

# Mortgage Loans Made to Business Entities: Mortgage Lenders Cannot Assume that Consumer Laws and Regulations Do Not Apply

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A federal district court case in New York has upended a common assumption of mortgage lenders: that a mortgage loan made to a business entity is never subject to the requirements of the Truth in Lending Act (“TILA”). The case found that two mortgage loans made to a corporation were subject to TILA despite the fact that the statute specifically states it only applies to credit offered or extended to a *natural person*.

The July 8, 2024 opinion from the U.S. District Court for the Eastern District of New York<sup>[1]</sup> is a warning to mortgage lenders that just because a mortgage borrower is a business entity does not automatically mean that TILA does not apply. The court held that the lender in this case required the individual seeking mortgage financing to create an entity to obtain financing, and, despite loans being made to the corporate borrower, deemed the lender to have “extended credit” to the individual. The court used similar reasoning to find that the lender violated a New York law on high-cost mortgage loans that only applies to borrowers who are natural persons.

The court’s findings resulted in significant consequences for the lender. The lender was found to have violated TILA, the Home Ownership and Equity Protection Act (“HOEPA”) (which added additional provisions to TILA on high-cost loans), and New York Banking Law Section 6-I (“Section 6-I”). In addition to establishing liability under those statutes, the court dismissed the lender’s foreclosure case based on those statutory violations.

A discussion of the facts of the case and the findings of the court are set forth below.

## **I. Facts of the Case**

According to the court’s decision, the facts of the case were generally not in dispute.<sup>[2]</sup> Carla Barker (“Barker”) lived in a two-family residential home in the East Flatbush neighborhood of Brooklyn, New York since she was 11 years old. Barker’s mother, who owned the home, died without a will, causing title to the home pass to Barker and her sister. Barker’s sister then sued Barker to partition the home and obtained a judgment against Barker. Feeling pressure from the partition judgment, Barker sought a loan to buy out her sister’s interest in the property and remain in the home.

After failing to qualify for traditional financing, Barker was introduced to Defendant Izia Rokosz (“Rokosz”), identified as a “private ‘hard money’ lender.” Rokosz lends to people who want to fix up their property, rent it, and then obtain standard home loans from banks. Rokosz prefers to lend to business entities rather than to individual homeowners, and most of his loans are to such entities. If a prospective borrower seeks to finance an owner-occupied property, Rokosz may require the borrower, as he did with Barker, to form a business entity to serve as the formal borrower.

Accordingly, J&M Property Holdings, Inc. (“J&M”) was incorporated to purchase Barker's property from Barker and her sister and to borrow money from Rokosz. J&M has no identified purpose other than borrowing funds from Rokosz and has never held any assets other than Barker's property.

Rokosz did not request, obtain, or review a loan application or any other documents from Barker, either in her individual capacity or in her capacity as J&M's president. He also had not reviewed Barker's finances or J&M's finances. Rokosz never provided any notices, disclosures, or other documents setting forth the amount financed, finance charges, points and fees, payment schedule, or annual percentage rate of the loan beyond what was already stated in the closing documents.

J&M proceeded to close on two separate loans from Rokosz totaling \$450,000. Shortly after the closings, Barker defaulted on both loans.

## **II. Findings of the Court**

The case involved motions for summary judgment by both Barker and Rokosz. Barker’s motion was to establish that Rokosz violated TILA, HOEPA and Section 6-I. Rokosz’s motion was to establish that he did not violate those statutes, and also to establish his entitlement to foreclosure on the loans. Barker’s motion was granted and Rokosz’s motion was denied.

In reaching its decision, the court rejected Rokosz’s two primary arguments: that TILA (and, as a result, HOEPA) and Section 6-I did not apply to the loans because (a) the borrower was not a natural person, and (b) the loans were primarily for a business purpose.

The court found that the “undisputed evidence permits no reasonable inference other than that Rokosz ‘extended credit,’ as TILA understands that phrase, to Barker in her personal capacity” despite the fact that the legal borrower was J&M. The court added:

“The only function J&M served from Barker's perspective was to satisfy a lender's condition for her to obtain a personal loan. The statutory protections TILA and HOEPA offer do not disappear in that circumstance.”

The court also rejected the primary purpose argument, concluding that:

“Barker's undisputed evidence establishes that she sought the subject loan to remain living in her childhood home. In response, Rokosz offered only equivocal and speculative testimony...that Barker intended to rent out part of the home, which does not create a genuine factual dispute as to whether the subject loan had a business purpose.”

Finally, the court found that the loans to Barker constituted “home loans” under Section 6-I, despite the definition of “home loan” requiring such a loan to be to a natural person. The court relied on a 2015 New York State case that held Section 6-I applicable to “any person who in bad faith attempts to avoid” the applicability of the statute.

### **III. Conclusion**

This appears to be the first reported decision in the Second Circuit on whether a loan to a business entity can be subject to TILA. There are cases in other circuits that are split on the issue, and it’s possible that this issue may ultimately be resolved by an appellate court. Notably, Rokosz’s attorney filed a Motion for Reconsideration of the decision on July 22, 2024, arguing that some key facts recited in the court’s decision are in fact disputed by Rokosz, despite the court’s opinion stating otherwise.

This case has important implications for mortgage lenders. Many lenders automatically assume that a loan to a business entity is not subject to TILA, HOEPA, Regulation Z, and certain state consumer laws and regulations. Lenders should now review any loan to an entity that could be viewed as effectively being to a consumer for a consumer purpose in order to determine whether consumer disclosures and requirements will apply.

This advisory is a general overview of developments in the law and is not intended as legal advice. If you have any questions about this advisory, please feel free to contact Joseph D. Simon at (516) 357-3710 or via email at [jsimon@cullenllp.com](mailto:jsimon@cullenllp.com), Elizabeth A. Murphy at (516) 296-9154, or via email at [emurphy@cullenllp.com](mailto:emurphy@cullenllp.com), or Gabriela Morales at (516) 357-3850 or via email at [gmorales@cullenllp.com](mailto:gmorales@cullenllp.com).

### **Footnotes**

[1] Barker v. Rokosz, 19-CR-514 (KAM) (JRC), 2024 U.S. Dist. LEXIS 119321 (E.D.N.Y. July 8, 2024).

[2] The lender in this case is seeking a reconsideration of the decision claiming that certain key facts are in fact in dispute.

### **Practices**

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