

**Basics of Mortgage Foreclosure and Contract-for-Deed Cancellation  
for Residential Tenants**

by

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## Basics<sup>1</sup> of Mortgage Foreclosure and Contract-for-Deed Cancellation for Residential Tenants<sup>2</sup>

### [1] Simplified Definitions

- a) Mortgage = Agreement between mortgagee (lender<sup>3</sup>) and mortgagor (borrower) whereby real estate (land plus buildings) is pledged as collateral for a loan (a “note”)
- b) Foreclosure = Procedure by which the lender gets the property back after borrower defaults on the loan
- c) Foreclosure by Action = Foreclosure through the court system
- d) Foreclosure by Advertisement = Foreclosure without a lawsuit
- e) Contract for Deed = Contract for sale of real estate. Typically, the vendee (buyer) agrees to pay vendor (seller) an agreed set of payments over time. If all payments are made, the deed is then transferred to the vendee and the vendee becomes the owner. If payment(s) is/are missed, the vendor can cancel the contract and take back the land. From an economist’s perspective, this functions in many ways like an alternative form of “mortgage” although the legal rules are different.<sup>4</sup>

### [2] Foreclosure by Advertisement<sup>5</sup>

- a) The procedure starts with lender advertising the sale in a legal newspaper at least 6 weeks

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<sup>1</sup>Those uninterested in the underlying legal analysis should skip the footnotes. Without the footnotes, this essay should be basic, and without the footnotes the essay is actually pretty short. This essay is about residential tenants; the law is different for commercial tenants .

<sup>2</sup>Minnesota statutes are available at <http://www.leg.state.mn.us/leg/statutes.asp> .

<sup>3</sup>For reading ease, throughout the rest of this outline, I’m going to use the word “lender” for mortgagee and “borrower” for mortgagor. Of course, some loans do not involve mortgages, so some lenders are not mortgagees and some borrowers are not mortgagors. However, this outline is about loans with mortgages.

<sup>4</sup>In context, in parts of this outline, “lender” will also refer to “vendor” as well as “mortgagee”.

<sup>5</sup>See Minn. Stat. § 580.03

before the sheriff's sale.

b) At least 4 weeks before the sheriff's sale, the lender's process server personally serves the occupant/s with notice of the sale.

### [3] Foreclosure by Action

a) The procedure starts with lender serving the borrower with a lawsuit seeking foreclosure. The lender also serves the occupants.

b) The defendant/borrower has 20 days to answer. After that (or by default if no answer), assuming the lender wins the case, the court will order a sheriff's sale.

c) This process is more cumbersome but does have one advantage over foreclosure by advertisement: the court has the power to issue a deficiency judgment (entering judgment for the money still owed if the bank eventually sells the property at a loss).

### [4] Sheriff's Sale

Officially this is an auction. Usually, the lender is the only bidder. The lender starts the bidding at the full amount of principal + accrued interest owing. (Since the lender eventually gets this amount, this bid effectively involves the lender paying itself and thus risking nothing.) Others, including the tenants, who attend are free to bid more.

The winner of the auction receives a Certificate of Sale. For the rest of this outline, I'm going to assume that the winner of the auction is the lender.

### [5] Redemption Period

a) After the sale, the lender does not possess the property. Instead, it has to wait for the redemption period to pass.

b) During the redemption period, the borrower remains in possession. This is a legal term. If the borrower is a landlord, he will continue to be the landlord just as before the sale. The tenants still pay him the rent and he still owes them the usual duties (e.g. doing repairs).<sup>6</sup>

c) During the redemption period, the borrower also has the right to redeem. This means paying

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<sup>6</sup>See Orr v. Bennett, 135 Minn. 443, 161 N.W. 165 (1917). Occasionally, the lender will get a court order creating a receiver to run the building during the six months. If so, the tenant will be served with the court order and should obey it. If the tenant is served with a non-court ordered Assignment of Rent, the rule is more complicated and the tenant should seek an attorney's advice.

off the entire winning bid (not just the unpaid monthly mortgage payments) + certain court costs. If the borrower redeems, he is fully restored to his prior position minus the mortgage. It is as if he had paid off the mortgage without all the unpleasantness.

[6] How Long is the Redemption Period?

a) In most cases, the redemption period is 6 months.<sup>7</sup>

b) Rarely, the redemption period is longer or shorter. For example:

- \* Most agricultural land has a 12-month redemption period.<sup>8</sup>
- \* Reverse mortgages have a 12-month redemption period.<sup>9</sup>
- \* Mortgages signed prior to July 1967 have a 12-month redemption period.<sup>10</sup>
- \* If the borrower has paid off 1/3 of the principal, the redemption period is 12 months.<sup>11</sup>
- \* Upon proper motion to the court, the lender can reduce the redemption period to 5 weeks for *abandoned* residential property smaller than five units.<sup>12</sup>
- \* The lender and borrower can make a certain kind of written agreement to reduce the redemption period to 2 months.<sup>13</sup>

[7] Cancellation of Contracts for Deed<sup>14</sup>

A Contract for Deed is not foreclosed. Instead, after a default the vendor serves a special notice

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<sup>7</sup>See Minn. Stat. §§ 581.10, 580.23.

<sup>8</sup>See Minn. Stat. §580.23.

<sup>9</sup>See Minn. Stat. §580.23. “Reverse mortgage” is defined in Minn. Stat. §47.58 .

<sup>10</sup>See Minn. Stat. § 580.23.

<sup>11</sup>See Minn. Stat. § 580.23.

<sup>12</sup>See Minn. Stat. § 582.032.

<sup>13</sup>See Minn. Stat. § 582.32.

<sup>14</sup>See Minn. Stat. § 559.21.

on the vendee giving the vendee a choice of curing the breach (typically, catching up on payments plus paying certain costs) or having the contract terminated. The vendee has 60 days to cure (similar to redeeming a mortgage). If the vendee does not cure or get a court order to stop the process, after the 60 days the ownership reverts to the vendor (similar to the mortgagee getting full ownership after the redemption period with a mortgage sheriff's sale). Just like the mortgage redemption period, during the 60 days the vendee is still the landlord and the tenant is still the tenant of the vendee.

#### [8] What Happens After the Redemption or Cancellation Period Ends?

Two statutes – one federal statute and one state statute – come into play.<sup>15</sup> The federal statute<sup>16</sup> does not take away any rights under state law. In any given situation, it either helps the tenant or has no effect on the tenant.<sup>17</sup> Rights under federal law are discussed first and then rights under state law.

##### Federal Law Rights

a) The federal statute<sup>18</sup> only applies to foreclosures<sup>19</sup> and not to cancellations of contracts for deed.

b) The federal statute is set to expire (“sunset”) on 12/31/14<sup>20</sup> and only applies to foreclosures after 5/20/09.<sup>21</sup>

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<sup>15</sup>At common law, after the redemption or cancellation period the lender simply took over, the lease was cancelled, and the tenant became a tenant at sufferance (like a trespasser). The one exception to this common-law rule is that if the lease was signed before the mortgage or contract for deed and the lender knew of the lease, then the lease is not cancelled. The theory behind this rule is that if the lender had nothing to do with a lease signed after the mortgage or contract for deed, the lender should not be burdened with something done completely out of his control. See *Schrunk v. Andres*, 221 Minn. 465,470, 22 N.W.2d 548,551 (1946). However, the statutes discussed in this essay overcome the common law.

<sup>16</sup>See Public Law 111-22, Title VII, reprinted in the Appendix.

<sup>17</sup>See Public Law 111-22, Section 702, end of clause (a).

<sup>18</sup>See Public Law 111-22, Title VII.

<sup>19</sup>Actually, only to residential foreclosures (dwellings like houses and apartments as opposed to businesses.)

<sup>20</sup>See Public Law 111-203, Section 1484(2), amending Public Law 111-22, Section 704.

<sup>21</sup>See Public Law 111-22, Section 702(a).

c) Aside from section-8 voucher leases where the law simply applies to current leases (discussed on page 6 in part g), the federal statute applies to tenants who signed their lease or orally formed their lease<sup>22</sup> prior to the end of the redemption period.<sup>23</sup>

d) The federal statute (1) makes the lease survive the foreclosure; and (2) also requires the lender to give 90-days notice to vacate even if the lease has less than 90 days to go. A month-to-month lease is an example of a lease with less than 90 days to go.<sup>24</sup>

e) The 90-day notice cannot be given until after the redemption period ends.<sup>25</sup>

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<sup>22</sup>The lease has to be “bona fide”, basically a fair deal and not a sweetheart lease. See Public Law 111-22, Section 702(b)..

<sup>23</sup>Section 702 set the cutoff date as the “Notice of Foreclosure”. This led to litigation over the meaning of “Notice of Foreclosure”. Recently passed legislation amended Section 702 to define “notice of foreclosure” as follows: “For purposes of this section, the date of a notice of foreclosure shall be deemed to be the date on which complete title to a property is transferred to a successor entity or person as a result of an order of a court or pursuant to provisions in a mortgage, deed of trust, or security deed.” See Public Law 111-203, Section 1484(1). Possibly, if the sheriff sale was held prior to 7/21/10, the date Public Law 111-203 was signed by the President, the old law governed and the meaning of “Notice of Foreclosure” would be subject to interpretation and might mean (might have meant) some earlier point in time such as the date the sheriff sale was scheduled or the date the sale was advertised in a legal newspaper. Public Law 111-203 refers to this definition as a “clarification”, strengthening the argument that this definition has always applied.

<sup>24</sup>Since the federal statute states that “nothing in this section shall affect ... any State or local law that provides longer time periods *or other additional protections for tenants*” (Public Law 111-22, Section 702(a)[end]), the tenant should be allowed to stand on his common-law right not to become the tenant of the lender if he doesn’t want to be the lender’s tenant. The tenant would decline to use or follow the federal law and just use his state-law rights if that is what he prefers. The legislative history suggests, however, that if the tenant wishes to use the federal right to occupy for 90 days or for the balance of the lease, he does so under the lease and its requirements.

<sup>25</sup>Public Law 111-22, Section 702(a)(1) requires the notice to be given by the successor in interest and the lender would not obtain this status until the redemption period is over. See Black’s Law Dictionary 1431 (6th ed. 1990) (“to be a ‘successor in interest’ a party must continue to retain the same rights as the original owner”). See also Public Law 111-5 at long paragraph on “Community Planning and Development, community development fund”, *in para materia* to Public Law 111-22, using “successor in interest” in virtually identical manner and then going on to discuss utility and other payments that make sense only when the successor in interest is in complete control of the property..

f) Under the federal statute, the lease (right to occupy) can be cut short if the unit is purchased by someone who will occupy the unit as a primary residence (in slang, an “owner occupant”).<sup>26</sup> However, the 90-day notice still must be given.

g) If the lease is a section 8, voucher lease, the lease and the HAP contract (contract between Housing Authority and landlord [now the lender]) survives the foreclosure.<sup>27</sup> The only exception is the same owner-occupant escape provision that applies to non-voucher leases.<sup>28</sup>

### State Law Rights - Cancellations

The vendor has to give the tenants a two-months<sup>29</sup> notice.<sup>30</sup> The notice can be given during the cancellation period so long as the notice is at least two months and so long as the notice period ends no earlier than the end of the cancellation period.<sup>31</sup> For example, if the cancellation period

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Minn. Stat. § 504B.285, subd. 1a (2010) explicitly requires the notice to be “effective no sooner than 90 days after the date of the expiration of the time for redemption.”

<sup>26</sup>See Public Law 111-22, Section 702(a)(2)(A).

<sup>27</sup>See Public Law 111-22, Section 703.

<sup>28</sup>See Public Law 111-22, Section 703.

<sup>29</sup>In this situation, the word “month” really means “month” and not “rental period”. For example, a lender’s notice given on January 17 to vacate by March 17 is a two-months’ notice. See Minn. Stat. § 645.14.

<sup>30</sup>See 2010 Minn. Laws ch. 315, s. 12, codified at Minn. Stat. § 504B.285, subd. 1b. This law actually only governs eviction actions. If the vendor (owner) used an alternative method to remove the tenant, such as an ejectment action, the tenant is not protected. However, the alternative methods tend to be expensive, time-consuming, or both. As a result, the time frames set out in this statute become the de facto timing rule.

Prior to August 1, 2008, if the tenant signed the lease during the redemption period (and by implication, the cancellation period), the two-month rule did not apply. Broszko, v. Principal Mutual Life Ins. Co., 533 N.W.2d 656 (Minn. Ct. App. 1995). However, the rule of Broszko was abrogated by 2008 Minn. Laws ch.177, sec.3, modifying Minn. Stat. § 504B.285, subd. 1(1)(i-iii). The 2009 legislature further modified this provision to clarify that it applies whether the tenant moved in before or after the sheriff sale so long as the tenant moved in before the end of the redemption or cancellation period. See 2009 Minn. Laws ch. 130, sec. 1. The 2010 legislature moved the language around but kept the language, and therefore the rule of law, intact. See and compare 2010 Minn. Laws ch. 315, s.10,12 to the 2008 and 2009 laws.

<sup>31</sup>See 2010 Minn. Laws ch. 315, s. 12, codified at Minn. Stat. § 504B.285, subd. 1b.

ends on October 15, the vendor could give the two-month notice on September 15 to be effective November 15.

If the tenant holds a Section-8 voucher, the cancellation may not cancel the lease and even a two-month notice might not be of any legal effect. The law is unsettled on this point.<sup>32</sup>

#### State Law Rights - Foreclosures Prior to January 1, 2013 - Virtually Same as Federal Law

Starting August 1, 2010 and ending December 31, 2012, the state eviction law is amended to provide tenants with virtually the same protections as federal law in foreclosure situations.<sup>33</sup> During this period, virtually the same limitations apply as well. The state eviction law does require a 90-day notice even for non-bona-fide leases. There are some other subtle differences between state and federal law, but these differences will come into play very rarely.

#### State Law Rights - Foreclosures On or After January 1, 2013

This essay is intended to be read for current situations. Therefore, the details of the law post December 31, 2012 will not be discussed.<sup>34</sup>

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<sup>32</sup>This is the holding in a set of cases from New England. See Bristol Savings Bank v. Savinelli, CV-95-0377478-S, 1996 Conn. Super Lexis 742 (Conn. Super. Ct. Mar. 21, 1996); Webster Bank v. Occhipinti, No. CV-970059147S, 1998 WL 846105 (Conn. Sup. Ct. Nov. 20, 1998); EMC Mortgage Corp. v. Smith, Civ. No. 95-04794, Housing Court Dept, City of Boston, MA (Jan. 5, 1996). These were foreclosure cases, but the principles should apply to cancellation cases.

<sup>33</sup>See 2010 Minn. Laws ch. 315, s. 11, codified at Minn. Stat. § 504B.285, subd. 1a.

The 2010 legislature changed the state law on this subject, making it essentially mirror federal law, effective August 1, 2010 but also sunset the new law and sunrise (reinstated prospectively) the old law effective the federal law's original sunset date of December 31, 2012.. See 2010 Minn. Laws ch. 315, s. 10-13. Under the old state law, cancellations and foreclosures are both subject to the same two-month notice.

Prior to August 1, 2011, the state law also protected non-residential tenants. Effective August 1, 2011, only residential tenants are protected. See 2011 Minn. Laws ch. 58. This same law appears to have removed the old two-month protection for non-residential tenants through December 31, 2012.

<sup>34</sup>See the prior footnote for a brief summary of what will be the law for tenants in foreclosure post December 31, 2012, assuming no more changes in the statutes.

## [9] What Happens If the Owner Sells the Building?

An owner in financial straits will often sell the building, or “give it away” in return for not being sued for money, or otherwise transfer the building voluntarily. Unless the voluntary redemption procedure (see footnote 13) or something like it is used, the buyer (“grantee” in legalese) simply steps into the shoes of the seller. In other words, the buyer is now the landlord of the tenant whether either likes it or not.<sup>35</sup>

## [10] Limit on Renting a Unit in Foreclosure or Cancellation.

An owner in foreclosure or cancellation generally may not lawfully sign a new lease for more than the redemption or cancellation period.<sup>36</sup> In addition, the owner must notify the prospective tenant in writing that the building is in foreclosure or cancellation and tell the tenant the date the redemption or cancellation period ends.<sup>37</sup>

However, if the lender gives the owner permission to enter into longer leases (up to a year) and agrees to honor the leases if it takes over the building, the owner may do so and does not have to warn the tenant of the impending foreclosure or cancellation.<sup>38</sup> If the lender does take over the building, the tenant is bound to the lender (new owner) under the lease as well. The idea behind this exception is that if the foreclosure or cancellation has no effect on the tenant, the tenant needs no special protection.

If this statute is violated, it doesn't do the tenant much good in fighting with the bank or vendor, but it could help in suing the landlord for money or defending an eviction case.

## [11] Security Deposits

- a) The security deposit is held by the landlord until 21 days after the end of the tenancy.<sup>39</sup> Thus, the security deposit is not actually in play while the tenant is still in the unit.
- b) The successor in interest to the original landlord, even the lender taking back the property, is

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<sup>35</sup> See Fisher v. Heller, 219 N.W. 79,80, 174 Minn. 233,236 (1928). Of course, the new landlord and the “old” tenant can make a deal to end the lease if they both agree to it.

<sup>36</sup> See Minn. Stat. § 504B.151.

<sup>37</sup> See Minn. Stat. § 504B.151.

<sup>38</sup> See Minn. Stat. § 504B.151, subd. 1(b), subd. 2-4.

<sup>39</sup> See Minn. Stat. § 504B.178.

liable for the deposit.<sup>40</sup>

c) The original landlord is also liable for the deposit unless he transfers the deposit to the successor, tells the tenant the amount transferred, and the tenant is given 20 days to object to the amount as well as a stamped envelope in which to send the objection.<sup>41</sup>

d) The security deposit statute was modified in 2008 such that the security-deposit statute's penalties for not paying the last month rent do not apply in the foreclosure/cancellation situation.<sup>42</sup> In most cases, the filing of an Eviction Action is the biggest threat to a non-paying tenant. In the last month of the redemption period, the owner is unlikely to file an Eviction Action because he is about to lose the property. Thus, faced with a broke owner in the last throes of his ownership, not paying the last month of rent should be a serious consideration.<sup>43</sup>

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<sup>40</sup>Minn. Stat. § 504B.178, subd. 6 provides that "Upon termination of the landlord's interest in the premises, whether by sale, assignment, death, appointment of receiver or otherwise, the landlord's successor in interest shall have all of the rights and obligations of the landlord with respect to the deposit, except that if tenant does not object to the stated amount within 20 days after written notice to tenant of the amount of deposit being transferred or assumed, the obligation of the landlord's successor to return the deposit shall be limited to the amount contained in the notice."

<sup>41</sup>See Minn. Stat. § 504B.178, subd. 5-6.

<sup>42</sup>See Minn. Stat. § 504B.178, subd. 8.

<sup>43</sup>In fact, Minn. Stat. § 504B.178, subd. 8 could be read to affirmatively allow the tenant to apply his deposit to pay rent during the last month of the redemption or cancellation period.

**Appendix**

**PUBLIC LAW 111-22, TITLE VII  
PROTECTING TENANTS AT FORECLOSURE ACT**

**SEC. 701. SHORT TITLE.**

This title may be cited as the 'Protecting Tenants at Foreclosure Act of 2009'.

**SEC. 702. EFFECT OF FORECLOSURE ON PREEXISTING TENANCY.**

(a) In General- 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),

except that nothing under this section shall affect the requirements for termination of any Federal- or State-subsidized tenancy or of any State or local law that provides longer time periods or other additional protections for tenants.

(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.

(c) Definition- For purposes of this section, the term 'federally-related mortgage loan' has the same meaning as in section 3 of the Real Estate Settlement Procedures Act of 1974 (12 U.S.C. 2602).

### **SEC. 703. EFFECT OF FORECLOSURE ON SECTION 8 TENANCIES.**

Section 8(o)(7) of the United States Housing Act of 1937 (42 U.S.C. 1437f(o)(7)) is amended--

(1) by inserting before the semicolon in subparagraph (C) the following: 'and in the case of an owner who is an immediate successor in interest pursuant to foreclosure during the term of the lease vacating the property prior to sale shall not constitute other good cause, except that the owner may terminate the tenancy effective on the date of transfer of the unit to the owner if the owner--

'(i) will occupy the unit as a primary residence; and

'(ii) has provided the tenant a notice to vacate at least 90 days before the effective date of such notice.'; and

(2) by inserting at the end of subparagraph (F) the following: 'In the case of any foreclosure on any federally-related mortgage loan (as that term is defined in section 3 of the Real Estate Settlement Procedures Act of 1974 (12 U.S.C. 2602)) or on any residential real property in which a recipient of assistance under this subsection resides, the immediate successor in interest in such property pursuant to the foreclosure shall assume such interest subject to the lease between the prior owner and the tenant and to the housing assistance payments contract between the prior owner and the public housing agency for the occupied unit, except that this provision and the provisions related to foreclosure in subparagraph (C) shall not shall not affect any State or local law that provides longer time periods or other additional protections for tenants.'.

### **SEC. 704. SUNSET.**

This title, and any amendments made by this title are repealed, and the requirements under this title shall terminate, on December 31, 2012.<sup>44</sup>

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<sup>44</sup>See footnote 20 for subsequent extension from December 31, 2012 to December 31, 2014.