

# **Minnesota's "Equity-Stripping" Statute**

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The 2004 Minnesota Legislature enacted Minnesota Statutes Chapter 325N to combat a growing problem in Minnesota's real estate market; namely, the practice of "equity stripping." A recent Minnesota Court of Appeals decision, the first such decision under Chapter 325N, now provide guidance as to key matters pertaining to the application of 325N.

### **What is Equity Stripping?**

Equity stripping, or equity skimming, is a recent practice arising in Minnesota whereby a homeowner in foreclosure sells his/her home and then enters into an agreement to repurchase the home at a later date. The purchaser finances the purchase with a loan constituting a significant percentage (typically 80%) of the home's value. The homeowner will have built up significant equity in the home due to the ever-increasing home prices in Minnesota but faces foreclosure due to difficult financial circumstances (such as job loss or significant high-interest debt). The purchaser will offer to "save the home" by taking title to the home and entering into a lease with an option to purchase or a contract for deed with the now-former homeowner. The purchaser walks away from the deal with the homeowner's equity and the homeowner commonly fails to stay current on payments under the lease/contract and never regains title to the home.

### **Minnesota Statutes Chapter 325N**

The 2004 Legislature enacted Chapter 325N as a means to provide protection to foreclosed homeowners who may be induced to enter into a "reconveyance transaction" as described above under the belief that the transaction will ultimately save their home. Chapter 325N places certain requirements on "foreclosure purchasers" (persons who engage in more than one reconveyance in any two year period and other joint venturers therein) as to the manner in which the transaction is conducted, as well as remedies for noncompliance.

### **Transaction Requirements**

For persons desiring to engage in reconveyance transactions with homeowners in foreclosure, Chapter 325N sets forth several procedural requirements as to the purchase agreement. First, all terms of the transaction, including the terms of the reconveyance (whether a leaseback/option or contract for deed) must be set forth in the written purchase agreement (in a specified typeface). Second, the foreclosed homeowner has an absolute right of rescission of the reconveyance contract of five days or the end of the foreclosure redemption period, whichever occurs first. Third, a notice of right to cancel must be printed next to the homeowner's signature on the agreement. Fourth, a separate notice must be printed immediately above the notice of right to cancel, which specifies that the foreclosed homeowner cannot be asked to sign any other documents until the rescission

period passes. Fifth and finally, the agreement must include a form notice of cancellation, which the homeowner can use to cancel the agreement.

Chapter 325N places further requirements on the transaction, most notably (i) the transaction must be completed through an in-person closing conducted by a licensed, unaffiliated closing agent; and (ii) the purchaser must verify the homeowner's ability to meet the terms of the reconveyance transaction. For example, if a leaseback/option transaction is proposed, the purchaser must verify that the homeowner can make the monthly lease payment and exercise the option to repurchase at the date specified. Essentially, this requires a purchaser to act as an underwriting as if the purchaser was financing the repurchase. The Minnesota Attorney General's office has promulgated a disclosure form as to the ability to pay verification requirements.

### **Limits on Encumbrances/Transfers**

A further significant restriction is that the purchaser cannot encumber or transfer the home during the period in which the foreclosed homeowner retains an interest in the property, including a leasehold interest or option to purchase.

### **Adjustment of Proceeds**

Finally, Chapter 325N provides a mechanism to adjust the proceeds received by the foreclosed homeowner in the event that (i) the homeowner does not repurchase the home within the allowed time period and (ii) the purchaser in turn conveys the home to another party upon the expiration of the time period.

### **Penalties for Noncompliance**

The penalties for noncompliance with Chapter 325N are significant and severe. They include fines, imprisonment, actual damages, attorney fees and "exemplary damages" equaling one and one-half times actual damages.

### **Sunset Provision**

Chapter 325N was enacted to combat what many believe is a problem spurred by current conditions in the real estate market (i.e., steep rises in home prices due to extended periods of low interest rates) and, as such, a five year sunset provision was included in the legislation enacting Chapter 325N.

### ***Real Estate Equity Strategies, LLC v. Michael E. Jones***

On August 8, 2006, the Minnesota Court of Appeals issued its decision in the case of *Real Estate Equity Strategies, LLC v. Michael E. Jones* (A05-2083). The decision is the first decision under Chapter 325N and provides clarification as to certain procedural aspects of a Chapter 325N. The parties to the case entered into a reconveyance transaction whereby the homeowner entered into a lease with an option to purchase

following sale. The now-former homeowner defaulted on the lease and the owner commenced an eviction proceeding against the former homeowner who in turn commenced an action against the owner/purchaser alleging violations of Chapter 325N. The former homeowner then attempted to claim that the housing court lacked subject matter jurisdiction in the eviction proceeding to decide the matter because of the outstanding title issues and the pending 325N action (a separate statute provides that the court has jurisdiction only to decide possession issues in an eviction proceeding). The District Court instead decided the eviction proceeding in favor of the owner/purchaser and the former homeowner sought relief from the court in the 325N case to stay the eviction. The court denied the requested relief.

The Court of Appeals affirmed the District Court's decision. In its opinion, the Court indicated that if a foreclosed homeowner being evicted wants to protect his/her claimed interest in the home, the proper procedure is to file a notice of lis pendens against the property. Additionally, the Court cited the provisions of Chapter 325N pertaining to exemplary damages to illustrate that the foreclosed homeowner does not lose entirely if he/she is evicted from the home.

### **Conclusion**

Chapter 325N, on its face, appears to be a powerful weapon for foreclosed homeowners and a significant consideration for foreclosure purchasers. Of course, until courts clarify their approach to the statute, the true impact of Chapter 325N will yet be determined. The *Real Estate Equity Strategies, LLC* case is the only court guidance thus far on Chapter 325N and it says little as to courts' opinion of Chapter 325N and the problem of equity stripping. Nonetheless, Chapter 325N must be followed to the letter in order to avoid significant penalties.