Sherman Atlas Sylvester & Stamelman

BANKING ALERT

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Governor Murphy Signs Law Requiring Notifications to Municipalities of Foreclosures on Commercial Properties

On January 18, 2022, Governor Phil Murphy signed a new law (A2877; chapter law citation pending) that requires creditors filing foreclosure complaints on commercial properties to notify municipal officials of the foreclosures. The law, which became effective immediately, essentially mirrors an existing law (N.J.S.A. 46:10B-51) relating to the registration and exterior property maintenance requirements imposed on creditors in residential foreclosures to address vacant and abandoned properties and imposes similar requirements in commercial foreclosures. The new law also authorizes municipalities to adopt ordinances to create registration programs for residential and commercial properties in foreclosure and impose fees for registration and fines for violations.

Among other things, the new law requires creditors in foreclosures of commercial properties to notify the municipal clerk and mayor (or other chief executive officer) of the municipality where the commercial property is located of the foreclosure **within 10 days of serving the summons and complaint**. The notice must include the name, address and telephone number for the representative of the creditor who is responsible for receiving complaints of property maintenance and code violations and for any person or entity retained by the creditor to be responsible for any care, maintenance, security or upkeep of the property. (Multiple properties within the municipality subject to foreclosure can be included in the notice.) Out-of-state creditors must provide such contact information for an in-state representative. Notice of any changes to the name or contact information for the representatives of creditors must be provided to the municipality within 10 days of such change(s).

The new law also imposes notice requirements on creditors with respect to pending commercial foreclosure actions. **Within 30 days of the effective date of the new law** (*i.e.*, by February 17, 2022), a creditor that has a pending foreclosure action on a commercial property must provide the municipality with a listing of all commercial properties in the municipality for which the creditor has pending foreclosures by street address and lot and block number.

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In addition, if a commercial property owner vacates or abandons a property on which a foreclosure proceeding has been initiated or if a commercial property becomes vacant at any point subsequent to the creditor's filing of a foreclosure action (but prior to vesting of title in the creditor or a third party) **and** the exterior of the property is found to be a nuisance or in violation of any applicable state or local code, the municipality is required under the new law to notify the creditor and the creditor has the same responsibility to abate the nuisance or correct the violation as the owner of the property. The notice from the municipality must include a description of the conditions giving rise to the notice and provide the creditor with at least 30 days from receipt of the notice to remedy the violation. If the creditor fails to timely remedy the violation, the municipality may impose penalties allowed for the violation of municipal ordinances.

The new law also permits a municipality to adopt ordinances to implement the new law that, among other things, (i) create a property registration program to identify and monitor residential and commercial properties for which a summons and foreclosure complaint have been filed; (ii) regulate the care, maintenance, security and upkeep of the exterior of vacant and abandoned residential and commercial properties subject to a foreclosure; and (iii) impose property registration fees on the creditor of residential or commercial properties on an annual or semi-annual basis. (Municipalities with existing property registration ordinances have until August 1, 2022 to amend such ordinances to be consistent with the new law.) According to the new law, if a municipality adopts such an ordinance, the ordinance must, among other things: (i) require the creditor, in addition to the notice provisions above of the new law, register the residential or commercial property as a property in foreclosure and provide the information required by either N.J.S.A. 46:10B-51 (for residential properties) or this new law (for commercial properties) and provide the date the summons and foreclosure complaint was filed, the court in which it was filed and the docket number and identify whether the property is vacant and abandoned in accordance with the definition in the ordinance required by the new law; (ii) require notice of change in name or contact information for the designated creditor representative; (iii) require the creditor to update the status of the property if it becomes vacant and abandoned; (iv) require the creditor to be responsible for the care, maintenance, security and upkeep of the exterior of vacant and abandoned properties; (v) require an out-of-state creditor to appoint in-state representative or agent; (vi) identify any requirements the municipality imposes on the creditor relating to the care, maintenance, security and upkeep of the exterior of vacant and abandoned properties; (vii) identify any fees that may be imposed on the creditor in connection with the property registration program; and (viii) define vacant and abandoned property in accordance with the conditions set forth in the new law. The ordinance must also provide that a notice of violation requires that the violation be corrected within 30 days of receipt of the notice (or within 10 days of receipt if the violation presents an imminent threat to public health and safety).

In addition, the municipality may contract with and set the compensation of a private entity to implement and administer the property registration program established pursuant to an ordinance adopted pursuant to the new law. The municipality may also impose an annual fee on a creditor required to register a property pursuant to an ordinance adopted pursuant to the new law, which must be identified in the ordinance and cannot exceed (i) $500 per property annually for any property required to be registered because a foreclosure action was filed and (ii) an additional $2,000 per property annually if the property is vacant and abandoned or becomes vacant and abandoned. An out-of-state creditor subject to an ordinance adopted pursuant to the new law and found to be in violation of the requirement to appoint an in-state representative is subject to a fine of $2,500 per day for each day of the violation. A creditor subject to an ordinance adopted pursuant to the new law and found to be in violation of the ordinance is subject to a fine of $1,500 per day for each day of the violation.

New Jersey Appellate Division Affirms Commercial Foreclosures That Were Based on Cross-Default Provision in Loan Agreements

In the consolidated appeals of *Bank of China v. L.V.P. Associates and Paul Profeta*, Docket No. A-1777-19 and *Bank of China v. 349 Associates, LLC and Paul Profeta*, Docket No. A-1778-19 (N.J. App. Div. Dec. 30, 2021) the Appellate Division affirmed the entry of summary judgment and final judgment in two commercial foreclosure actions based on a cross-default provision and the pre-maturity default of a third borrower.

In 2007, the Bank of China (the "Bank") made commercial mortgage loans to three limited liability companies owned by defendant Paul Profeta. The Bank loaned $14.35 million to 769 Associates LLC, $10.5 million to defendant 349 Associates LLC and $7.35 million to defendant LVP Associates ("LVP"), secured by mortgages on three commercial office buildings in New Jersey. The Appellate Division previously affirmed a final judgment of foreclosure of the mortgage securing the loan to 769 Associates. These recent appeals stemmed from the foreclosure actions against 349 Associates and LVP. There was no dispute that the defendants did not pay the balance due at maturity. However, the nonpayment occurred after the Bank refused to allow defendants to prepay their loans a month before maturity due to a default by 769 Associates. In defense of the foreclosure actions, the defendants argued the Bank's wrongful actions caused the defaults.

In declaring a default and initiating the foreclosure actions, the Bank invoked the cross-default provision in the loan agreements which makes it an event of default by one owner if there is a default by any of the other two borrowers. The Bank asserted that the pre-maturity defaults by 769 Associates constituted a default by the defendants. Specifically, the Bank alleged (1) there was a "material adverse change" in 769 Associates' financial condition, (2) the Bank "in exercise of its sole reasonable discretion" deemed itself insecure, and (3) the ratio of 769 Associates' net operating income to debt service (the "Debt Service Coverage Ratio") fell below the required 1.25 to1. The Chancery Division agreed with the Bank and granted summary judgment in favor of the Bank, deemed the Bank's foreclosure complaints as uncontested and later entered final judgment for foreclosure against defendants.

On appeal, the defendants argued that there were genuine issues of material fact regarding each pre-maturity default. When addressing the "material adverse change" default, the Appellate Division found that there was no reasonable factual dispute that there were adverse changes at 769 Associates' building. Specifically, the vacancy rate at the building grew from 27% in 2010 to above 40% in 2012. In addition, the value of the property fell from around $16 million in 2009 to just over $8 million in 2017 and the building's net operating income fell from $409,999 in 2014 to $10,700 in 2016. The Appellate Division further found these changes to be material, particularly when the property's value dropped below the $14.35 million indebtedness. When considering whether the Bank properly deemed itself "insecure," the Appellate Division relied on a statement by Profeta's employee that 769 Associates would not be able to repay the loan and, instead, would assist the Bank's efforts to lease space at the building. The Appellate Division held that this communication was sufficient to cause a reasonable lender in good faith to deem itself insecure and, based on that insecurity, could declare that 769 Associates was in default.

The Appellate Division also rejected the defendants' argument that 769 Associates' Debt Service Coverage Ratio was mistakenly depressed because it was calculated incorrectly using month-to-month leases instead of annual leases. The Appellate Division held that, even assuming *arguendo* that there was a genuine issue of fact as to whether the Debt Service Coverage Ratio was below the required 1.25:1, this fact would not defeat summary judgment because of the two other pre-maturity defaults by 769 Associates.

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