggest threat. In the last month of the redemption period, the owner is unlikely to file an Eviction Action because he is about to lose the property. Thus, faced with a broke owner in the throes of his ownership, not paying the last

¹⁶Fisher v. Heller, 219 N.W. 79,80, 174 Minn. 233,236 (1928). Of course, the new landlord and the "old" tenant can make a deal to end the lease if they both agree to it.

¹⁷See Minn. Stat. § 504B.151.

¹⁸See Minn. Stat. § 504B.178.

¹⁹Minn. Stat. § 504B.178, subd. 6 provides that "Upon termination of the landlord's interest in the premises, whether by sale, assignment, death, appointment of receiver or otherwise, the landlord's successor in interest shall have all of the rights and obligations of the landlord with respect to the deposit, except that if tenant does not object to the stated amount within 20 days after written notice to tenant of the amount of deposit being transferred or assumed, the obligation of the landlord's successor to return the deposit shall be limited to the amount contained in the notice."

²⁰Minn. Stat. § 504B.178, subd. 5-6.

²¹See Minn. Stat. § 504B.178, subd. 8.

month of rent should be a serious consideration.

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