
Creative Solutions from Practitioners in Dealing with Real Property Issues and the Increase in Drafting Language to Deal with the Possibility of Foreclosures in J&Ds

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I. Introduction

Prior to the current housing market downturn, the primary real estate question for family law practitioners was which party would be awarded the homestead. Today, with a significant number of homes “underwater” (meaning that the aggregate loan balances exceed the fair market value of the home), the focus has shifted to a more complicated set of questions, such as who is responsible for the mortgage, how are the parties affected by a potential foreclosure and potential lingering deficiency claims by mortgage lenders.

The disposition of the homestead is among the most difficult decisions the parties or the trial court must make in a dissolution proceeding. The decision is more difficult if the disposition of the homestead must consider the welfare of the minor children of the parties and whether retention or sale of the homestead is in their best interests, as well as the financial condition of both parties and the cost of maintaining the homestead. Prior to the economic downturn and the dramatic decline in the residential real-estate market, this difficult decision was not as complicated by the twists and turns brought on by job loss, the reality that the parties’ homestead may not be sold in a reasonable timeframe to allow the separation of their household upon entry of the decree (if not

sooner), and the complexities of foreclosures where the parties cannot afford to pay their mortgage(s). The homestead would be awarded to one party and that party could typically refinance to remove the other party’s name from the mortgage, or the property could be sold promptly and the parties could divide the proceeds, pay off debt and move on to separate residences with no lingering ties or issues related to a real estate encumbrance. Now, with more homeowners being forced into foreclosure because they cannot afford to pay the mortgage due to a job loss, homes not selling as quickly, the value of real estate plummeting, etc., parties desiring to have their marriage dissolved bring more complex issues to a dissolution that must be addressed. If not, the consequences for the parties may cause more litigation and expenses they did not foresee or desire.

This article will explain the applicable real estate laws which family law practitioners should be aware of given the current housing market. This article will further provide some practical drafting tips for judgments and decrees that reflect current realities and anticipate and provide dispute resolution mechanisms for future issues between the parties. Finally, this article will address some related issues such as the effects of one spouse’s bankruptcy, and foreclosure alternatives such as short sales and deeds in lieu of foreclosure.

II. What Unique Issues Have Arisen for Practitioners Because of the Housing Market Decline and the Rise in Foreclosures

A. Differences Between Being a Fee Title Owner of the Property and Being an Obligor on the Mortgage

Any discussion of the current conditions in the housing market must start with the recognition of the fact that there is a difference between the husband and wife being joint title owners of the home and being joint obligors on a mortgage. Minnesota is referred to as a “lien theory” state, which means that title to a property is vested in the borrower(s) subject to the security interest of the lender, which is evidenced by a mortgage. At a closing on the purchase of a home which is financed by a third party, two documents are recorded against the property: (i) the deed which transfers title to the buyer; and (ii) the mortgage, which evidences the lender’s security interest.

In the marital dissolution context, severing fee title ownership between the parties is simple and straightforward: one party executes a quit claim deed conveying his/her interest to the other party.

When it comes to the mortgage, however, severance is not easy, especially given the current market conditions and the financial difficulties many parties in dissolution proceedings are facing. A judgment and decree may place responsibility for the mortgage and the underlying loan upon the party retaining ownership of the home, but such a decree is not binding upon the third party lender to whom both parties remain obligated. Thus, the only means of removing the party not retaining ownership from the mortgage is to have the other party refinance

or assume the loan with a new loan obligating only that party. However, when the aggregate balance of all mortgage loans against the home exceeds its value, refinancing will be near impossible. Another issue that may arise is that the party seeking to refinance or assume the loan may not be able to qualify to take on the loans on his/her own. Accordingly, the decree should address enforcement of the requirement to refinance and what happens in the event the party awarded the real estate cannot refinance.

B. Differences in Types of Ownership: Joint Tenancy vs. Tenancy in Common

Ownership of real property in Minnesota amongst a husband and wife is structured in one of two ways: joint tenancy or tenancy in common. With a joint tenancy, the husband and wife have rights of survivorship; that is, when the first spouse dies, the surviving spouse becomes the sole legal owner of the property, needing only to file an affidavit of survivorship and a copy of the deceased spouse’s death certificate in order to clear title into their name.

Tenancy in common, by contrast, is co-ownership, but without survivorship rights. With a tenancy in common, each co-owner’s interest can be transferred (during life or at death) to a third party. In addition, if a property is owned by a husband and wife as tenants in common, and the husband dies, the husband’s interest in the property must be probated in order to pass clear legal title to the wife. Because of this added, unnecessary step, most real property owned by a husband and wife is designated as joint tenancy.

For property ownership to be structured as joint tenancy, the deed of conveyance must so specify.

C. Difference Between a “Foreclosure by Advertisement” and a “Foreclosure by Action”

Much confusion as to how to deal with a possible home foreclosure in Minnesota stems from Minnesota’s unique dual foreclosure system. Minnesota is one of only ten states that allows for non-judicial foreclosures. In Minnesota, non-judicial foreclosures are referred to as “foreclosures by advertisement.”³ Minnesota also provides a method of judicial foreclosure, known as “foreclosures by action.”⁴

1. Characteristics of Foreclosure by Advertisement and Implications for Homeowners

In a non-judicial foreclosure, also known as “foreclosure by advertisement”, the lender schedules a sheriff’s sale and publishes and serves notice of said sale. At the sheriff’s sale, the lender is typically the winning bidder as it can bid up to 100% of the amount of its mortgage debt against the property, while all other bidders must pay in certified funds. After the sale, there is a six (6) month “owner’s redemption period” during which the owner/borrower can redeem the property (i.e., buy it back) from the lender by paying the sale price plus any costs associated with the foreclosure, including a statutorily determined amount of attorney fees. If the owner/borrower does not redeem, and no junior lienholders exercise their redemption rights, the lender owns the property free and clear of any liens.

The key aspect of a foreclosure by advertisement from the perspective of the owner/borrower is that the lender, by electing this more expeditious method of foreclosure, gives up any right to seek a judgment against the borrower(s) for any deficiency between the sale price and the mortgage balance.

Instead, the lender is said to have elected its remedy in taking the property and is left to recover any unpaid amounts through its sale of the property to a third party once all redemption rights have expired.

2. Characteristics of a Foreclosure by Action and Implications for Homeowners

A foreclosure by action, by contrast, is a foreclosure that is accomplished through a district court lawsuit. The lender initiates this type of foreclosure by serving a summons and complaint on the borrower(s). A court order is required for the lender to schedule the sheriff’s sale and the lender must return to court for approval of the sale price before the sheriff’s certificate of sale is issued and the owner’s redemption period begins to run.

For the owner/borrower, a foreclosure by action will result in a deficiency judgment against them. The lender not only can recover the property, but it can also levy upon other assets in order to satisfy the judgment. Very often, a foreclosure by action forces the owner/borrower to file bankruptcy to discharge the deficiency judgment. (Under this scenario, the third party lender can obtain a deficiency judgment against both parties if they both remain obligated on the loan. Therefore, if a party does not remove a former spouse’s name from a home mortgage via the required refinancing, the third party lender may seek a judgment against the party that was not awarded the real estate if there is a foreclosure by action after the decree is entered. This could become a costly and unfair financial problem for the spouse that was not awarded the real estate after entry of the decree if this issue is not properly addressed.)

D. Ability of Lender to Initiate Collection Action on Promissory Note in Lieu of Foreclosing on the Property

Very often, a homeowner who falls behind on their mortgage payments expresses a desire to “walk away” from the property. If only a first mortgage exists, then the lender will likely proceed with a foreclosure by advertisement and the homeowner’s losses could be limited to a loss of the property and a declining credit score. If, however, there are one or more junior mortgages, the homeowner’s ability to “walk away” becomes difficult. This is because the mortgage merely serves as security for repayment of a loan. The loan is evidenced not by the mortgage but by a promissory note. Hence, a holder of a second mortgage is not out of options if the first mortgage holder forecloses. The junior mortgage holder is not required to redeem the property from the first mortgage holder; rather, the junior mortgage holder can instead pursue a collection action against the owner/borrower for the amount(s) due pursuant to the promissory note and thereby obtain a money judgment against the owner/borrower. As is the case with a foreclosure by action, the second mortgage holder’s pursuit of a money judgment against the owner/borrower will likely lead to their filing bankruptcy.

E. Effect of Bankruptcy

In the marital dissolution context, one party’s decision to file bankruptcy can profoundly impact the other party, and oftentimes the other party also is forced to file. Recall that the mortgage is a joint obligation of the parties. If one party files bankruptcy and both parties are yet obligated under the mortgage, the mortgage lender will look to the non-filing party (regardless of what the decree provides in terms of responsibility for the mortgage) for payment of the remaining mortgage balance.

III. Drafting

Tips for Drafting Real Property Language in the J&D if One Spouse Can Refinance the Property

- If you are representing the spouse ordered to refinance, determine if they can be preapproved for the loan before the decree is signed and what will happen if they are not approved to take on the loan on their own. (You should try to anticipate the financial impact of the sale and the repercussions to your client and whether a sale will diminish their share of the marital estate via the costs of the forced sale, capital gains taxes on rental real estate, etc.).
- If you are representing the spouse who wants the other party to refinance to remove their name off the mortgage and/or to receive their property award, ensure there are provisions in the decree that make refinancing enforceable. For example, you should include language that gives your client the right to put the property on the market for sale if the refinance is not completed for any reason (including the other party’s inability to refinance for financial reasons or simply not qualifying).⁵ If your client is receiving a cash award/equalizer you should ensure that the award is secured by a lien against the real estate and that the terms of the lien are defined and there is a mechanism for enforcement set forth in the decree.

You should also include language that provides:

- That the spouse who is not awarded the property will execute a quit claim deed conveying their interest in the property to the party awarded the real estate. Also include terms specifying that if that spouse fails to execute proper documents, recording a certified copy of the decree of dissolution will operate to effectuate the

transfer, and that both parties will cooperate in the prompt entry of a Summary Real Estate Disposition Judgment if requested.

- Indemnification terms setting forth that the spouse who is awarded the real estate will indemnify the other party against and assume the sole liability and responsibility for any loss, damages, expenses, civil or criminal liability including any deficiency assessment, penalty or interest regarding the real estate mortgage and include any of the obligations, notes, and personal guaranties relative to the real estate mortgage previously executed by the spouse, who is not awarded the real estate, in the indemnification terms.

If the party who was not awarded the real estate will have their name on the real estate mortgage for a period of time before the refinance, for as long as that party's name remains on the loan, include provisions to protect their interest and expedite possible post-decree issues. You may want to include terms that address the following issues:

- That the party who was awarded the real estate will execute a Confession of Judgment in favor of the spouse who was not awarded the real estate in an amount equal to the face amount of the mortgage (s). In the event of a default, credit will be given to the former spouse for any amounts already paid, and the spouse who was not awarded the real estate may enter the judgment up to the amount due on the loan. The Confession of Judgment can be held in escrow by the lawyer of the party who was awarded the real estate and given to the other party's lawyer in the event of non-payment of the loan (for example, non-payment of 3 consecutive loan payments). The process allows for immediate enforcement and disposition of

the judgment and there is less delay post-decree.

- That the party who was awarded the real estate will notify the other party who was not awarded the real estate any time he/she is 20 days late in paying the loan. The spouse who was not awarded the property may pay the mortgage at any time that the former spouse is late twenty (20) days. If the payment is made, you may want to include a provision specifying that the payment may be deducted from any support payments owed and constitute support for the month in question, or that the payment made becomes an immediate judgment that must be paid within a specified period of time.
- Include a provision that the spouse who will be awarded the property is required to maintain life insurance in an amount equal to the outstanding loan on the property so the surviving former spouse can pay off the loan in the event of that spouse's death while his/her name remains on the mortgage, but not on title.
- If the decree provides for the ability of the spouse who was not awarded the property to sell the property in the event that the other spouse defaults on the mortgage loan obligation(s), require the spouse who will be awarded the property to execute a quit claim deed which conveys title to the property to the other spouse. The deed can be held in escrow by the lawyer of the party who was awarded the real estate and given to the other party's lawyer in the event of non-payment of the loan (and can thus be recorded for purposes of vesting title in the other spouse sufficient to allow a closing on a sale of the property; without this title transfer, the spouse who defaulted on the mortgage loan remains the owner of record and a closing cannot be completed).

Special Tips for Dealing With Property That is Already in Foreclosure

If the property is in foreclosure consider including language in the decree that addresses the following:

- How title will be held by the parties after entry of the decree (tenants in common or joint tenants).
- Whether a spouse will be awarded exclusive use and occupancy of the homestead and who will be responsible for household payments, utilities, maintenance, and all other routine expenses relating to the property until foreclosure is complete.
- Whether both spouses are equally responsible for any future repairs, maintenance or improvement costs required to sell the homestead.
- How any deficiency in the mortgage(s) will be divided/addressed.
- Whether either spouse may seek to redeem the property from foreclosure. If so, how fair market value will be established.
- How any proceeds will be divided between the parties.
- Ensure the parties execute a deed reflecting how they will hold title. Include terms in the decree setting forth that if the deed is not provided, a certified copy of the judgment and decree will act as said deed to transfer the property in accordance with the terms of the decree.

Bankruptcy provisions

Consider including terms that address the obligations arising under the decree cannot be discharged, canceled, terminated, reduced, diminished or in any way affected by the filing of a petition in bankruptcy by either spouse, by a third party who is partial to and/or under the influence of either spouse to the

agreement, or by a business entity controlled or substantially controlled or owned by a spouse, or by the making of an assignment for the benefit of creditors. You may also want to include terms specifying that the spouse who is adversely affected by the bankruptcy filing will be entitled to apply to the court for modification of the decree and to obtain economic relief of any kind required to relieve the aggrieved spouse of the adverse impact of the bankruptcy or assignment, including, but not limited to, the granting of spousal maintenance, if there is no other recourse.

IV. Short Sales in the Context of a Marital Dissolution

An alternative to one spouse retaining ownership of the home and responsibility for the mortgage is for the parties to simply agree to sell the home (or for the court to order the sale if the case is contested). Where the property's value is less than the aggregate mortgage loan balances, such a sale is known as a "short sale." In today's economy, this may be a solution the parties to a dissolution may consider.

A short sale begins much like any other residential real estate transaction. The owners prepare a disclosure statement for prospective buyers, an offer is made and the terms of sale are negotiated between the parties. The purchase agreement will likely include the usual contingencies for inspection and financing.

Where the short sale differs, though, is that an additional contingency is added to the sale. This contingency deals with the fact that the sale is contingent upon the seller's lender(s) written consent for the deal. Why is lender consent required? Because in a short sale, the lender(s) are receiving less than full payment and are being asked to release their

mortgage liens from the property.

To obtain lender consent for a short sale, a voluminous package of documentation is sent to the lender. This package includes a financial statement of the borrower(s), tax returns, pay stubs, bank statements, information about the listing of the property, comparable sales information and a hardship letter explaining why the party or parties cannot continue to make the monthly mortgage payment. The lender reviews this information and either approves, rejects or counters with its own conditional consent to the short sale. Once an agreement is reached with each lender, the sale can be closed.

One key point in regards to short sales that arise out of a marital dissolution proceeding: very often the lender asks for some amount of the sale proceeds coupled with an additional amount paid over time by a promissory note secured by a confession of judgment. In essence, the lender issues a new loan to the borrower(s), and this new loan goes through a similar underwriting process as did the original loan. If both spouses are obligated on the mortgage, the information referenced in the preceding paragraph will be required of both spouses. Accordingly, if the parties agree to a short sale the parties should address all the terms of the short sale and who will be responsible for any additional amount that must be paid over time after the short sale in the decree.

V. A Note Regarding Foreclosure On Marital Liens

In July 2010, the Minnesota Court of Appeals addressed foreclosure of a marital lien in *Bakken v. Helgeson*, 785 N.W.2d 791 (Minn.App. 2010). The Court explained the law regarding marital liens and provided drafting guidance to decrease disputes regarding how a marital lien may be

enforced. In *Bakken*, the former wife brought an action against the landowner, former landowner and the bank to foreclose her \$5,000 marital lien. The former husband, who was deceased at the time, had a 1983 judgment that dissolved the marriage, and awarded the former wife a \$5,000 lien, payable when the property was sold, against the real estate awarded to him. The judgment containing the lien was recorded by the county recorder in 1983. The District Court granted a motion for summary judgment against the former wife based on the statute of limitations on judgments finding that her marital lien was barred by the 10-year statute of limitations for enforcing a judgment or judgment lien contained in Minnesota Statute §§ 548.09 and 550.01(2008).

The Court of Appeals reversed the summary judgment against the former wife, holding that the statute of limitations for mortgage foreclosure applied in her case. *Id.* at 795. The key fact was that the judgment and decree of dissolution did not expressly provide a means for enforcement, and the debt to the former wife was payable when the real estate was sold. The Court of Appeals concluded that marital liens are not judgment liens because they are a method of distributing property in a dissolution proceeding. *Id.* at 794-795. A marital lien is personal property, which may be foreclosed as a mortgage when the original judgment does not expressly provide a different means for enforcement. Minn. Stat. § 581.01 *et.seq.* *Id.* at 794-795. Accordingly, the statute of limitations for mortgage foreclosure applied to the former spouse's lien holder foreclosure action. Minn. Stat. Ann. § 541.03(1).

The Court of Appeals distinguished the *Bakken* case from its decision of *Dahlin v. Kroening*, 784 N.W.2d 406 (Minn.App. 2010), where the court held that a judgment for spousal maintenance arrearages may be

continuously renewed by filing an action within ten (10) years of entry of the previous judgment. The Court of Appeals emphasized that the marital lien in *Bakken* did not arise from a money judgment that expired after 10 years because it was directly awarded by the court as a way to divide property. In *Bakken*, the case was remanded for further proceedings to determine when the real estate was actually sold and the lien became due and payable.

Regarding drafting marital liens, the Court of Appeals provided the following guidance in *Bakken*:

Finally, to decrease the likelihood of such disputes, we suggest that courts using marital liens include in their orders: (1) the value of the debt to be secured by the lien, in terms of either an absolute dollar amount or a percentage of the equity or ultimate sale price of the property; (2) the applicable interest rate, if any, which should be justified in the accounting of the court's division of the marital assets, *see Thomas v. Thomas*, 407 N.W.2d 124, 127 (Minn.App.1987) (requiring specific findings to explain decision not to require payment of interest); (3) an ascertainable date of maturity; (4) a specific mechanism for enforcement; and (5) an explanation of whether the lien is in the nature of child support or purely a division of property, *see Holmberg v. Holmberg*, 578 N.W.2d 817, 825 & n. 8 (Minn.App.1998) (noting that lien in nature of child support is subject to modification, while divisions of property are final), *aff'd*, 588 N.W.2d 720 (Minn.1999). *Bakken*, at 795-796.

VI. A Word About Mortgage Modifications

Many homeowners are pursuing modifications to their mortgage loans in order to reduce their monthly mortgage payments and thereby retain ownership of their home. These modification programs can be offered privately through the lender or they could be in the form of government-sponsored programs such as the Making Home Affordable⁶ program.

In the marital dissolution context, the modification issue can trigger issues post-decree where a refinance is not possible, the parties cannot agree on a short sale but neither party wishes to see the property be foreclosed upon (and adversely affect their credit). When the party retaining ownership of the home seeks a modification of the mortgage and the former spouse is yet obligated on the mortgage that former spouse will be required to participate and sign documents relative to the modification. Without both parties' cooperation to obtain a modification, it is not likely that the modification efforts will be successful. Therefore, the parties' decree should address the loan modification in the decree and set forth the terms requiring both parties' cooperation in the process to avoid costly fees and possible court action after the decree is entered.

VII. Conclusion

Today's real estate market has thrown family law practitioners a curveball when it comes to dealing with the disposition of the home and responsibility for the mortgage upon the home. The challenges posed by the downturn in the economy and the real estate market can be overcome, but only with careful consideration of the possible scenarios, a basic knowledge of how the real estate laws affect the dissolution and vice versa, and a

creative mentality towards problem solving. It is a good idea to work with a real estate attorney to find creative solutions that will help protect your client and diminish costly post-decree actions to enforce the terms of the decree when these issues arise.

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³ See Minnesota Statutes Chapter 580.

⁴ See Minnesota Statutes Chapter 581.

⁵ Please see, *Zimmerman v. Zimmerman*, 2008 WL 1971650 (Minn.App. May 6, 2008) (unpublished), where the district court ordered the homestead to be sold when the former wife proved she could not refinance to assume the mortgage on her own. The former husband challenged the district court's determination that allowed the former wife to sell the property instead of refinancing because he would not receive the same amount of money from the equity if the property was sold. The former husband argued that the district court's order modified the parties' stipulated decree on the property division because he would not be receiving the same amount of funds as his share of the equity. The Court of Appeals specifically found that the district court properly interpreted the decree and applied the law, although they were "mindful that more diligent action by Jodi Zimmerman may have resulted in an earlier sale and possibly more revenue to both parties on the divided equity." *Id.* at *4. The Court of Appeals held: "We hold that the district court did not act beyond its discretion by ordering that Jodi Zimmerman sell the home so the equity may be evenly divided between the parties, rather than to require her to pay the amount of equity as previously estimated but never realized through refinancing."

⁶ For more information, please visit <http://www.makinghomeaffordable.gov>.