

## **MEMORANDUM**

### **“Cash for Keys” Agreements**

**James Smith, Reporter**

**May 17, 2012**

“Cash for keys” agreements are used in two sectors in the context of residential mortgage foreclosures. First, lenders have offered cash-for-keys agreements to homeowners who have defaulted on their home mortgage loans and are in the midst of foreclosure proceedings or are headed towards foreclosure. In this context of owner-occupied housing, cash for keys is considered by some to be one of the types of “graceful exits,” which results in the homeowner leaving without the need for completion of a foreclosure proceeding. Second, lenders have also used cash-for-keys agreements when foreclosing upon rental properties. Lenders pay tenants to vacate their premises when the landlord-mortgagor is facing or has suffered a foreclosure.

In both settings – owner-occupied housing and rental housing – the lender’s objective is the same: to remove occupants from dwelling units at a lower cost than that associated with the normal foreclosure process. Projected cost savings have both a temporal component and a regulatory component. The process of foreclosure and eviction is lengthy and costly when conducted in accordance with applicable laws. In most jurisdictions it takes a substantial amount of time to evict defaulting mortgagors from their homes. Generally recovering possession from a mortgagor cannot be accomplished, due to legal or practical restraints, until after completion of a foreclosure sale. In some states, eviction is delayed further due to an owner’s statutory right of redemption, which lasts for a time period after the foreclosure sale. Similarly, it is time consuming to evict tenants from dwelling units in most jurisdictions, even when there is proof that the lease has terminated due to the tenant’s default, has expired in accordance with its terms, or has ended as a consequence of the completion of foreclosure.

From the lenders’ perspective, cash-for-keys agreements not only accelerate the time when the lender or its buyer obtains vacant possession of the property; they also save regulatory costs. In the absence of the voluntary surrender of possession by homeowners and tenants, the lender must incur significant expenses to recover possession, which include attorneys’ fees, litigation costs, and other related regulatory expenses.

#### **I. Owner-occupied Housing**

Mortgage lenders and their representatives have developed cash-for-keys programs that offer cash settlements to homeowners in exchange for the keys, a quick turnover of possession, and a promise to leave the dwelling unit in good physical condition. Negotiation of cash-for-keys agreements gives the lender a degree of

assurance that the owner will not abandon the property, without notice to the lender. Such agreements also increase the likelihood that the owner will not commit waste or allow waste to the property.

Cash-for-keys agreements, in addition to specifying the cash payment and the transfer of possession, usually contain other owner promises relating to the condition of the property. Owners usually are required to waive any legal claims and defenses that they might otherwise assert against the lender, its successors, and buyers of the property through foreclosure. Relinquishment of title may be reflected by an owner's execution of a deed in lieu of foreclosure. The agreement may have the effect of waiving an owner's redemption right prior to the normal expiration of a redemption period, or accelerating the time at which deed in lieu of foreclosure will otherwise become effective under state law.

Cash-for-keys agreements may be individually negotiated between lenders or their servicers and homeowners facing foreclosure, or the lenders may offer standardized terms. One example of the latter is CitiMortgage, which in 2010 initiated a program allowing homeowners to remain in their homes for six months, without making any payments to the lender. At the end of six months, the owner must relinquish possession, title is transferred to the lender pursuant to a deed in lieu of foreclosure, and the owner receives \$1,000 in relocation assistance, provided that the property has remained in good shape.<sup>1</sup>

Cash-for-keys agreements have not yet generated any appreciable number of judicial decisions. In a Georgia case, Fannie Mae successfully relied upon a cash-for-keys agreement entered into between its representative and a tenant of the mortgagor as evidence that the mortgagor was not in possession of the leased premises on the date of the foreclosure sale.<sup>2</sup> In a Nevada case, a homeowner alleged that Wells Fargo participated in mediation in bad faith "because it refused to offer anything other than a cash-for-keys option to avoiding foreclosure," but the court resolved the litigation on other grounds.<sup>3</sup>

## II. Rental Housing

Congress enacted the Protecting Tenants at Foreclosure Act of 2009 (PTFA)<sup>4</sup> to address problems associated with the foreclosures of residential real estate. State mortgage law generally allows a purchaser at foreclosure (whether the lender or a third-party purchaser) to evict tenants who have leased part or all of the property from the mortgagor. The standard application of property priority rules achieves this result. When leases are junior to the mortgage (which usually is the case), leases are treated the same

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<sup>1</sup> Mary Ellen Podmolik, *Citi to Launch "Cash for Keys,"* Chicago Tribune, Feb. 11, 2010.

<sup>2</sup> Steed v. Federal Nat. Mortg. Corp., 689 S.E.2d 843 (Ga. Ct. App. 2009).

<sup>3</sup> Leyva v. National Default Servicing Corp., 255 P.3d 1275, 1277 n.1 (Nev. 2011) (lender violated mediation statute by failing to bring required documents to hearing).

<sup>4</sup> Pub. L. No. 111-22, §§ 701-704, 123 Stat. 1632, 1660-62 (2009).

as other real property interests that are subordinate to the mortgage being foreclosed. Junior interests are terminated.

The PTFA is designed to preempt the state-law rights of lenders and their foreclosure purchasers to terminate junior leases. All residential tenants must receive a 90-day notice before being evicted as the result of a foreclosure. Longer periods of possession are guaranteed for some tenants. The PFTA requires that the new owner honor existing leases for the duration of their term unless the tenant is “without a lease or with a lease terminable at will under state law,” or the purchaser at foreclosure is acquiring the property for occupancy as a primary residence.<sup>5</sup> In these cases, the tenants still have the right to receive the statutory 90-day notice to vacate, but they lack a right under the PFTA to stay longer than the notice period.

The PTFA has a sunset provision, which provides for expiration on December 31, 2012.<sup>6</sup> Congress may decide to extend all or part of the PTFA.

The PFTA does not state whether tenants may waive their statutory rights to remain in possession for the entire 90-day notice period. Lenders have negotiated cash-for-keys agreements whereby tenants agree to leave voluntarily during the notice period. In addition to relinquishing possession, cash-for-keys agreements typically include tenant waivers of claims against the lender and its successors in connection with the lease, including any liabilities arising under tort law.

Typically, the tenant also waives return of the security deposit. In other words, from the tenant’s perspective the return of the security deposit amount is one component of the agreed-upon cash payment. One concern mentioned in the literature is the possibility that some tenants fail to understand how the agreement treats their security deposit and fail to realize that their relocation expenses will include the need to pay a security deposit to a their new landlord.

Reports indicate that cash payments typically range from \$1,000 to \$3,000 per tenant. From the tenant’s perspective, the agreed-upon amount may be sufficient to enable the tenant to cover moving expenses and any related costs of finding a new rental home. Offers often include a premium over such projected costs, especially when the foreclosing party believes that the property value for resale will be maximized if the property is empty. Lenders sometimes tier the offered payment, offering a certain sum for a tenant to leave immediately (or within several days) and a lesser amount for vacating at a later date, such as within two weeks.

According to reports, one motivation for lenders to negotiate cash-for-keys agreements with tenants is to avoid the PTFA requirement that foreclosing lenders undertake state-law landlord duties to the mortgagor’s tenants after foreclosing on the properties.

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<sup>5</sup> PTFA § 702(a)(2).

<sup>6</sup> PTFA § 704.

When the foreclosure consists of multi-tenant buildings, the foreclosing lender (or its servicer who handles the foreclosure) has to make the decision whether it is preferable to sell an empty or largely empty property or one with existing tenants. One report claims that standard practice is for servicers to offer cash-for-key payments to induce tenants, even those who have not defaulted, to vacate based on a belief that empty properties increase third-party bids because prospective purchasers will not have to initiate their own cash-for-keys programs.<sup>7</sup>

In January 2009, prior to congressional adoption of the PTFA, Fannie Mae developed and implemented a program known as the “National Real Estate Owned (REO) Rental Policy.” The policy permitted tenants residing in Fannie Mae-owned foreclosed properties to remain in their dwelling units or to vacate the property with financial assistance. Tenants who chose to remain were required to sign a new month-to-month lease with Fannie Mae, providing for market rate rents and no security deposit. Alternatively, tenants could choose to vacate in exchange for a cash-for-keys payment designed to provide financial assistance for the move to another home. The cash-for-keys option was short lived. In June 2010, after the PTFA became effective, Fannie Mae replaced its policy with the “REO Tenant-in-Place Rental Policy.” Under the new policy, relocation assistance is only available to tenants who sign a twelve-month lease with Fannie Mae. Such tenants are eligible for relocation assistance, equal to one month’s rent, at the end of the lease term.<sup>8</sup>

Although the PTFA preempts state laws that provide residential tenants with less protection than the federal scheme, it allows states to give greater protection.<sup>9</sup> The PFTA is a floor, not a ceiling. Massachusetts is an example. In 2010 it adopted the Tenant Protections in Foreclosed Properties Act.<sup>10</sup> The Act regulates “eviction,” which is broadly defined as “an action, without limitation, by a foreclosing owner of a housing accommodation which is intended to actually or constructively evict a tenant or otherwise compel a tenant to vacate such housing accommodation.”<sup>11</sup> The Act provides that “a foreclosing owner shall not evict a tenant except for just cause or unless a binding purchase and sale agreement has been executed for a bona fide third party to purchase the housing accommodation from a foreclosing owner.”<sup>12</sup> The statutory language does not indicate whether tenants can waive their statutory rights by entering into cash-for-keys agreements, but the Massachusetts attorney general has interpreted the statute as prohibiting such agreements in the absence of a judicially approved agreement for judgment.<sup>13</sup>

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<sup>7</sup> Robin S. Golden, *Building Policy through Collaborative Deliberation: A Reflection on Using Lessons from Practice to Inform Responses to the Mortgage Foreclosure Crisis*, 38 *Fordham Urb. L.J.* 733, 739 (2011).

<sup>8</sup> See Fannie Mae’s REO Tenant-in-Place Rental Policy FAQs, available at [http://www.fanniemae.com/resources/file/help/pdf/rental\\_faqs.pdf](http://www.fanniemae.com/resources/file/help/pdf/rental_faqs.pdf).

<sup>9</sup> PTFA § 702(a).

<sup>10</sup> Mass. Gen. Laws ch. 186A.

<sup>11</sup> *Id.* § 1(a).

<sup>12</sup> *Id.* § 3.

<sup>13</sup> Mass. Att’y Gen. letter Dec. 13, 2010. See James F. Creed, *Residential and Commercial Landlord-Tenant Practice in Massachusetts* § 15.6.5 (Mass. Continuing Legal Education, Inc. 2011).

### III. Issues to Consider with Respect to Cash-for-keys Agreements

The following issues may be useful to consider in connection with possible statutory provisions that relate to “cash for keys” agreements.

1. Should the statute authorize cash-for-keys agreements? If so, what are the permissible terms for a cash-for-keys agreement? For example, some jurisdictions authorize a deed in lieu of foreclosure if the owner is released from personal liability for a deficiency judgment. *E.g.*, 735 Ill. Comp. Stat. § 5/15-1401 (but statute allows personal liability to continue “to the extent a person agrees not to be relieved in an instrument executed contemporaneously”). The Uniform Commercial Code applies the same rule for a transfer of personal property collateral to the secured party in a consumer transaction. UCC § 9-620(g) (prohibiting acceptance of collateral in partial satisfaction of the obligation in a consumer transaction).

2. The term “*cash*” for keys implies that the owner will receive a monetary payment. Should there be a minimum sum that the lender must pay? Defining a minimum might be difficult. In some circumstances, a total release of liability (waiver of the right to pursue a deficiency judgment) will be a substantial benefit to the owner. Similarly, if the owner is allowed a significant period of time to remain in possession before the agreed-upon date for the transfer of possession, that occupancy may represent a significant economic benefit.

3. How would statutory regulation of cash-for-keys agreements relate to general principles of contract law? For example, standard contract law would allow an owner to avoid a cash-for-keys agreement under doctrines that police bargaining behavior such as unconscionability, duress, undue influence, misrepresentation, and fraud. In appropriate cases, other doctrines such as mutual mistake of fact may apply. Would these standard contract-law doctrines adequately police cash-for-keys agreements without the need for statutory contract terms?

4. Should courts play a role in the ex-ante approval of cash-for-keys agreements? If so, for all such agreements; or only for a set of those agreements, such as those entered into after the filing of a judicial foreclosure action?

5. Are there issues of timing that a statute should address? For example, if a cash-for-keys agreement is to be judicially approved, should there be an accelerated foreclosure process, compared to the normal time sequence for foreclosures that are contested or that end with a default judgment? Is there a minimum time period for which the owner should have the right to retain possession before the agreed-upon date of vacation?

6. Should the statute address the quality of title obtained by the lender or the foreclosure purchaser pursuant to a cash-for-keys agreement? In the absence of a statutory provision, presumably the lender’s position with respect to junior interests in the

property can be no better than under existing law when the lender accepts a deed in lieu of foreclosure. In other words, junior interests as well as senior interests remain effective. The grantee under a deed in lieu of foreclosure gets the same title as the grantor-mortgagor. A statute could include a mechanism for terminating junior liens and other junior interests upon the closing of a cash-for-keys agreement. Whether such a mechanism is judicial or non-judicial, it should include a provision for notice to junior interest holders, with an opportunity for such holders to protect their interests.

7. What is the status of the owner in possession after execution of a cash-for-keys agreement? Does the owner become a tenant of the lender; and if so, what type of tenancy, and what are its terms?

8. How do cash-for-keys agreements relate to other similar transactions? When a cash-for-keys agreement is accomplished without ex-ante judicial supervision, is it the same as a deed-in-lieu of foreclosure transaction? When it is accomplished with judicial foreclosure, is it the same as strict foreclosure; or is it perhaps a subtype of strict foreclosure? Illinois has a special statutory procedure for “consent foreclosure” in which the lender takes title free of subordinate interests, the borrower waives all rights of reinstatement and redemption, and the lender waives all rights to a deficiency judgment. 735 Ill. Comp. Stat. § 5/15-1402 (enacted 1987). A cash-for-keys agreement may be seen as one type of consent foreclosure.

9. Should the statute deal with cash-for-keys agreements only in the context of owner-occupied property; or should it also deal with cash-for-keys agreements entered into between lenders and their agents and residential tenants?