Uniform Law Commission

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THE MODEL NEGOTIATED ALTERNATIVE TO FORECLOSURE ACT

- A Summary -

Home foreclosure is a difficult and expensive process for everyone concerned. The borrower, already in default and likely under financial stress, is often forced to pay moving expenses and faces the prospect of a diminished credit rating. The lender must pay legal fees to enforce the mortgage and then incur the additional costs of maintaining the property until it can be resold. In a period of declining home prices such as the recent mortgage crisis that began in 2007, there can be significant societal costs as well. Courts were overwhelmed with foreclosure filings during this period and the backlog of cases caused many homes to be abandoned, neglected, or vandalized while the process played out.

Negotiated alternatives to foreclosure are available and can be advantageous for both lenders and borrowers. But surprisingly few borrowers negotiated an agreement with their lenders during the recent crisis. Junior lienholders were a common obstacle because they had no incentive to negotiate terms and could force a foreclosure proceeding. When the borrower owes more to the first mortgage lender than the property is worth, proceeds from selling the property will not pay off the senior mortgage, much less any junior liens. Nevertheless, the holders of worthless junior liens can prevent a willing lender and borrower from reaching agreement and impose unwarranted costs and delay.

The Model Negotiated Alternative to Foreclosure Act (MNAFA) addresses this issue. Under MNAFA, a lender and borrower may enter into an agreement to transfer mortgaged property to the lender in full satisfaction of the debt. The agreement could allow the borrower to continue to occupy the property as a tenant, or include a payment from the lender to defray moving expenses. If the parties agree to terms, all junior lienholders must be notified of the proposal and will have 20 days to object. Objecting lienholders, however, have only one option for enforcement: redeem the property by tendering the amount of the first mortgage lien. The holder of a junior lien will only exercise that option if it determines the property is worth more than the amount owed on the senior obligation. If no objections are received, the junior liens are extinguished by law under MNAFA.

The MNAFA procedure is analogous to the "strict foreclosure" procedure for personal property under Article 9 of the Uniform Commercial Code, although the remedies differ slightly. Under Article 9, a junior lienholder who objects to the terms of a settlement agreement can force the senior lienholder to proceed with a foreclosure sale, which for personal property can usually be accomplished in a matter of weeks. In contrast, the more extensive foreclosure process for real estate can take years and impose significant costs on the lender, the borrower, and third parties whose property values are impacted by neighboring properties in a state of deterioration. These ancillary costs justify MNAFA's more limited remedy, which is designed to encourage fair, quick, and inexpensive resolution of mortgage defaults without unnecessary interference from the holders of worthless junior liens.

For further information about MNAFA, please contact ULC Chief Counsel Benjamin Orzeske at (312) 450-6621 or borzeske@uniformlaws.org.