

The Protecting Tenants at Foreclosure Act of 2009

Effective May 20, 2009, the United States Congress passed legislation that makes significant changes in landlord-tenant law in states throughout the country. The impact in North Carolina is likely to be most noticeable in small claims court, as new owners of rental property acquired through foreclosure find themselves in the unfamiliar—and sometimes quite unwelcome—role of landlords. The PTFA essentially provides that purchasers at foreclosure now assume their interest in foreclosed property subject to the interests of “bona fide tenants”. At a minimum, the new law requires that every such tenant receive 90 days notice provided by the new owner before being required to vacate the property. As we shall see, in many cases, tenants will be entitled to remain on the property even longer.

The PTFA is very short. It applies to all foreclosures on residential property. The primary provision of the Act is as follows:

In the case of any foreclosure on a federally-related mortgage loan or on any dwelling or residential real property after the date of enactment of this title, any immediate successor in interest in such property pursuant to the foreclosure shall assume such interest subject to__

(1) the provision, by such successor in interest of a notice to vacate to any bona fide tenant at least 90 days before the effective date of such notice; and

(2) the rights of any bona fide tenant, as of the date of such notice of foreclosure__

(A) under any bona fide lease entered into before the notice of foreclosure to occupy the premises until the end of the remaining term of the lease, except that a successor in interest may terminate a lease effective on the date of sale of the unit to a purchaser who will occupy the unit as a primary residence, subject to the receipt by the tenant of the 90 day notice under paragraph (1); or

(B) without a lease or with a lease terminable at will under State law, subject to the receipt by the tenant of the 90 day notice under subsection (1) ,. . .

(b) Bona Fide Lease or Tenancy- For purposes of this section, a lease or tenancy shall be considered bona fide only if__

(1) the mortgagor or the child, spouse, or parent of the mortgagor under the contract is not the tenant;

(2) the lease or tenancy was the result of an arms-length transaction; and

(3) the lease or tenancy requires the receipt of rent that is not substantially less than fair market rent for the property or the unit's rent is reduced or subsidized due to a Federal, State, or local subsidy.

Prior to May 20, 2009, a person seeking possession of property acquired at foreclosure could enforce a right to possession only by the procedure before the clerk set out in GS 45-21.29. When the occasional wanderer wandered into small claims court, magistrates properly found that the absence of a landlord-tenant relationship rendered summary ejectment unavailable in that case. The effect of the PTFA is that, by providing that a person acquiring property by foreclosure takes such property “subject to” an existing lease, a landlord-tenant relationship is created, even if the purchaser does not wish to become a landlord—or even if the purchaser was unaware of the lease! In effect, the purchaser at foreclosure is now treated just as any other purchaser of property: generally speaking, the purchaser “steps into the shoes” of the previous owner. The terms of the lease continue to apply to both tenant and new owner,

and the statutory obligations imposed on landlords by the Residential Rental Agreements Act apply with equal force to the purchaser at foreclosure, even if that purchaser is a bank or real estate investor.

It is important to note that the PTFA does impose some special rules that apply only to the situation in which a landlord acquired an interest in the property pursuant to foreclosure. Specifically, a landlord seeking to end a lease from period to period, whether the period is week-to-week, month-to-month, or year-to-year, is required to give the tenant 90 days notice of the intention to terminate the lease. Thus, in an action for summary ejectment based on holding over, the plaintiff must demonstrate that the tenants received this expanded notice. Furthermore, the new law requires this notice to be given by the purchaser; a trustee in foreclosure proceedings is not authorized to provide this notice.

Another special provision applies to leases for a definite period of time. With one exception, a purchaser of property subject to a lease for a year, for example, is not permitted to bring the tenancy to a premature halt, even if the tenant receives the 90-day notice. Thus, a purchaser who acquires property through foreclosure in January which is subject to a lease running from January to December will be required to honor the lease until it terminates in December. The exception arises when the purchaser wishes to sell the property to a buyer who wants to occupy the property as a primary residence. In this case, the tenant may be required to vacate the property before the expiration of the lease, but even here the 90-day notice applies.

The answers to several questions related to these general principles are not yet certain. First, consider the case in which a purchaser at foreclosure buys property on November 30, subject to a year-long lease due to expire on December 31. Even if the property had not changed hands, the tenant would have lost any claim to possession in one month. In this circumstance, is the purchaser at foreclosure required to provide a 90-day notice? A literal reading of the statute suggests that the answer is yes, but it remains unclear whether the courts will choose to read the law literally in this circumstance, in which a tenant suffers no negative impact as a result of foreclosure. A second question is whether the “primary residence exception” would apply to the situation in which a purchaser at foreclosure wishes to occupy the property. The literal language of the PTFA confines the exception to the instance in which a purchaser at foreclosure (such as a real estate investor) transfers the property to a buyer who plans to move in. Normally, the second buyer would take subject to the lease under the usual rules governing purchases of property subject to a lease. The application of the PTFA allows a premature termination (subject to the 90-day mandatory notice) of the lease in this instance. A good argument can be made that the same policy considerations do not favor the case in which a purchaser at foreclosure hopes to occupy the property as a primary residence, and thus that the law should be read literally in this instance.

Congress, for understandable reasons, did not attempt to establish a procedure for the protection of tenants’ rights, but instead left it to the individual states to determine how to best accommodate the requirements of the law within established procedures. Until the North Carolina Legislature has an opportunity to consider how the Act should be implemented, court officials are forced to operate in the absence of clear procedural rules, leaving all involved in something of a quandary. One of the most perplexing issues concerns the determination of whether a tenant is in fact “bona fide” and thus entitled to the protection of the PTFA. This may arise in several different ways.

First, a purchaser may seek an order for possession from the clerk as part of the statutory foreclosure procedure. If the clerk determines that a possessor is not a bona fide tenant, the order of possession will issue and the magistrate will never be confronted with the case. On the other hand, if the clerk

denies the order for possession based on a determination that the occupant is a bona fide tenant and thus entitled to protection under the PTFA, the existence of a landlord-tenant relationship has been judicially determined, and subsequent disputes between the parties will be governed by landlord-tenant law. If a tenant fails to pay rent, the new owner may seek summary ejectment just as the former owner would have, and the same is true in the event of breach of a lease condition. The effect of the PTFA is to modify only the showing the purchaser is required to make in order to obtain a judgment of summary ejectment based on holding over.

A more complicated question arises when the new purchaser initiates a summary ejectment proceeding before a magistrate and the issue of the occupant's status as a bona fide tenant arises at that point. If the magistrate determines that the occupant is in fact a bona fide tenant, the usual rules apply. What should a magistrate do, however, if the evidence establishes that the occupant is not a bona fide tenant? In such a case, there is no landlord-tenant relationship. Much like a case involving a vendor-vendee, the magistrate discovers that there is no jurisdiction to decide the case only after hearing some of the evidence. In this situation, the proper procedure is for the new owner to seek an order for possession from the clerk as part of the foreclosure proceeding. Unlike the vendor-vendee situation, however, the case is no more appropriate for district or superior court than it is for small claims court, so it makes little sense to return the case to the clerk. The best way to handle matters in this case may well be to dismiss the case with prejudice, being certain to explain in the judgment that the magistrate's lack of jurisdiction is due to the fact that the occupant is not a bona fide tenant.

Not surprisingly, the scope of the Act's application is broad, consistent with Congressional intention to protect so-called "innocent tenants" from losing their homes as a result of the housing crisis. The PTFA applies to all foreclosures occurring on or after May 20, 2009, and will affect leases entered into at any point prior to a purchaser's acquisition of an interest in the property. Even if a lease is entered into the day before the foreclosure sale, the PTFA will apply, assuming that the rental agreement otherwise satisfies the requirements related to a bona fide tenancy. The Act applies to all foreclosures on residential property, including private loan agreements. It applies to property subject to federal housing assistance, including Section 8 housing, and subjects a purchaser pursuant to foreclosure to obligations included in pre-existing housing assistance payment contracts as well as leases. The PTFA will sunset on December 31, 2014.