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JUDGMENT OF LOSS MITIGATION

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DEFINITIONS

An "***underwater mortgage***" is one in which the debt associated with the mortgage, along with any senior lien, exceeds the property's fair market value, as determined by a court.

A "***senior lien***" is the first security interest placed on a property to secure payment of a debt or performance of an obligation before one or more junior liens.

A "***junior lien***" is a security interest placed on a property to secure payment of a debt or performance of an obligation after a senior lien is placed on such property.

ISSUE

Describe "judgment of loss mitigation," the judicial alternative to foreclosure created by PA 16-65. **This report has been updated by OLR Report 2022-R-0282.**

SUMMARY

PA 16-65 (§§ 73-80 & 91) created a new alternative process to foreclosure in which a court, effective October 1, 2016, may enter a judgment of loss mitigation for owner-occupied one- to four-family residential properties. This allows (1) certain "underwater" (see sidebar) residential mortgages to be modified without a junior lienholder's consent or (2) the mortgagor (borrower) to satisfy all or part of his or her obligation by conveying the property using a transfer agreement. The act does not prohibit the parties from completing a consensual mortgage modification or conveyance outside the judicial process.

A judgment of loss mitigation does not eliminate the debt or any judgment associated with a junior lienholder on the residential real property encumbered by the underwater mortgage.

The act exempts title transfers resulting from judgments of loss mitigation from the real estate conveyance tax.

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JUDGMENT OF LOSS MITIGATION

A judgment of loss mitigation allows the mortgagor to modify the mortgage or convey the property to the mortgagee (lender) or a third party through a transfer agreement.

Mortgage Modification

If approved by the court through a judgment of loss mitigation, an underwater mortgage may be modified to increase the principal loan balance by the amount of any accrued interest, fees, and costs allowed by law, without any (1) junior lienholder's consent and (2) loss of priority to the senior lienholder for the full amount of the modified loan.

Conveyance to Mortgagee

A mortgagor of an underwater mortgage may satisfy all or part of his or her obligation to the mortgagee by conveying the residential real property to the mortgagee. The mortgagor may do so through a transfer agreement executed by both parties. This agreement must:

1. convey to the mortgagee all interests in the property except for any interests (a) reserved to the mortgagor in the agreement, (b) held by more senior mortgagees or lienholders, or (c) held by junior lienholders not subject or party to the action;

2. consider a discharge of the mortgage after the mortgagor satisfies the transfer agreement's conditions;

3. consider the termination of any other interest in the property subordinate to the lienholder that is party to the transfer agreement following a judgment of loss mitigation; and

4. contain other provisions mutually agreeable to the mortgagor and mortgagee including either party's cash contribution to the other or the execution of a promissory note by one party in favor of the other.

Conveyance to a Third Party

A mortgagor of an underwater mortgage may enter into a transfer agreement to convey residential real property subject to the mortgage to a third party and, as a condition of the conveyance, pay less to the mortgagee than the outstanding balance on the mortgage debt. Such payment must satisfy all or part of the mortgagor's obligation to the mortgagee. The transfer agreement must be executed by the mortgagor and the mortgagee and consider:

1. transferring all the mortgagor's interests in the property to the third party, except for interests (a) reserved to the mortgagor in the transfer agreement, (b) held by more senior mortgagees or lienholders, or (c) held by junior lienholders not subject or party to the action;

2. discharging the mortgage after the mortgagor satisfies the transfer agreement's conditions;

3. terminating any other interest in the property subordinate to the mortgagee following a judgment of loss mitigation; and

4. other provisions mutually agreeable to the mortgagor and mortgagee including either party's cash contribution to the other or the execution of a promissory note by one party in favor of the other.

JUDGMENT FOLLOWING TRANSFER AGREEMENT

Fifteen days after the return date of a pending foreclosure action, a mortgagee may file a motion for judgment of loss mitigation after entering into one of the transfer agreements described above. The act does not (1) allow the court to enter a judgment without the express written consent of both the mortgagor and mortgagee or (2) require a mortgagee to consider consenting to such a judgment in foreclosure mediation. A party's failure to consent to a judgment of loss mitigation is not a basis for a claim of bad faith.

Findings at the Hearing

Upon the motion of the mortgagee and with the mortgagor's consent, the court, after notice and a hearing, may enter a judgment of loss mitigation approving the modification or conveyance.

All parties to the action may participate in the hearing and the judgment is final for purposes of appeal. The issues at the hearing must be limited to:

1. a finding of the residential property's fair market value, which may be determined by a written appraisal obtained by the mortgagee and performed by a licensed appraiser;

2. a finding of the outstanding balance of any priority liens on such property, to the extent necessary;

3. the debt owed to the mortgagee secured by the mortgage;

4. whether the mortgage is underwater; and

5. for purposes of mitigation, whether the contemplated transaction was agreed to in good faith.

The hearing must also consider whether the parties to the contemplated transaction other than the mortgagee meet the financial requirements of a mortgagor (i.e., personal net liquid assets that are less than $100,000, excluding retirement and tax advantaged health savings plans). This must be determined by (1) a financial statement submitted by the proposed mortgagor or mortgagors or (2) other financial information the court requires.

The act prohibits the court from entering a judgment of loss mitigation unless it makes express findings that the mortgage is an underwater mortgage and the parties agreed to the transaction in good faith. For cases involving mortgage modification or the conveyance of property to a mortgagee, the court must also find that the mortgagor meets the above financial requirements.

Effect of Judgment

If, immediately after the expiration of any applicable appeal period or after the judgment has been affirmed on appeal, the court enters a judgment of loss mitigation, the (1) mortgage must be increased according to the judgment and the lien of any junior lienholder subject or party to the action must be deemed subordinated to the mortgage, in the same order as before the judgment or (2) property is conveyed to the mortgagee in accordance with the transfer agreement. If a conveyance to a mortgagee is later set aside or avoided due to the application of Chapter 11 bankruptcy provisions, the judgment of loss mitigation must be set aside and all parties retain the same interests in the property as existed before the judgment to the extent permitted under the applicable bankruptcy laws.

In cases involving conveyance to a third party, the conveyance to the third party must be ordered to take place by the date in the transfer agreement. This may be extended up to 60 days if the parties agree, or longer as ordered by the court after notice and a hearing.

Appeals

In the event of an appeal, the mortgagor and the mortgagee may withdraw their consent to the foreclosure by loss mitigation. If either does so, the foreclosure may continue without any further restriction.

TITLE CONVEYANCE AND RECORDING

Within 30 days after a mortgage modification or conveyance to a mortgagee, the mortgagor and mortgagee must record the judgment of loss mitigation with the town clerk.

For conveyances to third parties, the mortgagor must submit the judgment of loss mitigation to the town clerk for recording before recording the document conveying title to the third party. After the mortgagee receives the funds and other consideration as specified in the transfer agreement, the mortgagee must file a satisfaction of judgment of loss mitigation with the court.

The act does not prohibit (1) the parties from consummating a consensual mortgage modification or deed in lieu of foreclosure outside the judicial process or (2) a consensual release of a mortgage by a mortgagee for less than the full indebtedness secured by the mortgage.

MORTGAGOR'S PETITION TO ENTER FORECLOSURE MEDIATION

If the court does not enter a judgment of loss mitigation, the loan modification or property transfer described above may not be completed. At this point, the (1) mortgagor may petition for inclusion in the foreclosure mediation program and (2) mortgagee may request a judgment of foreclosure available under existing law, including strict foreclosure. (The state's foreclosure mediation program assists homeowners and lenders achieve a mutually agreeable resolution to a mortgage foreclosure action through the mediation process.)

To be eligible for the mediation program, the mortgagor, in addition to meeting existing law's eligibility criteria for the program, must not have substantially contributed to the events leading to the court's decision or other circumstances resulting in the decision not to enter a judgment. To grant the mortgagor's petition, the court must find that (1) it is highly probable the parties will reach an agreement through mediation and (2) the petition is not motivated primarily by a desire to delay a foreclosure judgment. The court must consider any testimony or affidavits the parties submit supporting or opposing the mortgagor's petition.

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