New York Foreclosure Abuse Prevention Act

January 30, 2023

On December 30, 2022, New York State Governor Kathy Hochul signed into law the "Foreclosure Abuse Prevention Act" ("**Act**"). The Act became effective immediately and applies to any foreclosure action in New York that was pending as of December 30, 2022 or filed thereafter. The Act applies to both residential and commercial foreclosures.

The Act was strenuously objected to by the banking industry because it may significantly impact a lender's ability to work out troubled loans after a foreclosure is filed. The Act imposes certain risks on lenders in negotiating workouts, which limits what lenders may be reasonably willing to do to help borrowers in workout situations. Unfortunately, the Act, which was meant to help borrowers, may actually hurt them. At the same time, the Act can trap unwary lenders into losing their ability to recover on loans in certain circumstances. In other words, it may prove to be of little help to borrowers or lenders and a burden to both.

Significantly, the Act limits a lender's ability to stop the statute of limitations from running once the loan has been accelerated. Even when the lender and borrower agree to discontinue a foreclosure action as part of a workout, the failure to properly address the statute of limitations may prevent the lender from foreclosing in the future. The need for a lender to ensure that the statute of limitations is not compromised in the event further legal action is required against a borrower may limit the relief that the lender can offer to the borrower in a workout. Below, we explain the problem and outline steps lenders can take to limit risk and still offer some help to deserving borrowers.

I. Discontinuance of Foreclosure No Longer Resets the Six-Year Statute of Limitations

New York law provides that a lender has six years to commence a mortgage foreclosure action from the earlier of (i) the date that the lender accelerates the loan based on a borrower default or (ii) the maturity date. The most common default is, of course, a borrower's failure to make timely loan payments. Once the borrower defaults, the lender may accelerate the loan and thereby demand immediate repayment of the entire outstanding debt. An acceleration of the loan permits the lender to commence an action to foreclose the mortgage. As such, the cause of action to recover the entire balance of the debt accrues at the time that the loan is accelerated, beginning the six-year period to commence a foreclosure action.

After commencement of a foreclosure action, the lender and borrower frequently engage in workout discussions. This can take various forms. For example, the parties may enter into a forbearance agreement where the lender agrees not to exercise its right to foreclose on the mortgage in exchange for the borrower's agreement to a payment plan which, over a certain time period, will bring the loan current. The parties may also enter into a loan modification in which the parties may agree, among other things, to adjust the interest rate of the loan, monthly payments, and/or the time for repayment. Regardless of the form of the workout, for a lender, it is important that once the parties reach agreement, the six-year statute of limitations must stop running. If the statute of limitations stops running and the borrower defaults again, the lender will have a full six years from the future acceleration or maturity of the loan to file a new foreclosure action. Generally, a workout agreement includes a provision whereby the lender stops the six-year period from running by revoking the acceleration, thus "de-accelerating" the loan. Otherwise, the lender may be prevented from foreclosing in the future.

Prior to the adoption of the Act, New York law provided that by voluntarily discontinuing the foreclosure action, the lender de-accelerated the loan unless, at the time of the voluntary discontinuance, the lender expressly stated that it was not revoking the acceleration. By de-accelerating the loan, the lender stopped the statute of limitations from continuing to run and ensured that it would have six years to file a new foreclosure action from a future acceleration of the loan based on a new default by the borrower or the loan's maturity.

The Act changed this well-established and understandable bright-line rule.

It provides that a voluntary discontinuance, whether effectuated by a motion, court order, parties' stipulation or unilateral lender's notice, does not "waive, postpone, cancel, toll, extend, revive or reset" the six-year statute of limitations period, unless expressly prescribed by statute.

With this change in the law, how can a lender de-accelerate a loan and stop the six-year statute of limitations from continuing to run? Can the lender de-accelerate the loan so that upon a future default and acceleration, the six-year period will start running anew and thereby permit the lender to commence a timely foreclosure action?

A. Hypothetical # 1 – A Loan Modification Extending the Maturity Date by Seven Years

Imagine the following scenario. The lender accelerated a loan on January 1, 2023, commences a foreclosure action on February 1, 2023, and settles the foreclosure by entering into a loan modification with the borrower on March 1, 2023. The loan modification maintains the same monthly payments as originally agreed, extends the maturity date until January 1, 2030,[1] and provides for a balloon payment due at maturity. Let's assume that in the seventh year of the extension, the borrower defaults, either by failing to make monthly payments or failing to make the balloon payment due at maturity on January 1, 2030.

B. Consequences of the Act

Prior to the Act, after entering into the loan modification, the lender would simply discontinue the foreclosure action. This would de-accelerate the loan and stop the six-year statute of limitations from continuing to run. Upon the borrower's default in the seventh year, the lender would accelerate the loan again and could commence a new foreclosure action within six years from that new acceleration. Alternatively, assuming the borrower made all monthly payments but did not make the final balloon payment at maturity, the lender can commence a new foreclosure action within six years from that maturity date.

Under the Act, the voluntary discontinuance of the first foreclosure action would not, on its own, de-accelerate the loan. Therefore, the statute of limitations would continue to run despite such discontinuance and expire on January 1, 2029. If the borrower defaults after January 1, 2029, whether due to the failure to make monthly payments or due to the failure to make the balloon payment upon maturity, the borrower could successfully argue that the foreclosure is barred by the statute of limitations. This result is due to the fact that under the Act, the acceleration was not revoked and thus the six-year statute of limitations expired on January 1, 2029. The lender would therefore be precluded from foreclosing or otherwise collecting on the loan.

So, what can the lender do to protect itself and make sure that it does not lose the right to foreclose in the future? Ironically, by creating this need for the lender to protect itself, the Act (which was intended to help borrowers) will likely have the effect of limiting lenders' ability to offer certain workout options to the detriment of borrowers.

Before turning to potential solutions, let's take a quick look at one other scenario.

C. Hypothetical # 2 - A Six-Month Forbearance Agreement

Consider a similar timeline. The lender accelerated a loan on January 1, 2023, but regardless of whether the lender commences a foreclosure action on February 1, 2023, the borrower enters into a forbearance agreement on March 1, 2023. Let's assume that the forbearance agreement provides that the lender will forbear from commencing a foreclosure or continuing to foreclose for a period of six months from the date of that agreement, that is, until September 1, 2023, in order to allow the borrower to either pay back all arrears and reinstate the loan or pay it off in full.

Given such a short forbearance period, a lender might be hesitant to concurrently discontinue any existing foreclosure action, if it is not required to do so. Regardless of whether the foreclosure is discontinued at that time, under the Act, the acceleration remains unrevoked, and the statute of limitations will expire on January 1, 2029. This may not pose an issue where the forbearance agreement requires a payoff on September 1, 2023, because the lender would be well within the statute of limitations to commence foreclosure were that not to occur. However, if the loan is merely reinstated as of September 1, 2023, and if its maturity date is a date after January 1, 2029, then an action brought after January 1, 2029 would be time-barred due to the January 1, 2023 acceleration.

II. Borrower's Agreement to Reset the Six-Year Statute of Limitations

The Act allows for the borrower to agree to postpone, cancel, reset, toll, revive or otherwise extend the six-year statute of limitations. However, under the Act, the effectiveness of any such agreement is limited by New York General Obligations Law ("**GOL**") § 17-105.

Critically, GOL § 17-105 does not allow an agreement which indefinitely stops the six-year period from continuing to run. It does not permit the parties to agree that the full six-year statute of limitations will start running anew upon any future acceleration or maturity date. Instead, it only permits that six-year period to be reset to start anew from the date of the agreement resetting the six-year period. This is a potential major trap for lenders, but the literal language of the Act and GOL § 17-105 only allows the limitations period to be reset as such, even if the term of the loan exceeds that six-year period.[2]

Going back to Hypothetical # 1, as part of the workout, the loan modification agreement that the borrower signs can include a provision resetting the six-year statute of limitations pursuant to GOL § 17-105. Again, such agreement is likely limited to resetting the six-year period such that it starts from the date of the agreement (*i.e.*, March 1, 2023 in the hypothetical). Thus, the statute of limitations would still expire on March 1, 2029 (six years from the agreement) unless the borrower signs a new agreement (which should be signed prior to March 1, 2029, but, as discussed below, can only be signed after a cause of action to foreclose accrues), resetting that six-year period again.

For Hypothetical # 2, the forbearance agreement that the borrower signs can include a similar provision resetting the statute of limitations for up to six years from the date of the agreement, or until March 1, 2029, unless again, the borrower signs a new agreement further resetting that six-year period. This may be helpful, at least for commercial loans, if the maturity date is a date sufficiently before March 1, 2029 as it would allow the lender to file a foreclosure action before that deadline.

However, under either hypothetical, if the loan does not even mature until after the March 1, 2029 statute of limitations deadline, the lender may be barred from commencing a foreclosure action. Thus, it is imperative that lenders are mindful of these dates, calendar them, and take them into consideration, even when deciding whether to enter into a workout agreement, and if so, under what terms and conditions, so as to ensure that a foreclosure action, if at all necessary, can be filed before the expiration of the statute of limitations.

As such, lenders need to take great care when entering into a workout agreement (e.g., forbearance, modification, and/or extension), especially if the remaining term of the loan exceeds six years from the date of the new agreement. While it remains to be seen how courts will interpret the Act, based on the literal language of GOL § 17-105(1), an agreement suspending the six-year statute of limitations may only reset the statute of limitations for six years from the date of that agreement.

Lenders and their counsel should either limit the remaining term of the loan in a workout agreement to less than six years (probably the safest option) or attempt to include provisions in the workout agreement that otherwise address the impact of the Act. If the lender limits the remaining term of the loan to less than six years of the earlier of the original acceleration or maturity, with a sufficient cushion of time to comply with any conditions precedent to foreclose and to have counsel prepare and file requisite foreclosure pleadings, then the lender should be able to timely commence a foreclosure action within that original six-year period. The lender may also limit the remaining term of the loan to less than six years from the date of the workout agreement as long as the agreement includes a provision resetting the six-year statute of limitations to run from the execution of the workout agreement in accordance with GOL § 17-105; in that case, so long as the lender has a similar time cushion, it should be able to timely commence a foreclosure action within six years from the workout agreement.

What about long-term loans (such as common 15-year or 30-year loans) or loans where the parties would like to allow the term to remain beyond six years from the date of the workout agreement?

If the workout agreement includes a provision in accordance with GOL § 17-105 resetting the six-year statute of limitations, then, at first glance, it may seem that the agreement can also require the borrower to enter into agreements in the future to further toll, reset or otherwise extend the statute of limitations with borrower's failure to enter those subsequent agreements constituting a default under the workout agreement. However, GOL § 17-105(1) contains a potential trap for unwary lenders which may render those subsequent agreements resetting the statute of limitations ineffective.[3] As such, until the law is clarified by the courts or amended, the best approach may be to limit any future term of the loan under a workout agreement to less than six years, with the loan maturing within that time period and with a sufficient time cushion, as described above. If the borrower defaults on any monthly payments or fails to pay off the loan at maturity, the lender could either foreclose (within the six-year period from the execution of the workout agreement) or the parties can enter into a new workout agreement with a new provision resetting the statute of limitations in accordance with GOL § 17-105.

Lenders should also build a chronology of relevant events and have a reliable calendaring system (similar to the systems used for UCC continuation statements) and use that system to track (i) deadlines for the borrower to execute a new agreement extending the six-year statute of limitations, and (ii) new maturity dates with the related warning that the statute of limitations may be shorter than the usual six years and that a foreclosure action may need to be commenced soon after maturity if the loan is not paid off. Since, under these scenarios, the timeframe to commence a foreclosure action will be significantly shorter than usual, lenders should be mindful of the time cushion described above.

Courts will weigh in and hopefully determine that such provisions are consistent with the Act or interpret the Act—seemingly contrary to its plain but common-sense defying language—to allow the statute of limitations to run anew upon any subsequent acceleration. However, for now, it appears that the Act imposes a strict rule of the six-year statute of limitations, running from the execution of the agreement resetting the statute of limitations in accordance with GOL § 17-105, with very limited opportunity for workaround provisions.[4]

As noted above, unfortunately this new law, designed to help borrowers, will end up hurting them when lenders take the conservative approach of de-accelerating but requiring the new loan term to be less than six years, even when the original loan term may have been for many years longer.

III. Related Act Provisions

The Act also amends New York's "election of remedies" statute. Generally, after a borrower's default on a mortgage loan, the lender has the option of "electing" to commence either (a) a foreclosure action, with the goal of a foreclosure sale of the mortgaged property, or (b) an action on the underlying mortgage note, which usually results in a money judgment that the lender can use to pursue the borrower's other assets, if any, keeping the right to foreclose on the property if the lender cannot collect from other assets. Now, once a foreclosure action is adjudicated to be barred by the statute of limitations, the Act prohibits a lender from bringing any other action to recover the same part of the debt, whether it be a new foreclosure action or a note action.

Moreover, the Act provides that while a foreclosure action is pending, or after final judgment in a foreclosure action, a lender must obtain leave of court to commence any other action, that the failure to obtain such leave is a defense to the second action, and that if the second action is commenced without obtaining such leave, the first action may, in certain circumstances, be deemed discontinued.

Additionally, in a foreclosure or note action where a borrower raises the defense that the statute of limitations expired, unless certain conditions are met, the Act prevents the lender from asserting that the statute of limitations has not expired because there was no valid acceleration prior to, or by way of, a prior action. The lender is also prevented from asserting this argument as a defense in a quiet title action in which a party having an interest in the subject property seeks a court order to cancel or discharge a mortgage on the grounds that foreclosure of said mortgage is barred by the statute of limitations. Under the Act, the lender can only assert such an argument if the prior action was dismissed based on a court ruling, made upon a timely asserted defense, that the prior acceleration was invalid.

Finally, prior to the Act, if a foreclosure or note action had been timely commenced but terminated under certain circumstances, a lender was able to commence a new action within six months of that termination, subject to certain conditions. The Act reduces the circumstances under which this “savings clause” permits the commencement of a new action. It only permits one such six-month extension. Moreover, it also imposes greater conditions under which the new action would be permitted and in fact requires that an assignee of a mortgage cannot utilize the savings clause unless it pleads and proves that it is acting on behalf of the original plaintiff. This may have a significant impact on sales of mortgage loans that are already in foreclosure.

In sum, the Act poses a number of potential issues for loan workouts, foreclosures and loan sales. Dealing with these obstacles will require an in-depth analysis of the interplay of the various laws amended and added by the Act, as well as a greater level of scrutiny of the loan documents and court filings on a case-by-case basis. As such, this memorandum is intended to provide a broad overview of the Act’s main provisions rather than specific advice for any particular loan. Given the evolving nature of this area of the law, Cullen and Dykman LLP will keep you apprised of critical developments.

Please note this is a general overview of developments in the law and does not constitute legal advice. Nothing herein creates an attorney-client relationship between the sender and recipient. If you have questions regarding the Foreclosure Abuse Prevention Act and its impact, please reach out to your attorney contact or call us at (516) 357-3700.

About Cullen and Dykman’s Loan Workout Practice Group

Obtaining maximum value when faced with a distressed loan, company or property starts well before the initiation of formal foreclosure or bankruptcy proceedings. We work with clients at all stages of the loan restructuring and workout processes to develop and execute strategies that are carefully tailored to the unique circumstances of any distressed situation. Taking a practical and business-oriented approach, the attorneys in our Loan Workout practice coordinate with members of our Banking and Financial Services, Bankruptcy and Creditors’ Rights, Corporate, Real Estate, Taxation and Commercial Litigation practices to offer comprehensive solutions that reflect the complexities of the particular circumstances at hand. Our experience includes complex interstate transactions, sometimes involving creditors, lenders and borrowers across the country. Members of our group have appeared before federal and state courts from coast to coast.

Footnotes

[1] Alternatively, it can also be assumed here that the maturity date either already is, or is extended by the loan modification to, a date beyond six years from the January 1, 2023 acceleration.

[2] Specifically, the newly adopted GOL § 17-105(4) requires any agreement to be "made as provided in" GOL § 17-105. In turn, GOL § 17-105(1), provides that the agreement is effective "to make the time limited for commencement of the action run from the date of the waiver or promise." As such, the parties can only agree to reset the six-year statute of limitations to run from the date of the agreement. Stated otherwise, an agreement entered into under GOL § 17-105 will not necessarily nullify the six-year statute of limitations period in the same way that a voluntary discontinuance would prior to the adoption of the Act. By permitting a voluntary discontinuance to stop the running of the statute of limitations, the prior law treated this situation as if the prior acceleration never occurred and the statute of limitations had never begun to run, which made eminently more sense.

[3] Specifically, GOL 17-105(1) provides that the borrower can only agree to reset the statute of limitations to run from the date of an agreement if the agreement is made "after the accrual of a right of action to foreclose the mortgage."

A right of action to foreclose generally accrues at acceleration or maturity. Such a cause of action clearly accrued prior to the execution of the first workout agreement when the borrower defaulted and the lender accelerated the loan. However, whether such accrual continues to persist after the parties enter into a workout agreement, and thus permits subsequent extensions of the statute of limitations pursuant to GOL § 17-105, is unclear. Generally, the purpose of a workout agreement is to resolve the existing foreclosure claim. As such, after the parties enter into a workout agreement, the foreclosure claim is arguably no longer "accrued" for purposes of subsequent agreements extending the statute of limitations pursuant to GOL § 17-105. Instead, it may be that a new cause of action to foreclose must accrue, either by way of maturity or acceleration, to render subsequent agreements resetting the statute of limitations effective under GOL § 17-105. As such, lenders should be very careful when entering into workout agreements which extend the term of the loan for more than six years even when that agreement contains a provision that the borrower will be required to execute future agreements resetting the statute of limitations. While the borrower may execute such future agreements, courts may ultimately determine that those agreements were ineffective under a strict reading of GOL § 17-105.

Moreover, including a provision in the initial workout agreement that requires the borrower to sign subsequent agreements resetting the statute of limitations might prevent a lender from foreclosing at the end of that extension even if the lender is otherwise entitled to do so. This is because the borrower may be able to make an equitable argument in a foreclosure action that such post-maturity covenant is evidence of a further extension of the loan.

[4] In addition to interpreting the various provisions of the Act, courts will need to weigh in on the interplay of those new provisions with other existing laws, including, for example, GOL § 17-107 which addresses the effect of payments on the statute of limitations. *See* GOL § 17-107(1) ("A payment on account of a mortgage indebtedness, or instalment thereof or interest thereon, which is effective to revive an action to recover such indebtedness, instalment or interest or to extend the time limited for such action, is also effective . . . to make the time limited for commencement of an action to foreclose the mortgage run from the date of payment, unless the payment is accompanied by written disclaimer of intention to affect the time limited for foreclosure of the mortgage.").

Practices

- Loan Workout