

Renters in Foreclosure: What Are Their Rights?

Federal legislation signed in May 2009 gives important rights to tenants whose landlords have lost their properties through foreclosure.

The mortgage industry crisis that started in 2006 has resulted in thousands -- no, make that millions -- of foreclosed homes. Most of the occupants are the homeowners themselves, who must scramble to find alternate housing with very little notice. They're being joined by scores of renters who discover, often with no warning, that their rented house or apartment is now owned by a bank, which wants them out.

Who Are the Renters?

Renters who lose their homes to foreclosures don't fit a single profile. Many of them live in smaller buildings, condos, and single-family homes. They're located in cities and surrounding suburbs, in low-income and upscale neighborhoods. In short, foreclosed homes are everywhere, and they're rented by people with widely varying incomes, including some with "Section 8" (federal housing assistance) vouchers.

Who Are the Defaulting Owners?

The typical foreclosed home may have originally been owner-occupied, but more often it's owned by investors and speculators who were hoping to profit from the rents. Caught between the slump in housing values and the rise of mortgage interest rates, these owners could not feasibly sell or extract enough rent to cover their monthly costs. In droves, they lost their investments. For example, in Minneapolis and its surrounding suburbs, 38% of the 2006 foreclosures involved rental properties; in Minneapolis alone, 65% were rentals.

Who Are the New Landlords?

When an owner defaults on a mortgage, the mortgage holder, often a bank, either becomes the new owner or sells the property at a public sale. If the bank becomes the owner, it may pay a servicing company to handle the property. But don't expect close attention -- these companies are focused on financial matters, not mundane things like maintenance.

Some renters find themselves with a new owner even before the foreclosure. Lawyers in Massachusetts, for example, contend that many new rental property owners are investment trusts that specialize in purchasing troubled loans directly from banks, then foreclosing, evicting, and selling.

NEW OWNERS MEANS NO MAINTENANCE

Many tenants have no idea that their building has been taken at foreclosure. They continue to pay rent to the former owner, who often pockets the money but is hardly inclined to maintain the building it no longer owns. In the meantime, the new owners simply refuse to be landlords, never making repairs or even paying utility bills. Because the banks are stuck with

increasing numbers of foreclosed properties that they can't sell, they remain non-landlords for some time, making life impossible for their tenants until those tenants are evicted.

Renters in Foreclosed Properties No Longer Lose Their Leases

Before May 20, 2009, most renters lost their leases upon foreclosure. The rule in most states was that if the mortgage was recorded before the lease was signed, a foreclosure wiped out the lease (this rule is known as "first in time, first in right"). Because most leases last no longer than a year, it was all too common for the mortgage to predate the lease and destroy it upon foreclosure.

These rules changed dramatically on May 20, 2009, when President Obama signed the "Protecting Tenants at Foreclosure Act of 2009." This legislation provided that leases would survive a foreclosure -- meaning the tenant could stay at least until the end of the lease, and that month-to-month tenants would be entitled to 90 days' notice before having to move out (this notice period is longer than any state's non-foreclosure notice period, a real boon to tenants).

An exception was carved out for the buyer who intends to live on the property -- this buyer may terminate a lease with 90 days' notice. Importantly, the law provides that any state legislation that is more generous to tenants will not be preempted by the federal law. These protections apply to Section 8 tenants, too.

Importantly, tenants who live in cities with rent control "just cause" eviction protection are also protected from terminations at the hands of an acquiring bank or new owner. These tenants can rely on their ordinance's list of allowable, or "just causes," for termination. Because a change of ownership, without more, does not justify a termination, the fact that the change occurred through foreclosure will not justify a termination.

Does It Make Sense to Evict Tenants?

New owners may want to terminate existing tenants because they believe that vacant properties are easier to sell. Common sense suggests otherwise. In many situations a building full of stable, rent-paying tenants will be more valuable (and command a higher price) than an empty building. Emptied buildings are also prone to vandalism and other deterioration -- after all, no one is on site to monitor their condition. When entire neighborhoods become a wasteland of empty foreclosed multifamily buildings, their value drops even further. It's hard to understand why new owners choose to pay lawyers to start eviction procedures instead of paying a modest fee to a management company to collect rent and manage the property while they wait to sell.

"CASH FOR KEYS"

To encourage tenants to leave quickly and save on the court costs associated with an eviction, banks offer tenants a cash payout in exchange for their rapid departure. Thinking that they have little choice, many tenants -- even Section 8, protected tenants -- take the deal. It doesn't help them much as they join the swelling ranks of newly displaced tenants (and former homeowners) who are competing to find an affordable new rental.

What Can a Foreclosed-Upon Tenant Do?

Thanks to the 2009 federal legislation, most tenants with leases will keep their leases, and month-to-month tenants will have at least 90 days to relocate. Tenants with leases have no legal recourse against their former landlords, because they are in the same position vis a vis the new owner as they were with the old: The lease survives and ends as it would had there been no foreclosure. Similarly, month-to-month tenants always know that they can be terminated with proper notice, and 90 days is longer than any state's termination period.

However, a lease-holding tenant whose rental has been bought by a buyer who want to move in to the property ends up less fortunate than before the new law -- he may lose his lease with 90 days' notice, a result that probably would not have happened had the owner simply sold the property to a buyer who intended to occupy the property. (Normally, the new owner has to wait until the lease ends, absent a lease clause providing for termination upon sale, though such clauses may not be legal in all situations.)

Suing in Small Claims Court

A lease-holding tenant who has to move out so that new owners may move in might consider suing their former landlord in small claims court. Here's how it works.

After signing a lease, the landlord is legally bound to deliver the rental for the entire lease term. In legalese, this duty is known as the "covenant of quiet enjoyment." A landlord who defaults on a mortgage, which sets in motion the loss of the lease, violates this covenant, and the tenant can sue for the damages it causes.

Small claims court is a perfect place to bring such a lawsuit. The tenant can sue the original landlord for moving and apartment-searching costs, application fees, and the difference, if any, between the new rent for a comparable rental and the rent under the old lease. Though the former owner is probably not flush with money, the awards in these cases won't be very much, and the court judgment and award will stay on the books for many years. A persistent tenant can probably collect what's owed eventually.

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