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Authors:

Nanci L. Weissgold
nanci.weissgold@klgates.com
+1.202.778.9314

Morey E. Barnes
morey.barnes@klgates.com
+1.202.778.9215

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New Jersey's Latest Anti-Foreclosure Efforts Continue to Complicate Modifications

Imagine that you have signed on to President Obama's Making Home Affordable Program ("MHA"), evaluated a borrower's eligibility for a loan modification under MHA guidelines and concluded that the capitalization of the arrearages, reduction of the interest rate, extension of the term, and deferment of principal are not enough to qualify the borrower for a material rewrite of the loan. Or suppose that the borrower qualified for the loan modification but failed the three-month trial period. What do you do next?

If you are in New Jersey, foreclosing on the home is not the correct answer. Instead, you have to sit back while the borrower is entitled to a six-month forbearance period during which he or she is not required to pay anything. Of course, if the borrower requests, the borrower and creditor must participate in the Judiciary's Foreclosure Mediation Program or in another form of mediation or settlement discussion, presumably to discuss in greater detail why the borrower does not qualify for a loan modification under President Obama's MHA. All the while, the arrearages continue to accrue and the property value may decline.

On July 2, 2009, New Jersey Governor Jon Corzine signed Assembly Bill 3821 (P.L. 2009 ch. 84; the "Amendments") modifying the Mortgage Stabilization and Relief Act (the "Act"), a measure that took effect April 1, under which certain distressed borrowers may obtain a six-month forbearance after a foreclosure action is filed. Among other changes, the Amendments provide that a borrower is not required to pay anything during that forbearance period. Default is looking like a smart economic move in New Jersey.

As we suggested in our February 3, 2009 Alert, [New Jersey's New Anti-Foreclosure Law Discourages Modifications](#), the Act may create perverse incentives to delay serious modification discussions. Effective July 2, 2009, the Amendments modify this six-month forbearance requirement, but do not eliminate those incentives. The Act also repeals, retroactive to January 9, 2009, the requirement codified in Section 46:10B-52 of New Jersey Statutes designed to prohibit the use of mortgage trigger leads. Below we provide a brief overview of the Amendments, which notably include several alterations of the Act's original forbearance provisions.

Six-Month Foreclosure Forbearance

Among other significant provisions, the Act requires a creditor to grant a six-month forbearance from foreclosure on a "high risk mortgage loan" to pursue a workout or modification through the state court's mediation program ("Judiciary's Foreclosure Mediation Program"). The Amendments make four changes to the provisions regarding forbearance that merit note here.

First, as was the case under the existing version of the Act, the forbearance applies to a “high risk mortgage loan,” defined as a first mortgage that has one or more identified characteristics including being “subprime” (a term the Act did not previously define) or having a reset mortgage interest rate that increases the initial interest rate by two or more percentage points. With regard to a high risk mortgage loan that is “subprime,” the Amendments provide that such a mortgage is a consumer credit transaction, secured by the consumer’s principal dwelling, with an annual percentage rate (“APR”) that exceeds the average prime offer rate for a comparable transaction, as of the date the interest rate is set, by 1.5 or more percentage points for a first-lien loan or by 3.5 or more percentage points for a subordinate-lien loan.¹ (Neither the Act nor the Amendments define the terms “average prime offer rate” and “annual percentage rate,” leaving those terms open to interpretation. As of the date of this Alert, the average prime offer rate for New Jersey had not been issued.) Although the Amendments were intended to clarify the Act’s applicability, this seemingly conflicting definition of “subprime” raises a new question as to whether the forbearance program could apply to subordinate-lien loans.

Second, the Amendments revise the procedural requirements related to the forbearance, imposing a notice requirement on a creditor that is triggered upon the creditor’s serving the summons and complaint in a foreclosure action. The Amendments also specify certain information that the creditor must include in the notice. For instance, the notice must inform the borrower that he or she has a right to forbearance if he or she makes a written request within 30 days of receipt of the summons and complaint. (It is not clear if the creditor must receive the borrower’s request within those 30 days.) Previously, the creditor was obligated to provide the six-month forbearance to all eligible borrowers.

Third, the Amendments revise the definition of “forbearance” to remove the condition that the borrower must continue making monthly mortgage payments during the six-month forbearance period. This requirement was unrealistic, because a borrower making payments would be unlikely to default on his or her loan; however, as a result it appears that the borrower is under no obligation to make any sort of payment during the six-month

forbearance period. The Amendments further clarify the definition of “forbearance” to provide that a creditor receiving a request for forbearance must “suspend all efforts to advance any judicial foreclosure proceedings” (as well as notifying the court of the forbearance and the dates of the forbearance period). The timeframe for non-judicial foreclosures in New Jersey varies from as little as three months to an average of six to nine months, if uncontested; thus, the requirement that a creditor suspend efforts to advance a foreclosure will further extend that timeline. As amended, the Act provides that when a forbearance period is granted, the borrower and creditor must participate in the Judiciary’s Foreclosure Mediation Program, where eligible, “or another form of mediation or settlement discussion.” If the borrower abandons the property during the forbearance period or affirmatively advises the creditor in writing that it will not participate in mediation or settlement discussions, the creditor must notify the court and only upon court approval will the forbearance period end. If a borrower remaining in his or her property redefaults, it remains unclear whether that borrower could be entitled to more than one forbearance period.

Finally, the Amendments act to extend the Act’s expiration until July 2, 2011. However, the Amendments clarify that borrowers who are granted a forbearance within six months of the Act’s expiration will still receive the full six-month forbearance period.

Interaction with other New Jersey Laws

As we noted in our earlier Alert, when the Act became effective it was unclear how it would interact with the Save New Jersey Homes Act, an emergency measure that became effective in September 2008. That measure includes a three-year foreclosure moratorium for “introductory rate mortgages” if the borrower affirmatively acts, completing a certification of extension for agreeing to modification of the loan and to repayment of the modified loan. As the Amendments define a “high risk mortgage loan,” it is possible that such a loan may also qualify as an “introductory rate mortgage,” and may thus be subject to both the Act and the Save New Jersey Homes Act. The Amendments do not clarify the interplay between these two

measures. Could a borrower take advantage of the six-month forbearance and then apply for the moratorium? Although the Save New Jersey Homes Act declares priority over other laws, certain questions still remain.

Repeal of trigger lead prohibition

Finally, the measure repeals Section 18 of the Act (codified as N.J.S.A. 46:10B-52), under which a consumer reporting agency or other business entity may not sell or exchange with any other party (except for the holder of a mortgage loan) “the existence of a credit inquiry arising from a consumer mortgage loan application when the sale or exchange is triggered by an inquiry made in response to an application for credit.” The repeal of that section is retroactive to the Act’s original January effective date.

Other provisions of the Act

Among other provisions of the Act, the Amendments do not impact either the Mortgage Stabilization Program (which facilitates the restructuring of certain “covered mortgages”) or the Housing Assistance and Recovery Program, which provides assistance to homeowners in imminent danger of foreclosure to allow them to remain in their homes by encouraging a lease-purchase arrangement. Similarly, the Amendments do not impact the Act’s quarterly reporting obligation, under which a creditor instituting a foreclosure action in the state’s Superior Court must provide a quarterly report on the number of foreclosure actions it has filed in the state to the Department of Banking and Insurance.

Federal preemption

On its face, the Act applies to all lending entities: the term “lender” is defined as “any lawfully constituted

mortgage lender, mortgage investor or mortgage loan servicer that owns and is willing to refinance or is authorized to negotiate the terms of the homeowner’s mortgage.” At the time the Act took effect, it was unclear whether its requirements would apply to federally-chartered banks (i.e., national banks and federal thrifts) and their operating subsidiaries (collectively, “Federal Lenders”), who generally must follow the procedures set forth by state law when foreclosing on mortgage loans. However, as we discussed in our February 3, 2009 Alert, New Jersey’s New Anti-Foreclosure Law Discourages Modifications, federal regulators have limited the scope of that rule and have indicated that a state foreclosure law may morph into indirect, impermissible lending regulation and be preempted by federal law.

Moreover, since the Act took effect, the Supreme Court has issued a decision (*Cuomo v. Clearing House Association, L.L.C.*), in which it held that state attorneys general (and, presumably, other state officials with enforcement authority under state law) may enforce non-preempted state laws against national banks and their operating subsidiaries, subject to certain limitations. The *Cuomo* decision does not affect which state laws actually are preempted—it just says that state officials may enforce a state law if the state law is not preempted—but it still could make it more difficult for federally-regulated lenders and their operating subsidiaries to rely on federal preemption. Before *Cuomo*, a federally-chartered bank did not need to be concerned about the fact that state officials disagreed with the bank’s assessment that a state law is preempted (which, unsurprisingly, was common). Now, state officials can bring a federally-chartered bank to court if they disagree with the bank’s preemption assessments.

ⁱ This definition mirrors that for a “higher cost loan” utilized by the Board of Governors of the Federal Reserve System in last year’s regulations implementing the Home Ownership and Equity Protection Act.

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For more information, please contact one of the professionals listed below.

LAWYERS

Boston

R. Bruce Allensworth	bruce.allensworth@klgates.com	+1.617.261.3119
Irene C. Freidel	irene.freidel@klgates.com	+1.617.951.9154
Stephen E. Moore	stephen.moore@klgates.com	+1.617.951.9191
Stanley V. Ragalevsky	stan.ragalevsky@klgates.com	+1.617.951.9203
Nadya N. Fitisenko	nadya.fitisenko@klgates.com	+1.617.261.3173
Brian M. Forbes	brian.forbes@klgates.com	+1.617.261.3152
Andrew Glass	andrew.glass@klgates.com	+1.617.261.3107
Phoebe Winder	phoebe.winder@klgates.com	+1.617.261.3196

Charlotte

John H. Culver III	john.culver@klgates.com	+1.704.331.7453
--------------------	-------------------------	-----------------

Los Angeles

Thomas J. Poletti	thomas.poletti@klgates.com	+1.310.552.5045
-------------------	----------------------------	-----------------

Miami

Paul F. Hancock	paul.hancock@klgates.com	+1.305.539.3378
-----------------	--------------------------	-----------------

New York

Philip M. Cedar	phil.cedar@klgates.com	+1.212.536.4820
Elwood F. Collins	elwood.collins@klgates.com	+1.212.536.4005
Steve H. Epstein	steve.epstein@klgates.com	+1.212.536.4830
Drew A. Malakoff	drew.malakoff@klgates.com	+1.216.536.4034

San Francisco

Jonathan Jaffe	jonathan.jaffe@klgates.com	+1.415.249.1023
----------------	----------------------------	-----------------

Seattle

Holly K. Towle	holly.towle@klgates.com	+1.206.370.8334
----------------	-------------------------	-----------------

Washington, D.C.

Costas A. Avrakotos	costas.avrakotos@klgates.com	+1.202.778.9075
Melanie Hibbs Brody	melanie.brody@klgates.com	+1.202.778.9203
Daniel F. C. Crowley	dan.crowley@klgates.com	+1.202.778.9447
Eric J. Edwardson	eric.edwardson@klgates.com	+1.202.778.9387
Anthony C. Green	anthony.green@klgates.com	+1.202.778.9893
Steven M. Kaplan	steven.kaplan@klgates.com	+1.202.778.9204
Phillip John Kardis II	phillip.kardis@klgates.com	+1.202.778.9401
Rebecca H. Laird	rebecca.laird@klgates.com	+1.202.778.9038
Laurence E. Platt	larry.platt@klgates.com	+1.202.778.9034
Phillip L. Schulman	phil.schulman@klgates.com	+1.202.778.9027
Nanci L. Weissgold	nanci.weissgold@klgates.com	+1.202.778.9314
Kris D. Kully	kris.kully@klgates.com	+1.202.778.9301
Morey E. Barnes	morey.barnes@klgates.com	+1.202.778.9215
David L. Beam	david.beam@klgates.com	+1.202.778.9026
Emily J. Booth	emily.booth@klgates.com	+1.202.778.9112

Holly Spencer Bunting	holly.bunting@klgates.com	+1.202.778.9853
Krista Cooley	krista.cooley@klgates.com	+1.202.778.9257
Elena Grigera	elena.grigera@klgates.com	+1.202.778.9039
Melissa S. Malpass	melissa.malpass@klgates.com	+1.202.778.9081
David G. McDonough, Jr.	david.mcdonough@klgates.com	+1.202.778.9207
Stephanie C. Robinson	stephanie.robinson@klgates.com	+1.202.778.9856
Kerri M. Smith	kerri.smith@klgates.com	+1.202.778.9445
David Tallman	david.tallman@klgates.com	+1.202.778.9046

**Director of Licensing
Washington, D.C.**

Stacey L. Riggan	stacey.riggan@klgates.com	+1.202.778.9202
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**Regulatory Compliance Analysts
Washington, D.C.**

Dameian L. Buncum	dameian.buncum@klgates.com	+1.202.778.9093
Teresa Diaz	teresa.diaz@klgates.com	+1.202.778.9852
Jennifer Early	jennifer.early@klgates.com	+1.202.778.9291
Robin L. Gieseke	robin.gieseke@klgates.com	+1.202.778.9481
Allison Hamad	allison.hamad@klgates.com	+1.202.778.9894
Brenda R. Kittrell	brenda.kittrell@klgates.com	+1.202.778.9049
Dana L. Lopez	dana.lopez@klgates.com	+1.202.778.9383
Patricia E. Mesa	patty.mesa@klgates.com	+1.202.778.9199
Jeffrey Prost	jeffrey.prost@klgates.com	+1.202.778.9364

Anchorage Austin Beijing Berlin Boston Charlotte Chicago Dallas Dubai Fort Worth Frankfurt Harrisburg Hong Kong London
Los Angeles Miami Newark New York Orange County Palo Alto Paris Pittsburgh Portland Raleigh Research Triangle Park
San Diego San Francisco Seattle Shanghai Singapore Spokane/Coeur d'Alene Taipei Washington, D.C.

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