

**FARM LEGAL SERIES****June 2015**

# Mortgage Foreclosures

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## INTRODUCTION

If a farm debtor is unable to perform under the terms of his real estate mortgage, the rights of the parties are determined by state law. If the farmer defaults under his mortgage, it is possible that the creditor will foreclose on the mortgage. Minnesota law is very specific with respect to the foreclosure of real estate mortgages. Specific time periods are provided by the statutes and must be followed to the letter by the creditor attempting to foreclose its security interest. Failure to follow each step of the foreclosure process properly may result in an invalid foreclosure.

## DEFAULT

### Acts of Default

A typical real estate mortgage includes several terms that require the farmer (or the “mortgagor”) to do more than merely make the necessary periodic payments. For example, the mortgagor is required to maintain insurance on the premises, pay all real estate taxes and maintain the premises for the benefit of both the mortgagor and the creditor (or the “mortgagee”). In addition, mortgages may include a provision prohibiting the sale of all or any portion of the premises without the prior written consent of the mortgagee. Such provisions are known as “due on sale clauses.” If the mortgagor fails to abide by any of the terms in the mortgage, he is in default.

### Acceleration

If default occurs, most mortgage documents contain acceleration clauses. These clauses allow the mortgagee to require the mortgagor to pay all payments due. For a more detailed discussion on these clauses see fact sheets *Contracts, Notes and Guaranties* and *Mortgages and Contracts for Deed*.

### Notice and Cure

Even after default, the terms of the mortgage may give the mortgagor the right to notice and the opportunity to cure the default. If this type of provision is included in the mortgage, the mortgagee must notify the mortgagor if there is a default, the nature of the default (e.g., nonpayment) and allow a reasonable amount of the time to cure that default.

## MORTGAGEE’S OPTIONS UPON DEFAULT

Once a default has occurred, the creditor, or the mortgagee, has several available options in addition to foreclosing on the mortgage.

### Deed in Lieu of Foreclosure

The mortgagee can negotiate an arrangement with the mortgagor whereby the mortgagor gives the property back to the mortgagee in satisfaction of the underlying debt. Such a procedure is known as the mortgagor giving the creditor a “deed in lieu of foreclosure.” When a mortgagor undertakes such action, he is voluntarily surrendering his redemption or reinstatement rights (discussed below). Because such an action results in the transfer

of ownership and the right to possession, Minnesota courts have long held that such transactions are subject to close scrutiny to protect the mortgagor from oppression by the mortgagee. For such an agreement to be upheld by a court, it must not be the result of any oppressive means or overreaching on the part of the mortgagee, and adequate consideration must be given.

### **Legal Action**

A second course of action for the mortgagee is to bring a lawsuit on the underlying debt based on the promises of the mortgagor contained in the promissory note. A mortgage generally will be granted by a mortgagor to secure the performance of the promises of payment contained in a promissory note. If the value of the real property is less than the amount due under the mortgage, the mortgagee may elect to bring an action seeking the payment of the amount due under the promissory note. Such a course of action, however, may not be attractive to a mortgagee unless the mortgagor has other nonexempt assets that can be reached to satisfy the underlying debt.

### **Mediation**

Under the Farmer-Lender Mediation Act, when dealing with a mortgage on farm land, the mortgagee may be required to serve the farmer with notice of the option of mediation. This is discussed in more detail below.

## **METHODS OF MORTGAGE FORECLOSURE**

Under Minnesota law, there are two methods of foreclosing a real estate mortgage, foreclosure by advertisement and foreclosure by action. Foreclosure by advertisement is the most common. Foreclosure by action requires the creditor to bring an action in court to determine its right to foreclose prior to any foreclosure sale. It is therefore more

costly and time consuming for the lender and is rarely used.

Where a mortgage encumbers agricultural real estate, Minnesota's farmer-lender mediation statute generally requires the lender to offer mediation of the debt to the borrower prior to beginning foreclosure proceedings. The farmer-lender mediation statute began requiring mediation in 1986, with the statute's expiration date being extended in the years following original passage. Generally, the statute requires, among other things, that a mortgagee seeking to enforce a mortgage on agricultural real estate, either by advertisement or action, first send notice to the mortgagor and offer the mortgagor the opportunity to mediate a resolution to the debt prior to beginning such action. If the mortgagor elects to mediate the debt, the mortgagee's enforcement of the mortgage can be suspended for a period of up to 90 days pending completion of the mediation. Where the debt involved has been scheduled by the mortgagor in a bankruptcy or involved in a previous farmer-lender mediation, the debt is not subject to the farmer-lender mediation statute and the mortgagee can enforce its mortgage without first offering mediation.

Where a mortgage encumbers the home of the borrower (or a rental home owned by the borrower), Minnesota's law requires that the creditor provide certain additional notices to the borrower (and any tenant).

## **FORECLOSURE BY ADVERTISEMENT**

Foreclosure by advertisement is by far the preferred method of foreclosure, as it is faster, simpler and less expensive than a foreclosure by action. Foreclosure by advertisement is only available for mortgages that include a power of sale clause. A power of sale clause simply grants the lender the right to sell the property upon default, and is included in most mortgages. A foreclosure by

advertisement is also only available where there has been no action or proceeding to recover the underlying debt secured by the mortgage, or if the action has been discontinued.

### **Notice**

To initiate a foreclosure by advertisement, the creditor must prepare a notice of mortgage foreclosure sale. The notice must specify (1) the name of the mortgagor and of the mortgagee, (2) the original principal amount secured by the mortgage, (3) the date of the mortgage and when and where recorded, (4) the amount claimed to be due under the mortgage including taxes paid by the mortgagee, (5) a description of the mortgaged premises (e.g., legal description and commonly used street address), (6) the time and place of sale, and (7) the time allowed by law for redemption by the mortgagor. Once the notice has been prepared by the creditor, it must be published in a qualified newspaper in the county where the mortgaged property is located for six weeks prior to the sale.

The notice must be personally served upon the person in possession of the mortgaged premises at least four weeks before the sale. It must be served in a manner similar to that required for service of a summons initiating a civil action.

### **Designation**

Where the property is homestead property, a homestead designation notice must be served, and if the property is agricultural, an agricultural designation notice must be served. Designation notices disclose the rights of the mortgagor to designated for separate sale and redemption the homestead area, or the home and some of the surrounding land, and to similarly designate one or more separate tracts of agricultural property within the total property.

### **Foreclosure Sale**

Following publication and service of the required notice of mortgage foreclosure sale, the sheriff of the county in which the mortgaged property is located conducts the foreclosure sale. The sheriff's sale is conducted as an auction. The mortgage holder is the seller; the sheriff acts as the auctioneer. If a party other than the mortgagee bids at the foreclosure sale, he must pay cash. The sale is made to the highest bidder. In most cases, the highest bidder at the foreclosure sale will be the mortgagee, and in many cases, the mortgagee will bid the amount due the mortgagee. Following the sale, the mortgagee's costs of sale are reimbursed and the debt owed to mortgagee is paid to the extent covered by the sale price. Any bid in excess of the amount owed the mortgagee is a surplus and may be reached by junior lien holders. If no such holders exist, the surplus must be returned to the mortgagor. Any shortage between the sale price and amount due is called a "deficiency." Where, as in most cases involving agricultural property, the redemption period is twelve months, the mortgagee can obtain a deficiency judgment in the amount of the difference between the fair market value of the property and the amount remaining unpaid on the mortgage by initiating a lawsuit within 90 days following the foreclosure sale.

### **Certificate of Sale**

Upon completion of the sale, the sheriff prepares a certificate of sale, which operates as a conditional conveyance of the mortgaged premises subject to the debtor's rights of redemption. The certificate must contain a description of the mortgage and the property, the price paid, the time and place of the sale, the name of the purchaser, the interest rate in effect on the date of the sale, and the duration of the redemption period.

This certificate must be recorded within 20 days of the sale.

## **FORECLOSURE BY ACTION**

Even though foreclosure by advertisement is the preferred method of foreclosure because it does not require legal action and is less time consuming, foreclosure by action may be required in some instances. For example, if a power of sale clause is not included in the mortgage, a foreclosure by action is the only option. A foreclosure by action may also be elected by the mortgagee for any variety of technical reasons such as erroneous descriptions, a mistaken release of the mortgage or if an issue of priority with another lien holder must be resolved.

### **Initiation**

To initiate a foreclosure by action, a summons and complaint must be served according to the Minnesota Rules of Civil Procedure. The complaint will name as defendants all of the present owners of the property, other lien holders and those with a right to possession of all or a portion of the premises. If no party defends the action, the mortgagee may obtain a default judgment or a determination from the court that it has a valid mortgage. If, however, any of the defendants objects (e.g., interposes an Answer), a trial may be necessary to establish the right of the mortgagee to foreclose.

### **Notice**

Once the court has made its decision regarding the right to foreclose, the sheriff will publish a notice of a foreclosure sale for a six-week period. The notice must include a description of the property and the date, time, and place of the sheriff's sale. In addition, if the debtor is a resident of the county in which the mortgaged premises are located, a copy of the judgment of the court and the sheriff's notice of sale must be

served upon the debtor. After serving the notice of sale on the debtor, the sheriff must post the notice of sale for six weeks.

### **Sale**

At the sale, the sheriff may sell the property to cash bidders only, except for the mortgagee, which can bid its total debt. Following the sale, the sheriff reports the sale to the court, which will then confirm the sale. Once the court has confirmed the sale, the statutory period of redemption for the debtor begins. The time periods for redemption are the same as for foreclosure by advertisement as discussed below.

## **REINSTATEMENT**

After the foreclosure notice has been prepared and publication has begun, the debtor may reinstate the mortgage. This applies to both foreclosures by advertisement and foreclosures by action. This right to reinstate is guaranteed by Minnesota law even though the creditor may have accelerated the balance due under the mortgage prior to the initiation of foreclosure proceedings. To reinstate the mortgage, the debtor must pay to the mortgagee the amount constituting the default at the time the mortgage foreclosure proceedings were initiated, including insurance, delinquent taxes, if any, together with all costs of foreclosure that have been incurred to the date of reinstatement, including half of any attorneys' fees allowed by law or \$150, whichever is greater. If the debtor reinstates the mortgage, the foreclosure proceeding is annulled. To reinstate the mortgage, however, the required payment must be made prior to the sheriff's sale, which is provided for by the foreclosure proceedings.

Within seven days of a written request by the sheriff, the mortgagee must provide the sheriff: (1) the current payoff amount,

showing outstanding principal, interest, and a daily interest accrual amount, (2) an itemized schedule of the current amounts necessary to reinstate the mortgage, and (3) the identity of the person or entity with authority to act on behalf of the mortgagee. If the mortgagee does not respond to the request in the time required, the sheriff must postpone the sale.

### RIGHT OF REDEMPTION

Following the foreclosure sale, the mortgagor has a right under Minnesota law to redeem from the sale. Such a redemption annuls the sale. If there are any junior liens, however, they are revived by the redemption by the mortgagor.

The mortgagor must redeem within six months of the date of the sale unless one or more of the following applies, in which case the redemption period is twelve months:

1. The mortgage was executed prior to July 1, 1967.
2. The amount claimed due and owing as of the date of the notice of foreclosure sale is less than two-thirds of the original principal amount secured by the mortgage.
3. The mortgage was executed prior to July 1, 1987, and the mortgaged property, as of the date of the execution of the mortgage, exceeded ten acres in size.
4. The mortgage was executed prior to August 1, 1994, and the mortgaged property, as of the date of the execution of the mortgage, exceeded ten acres but did not exceed 40 acres in size and was in agricultural use as defined by Minnesota statute.
5. The mortgaged property, as of the date of the execution of the mortgage, exceeded 40 acres in size.

6. The mortgage was executed on or after August 1, 1994, and the mortgaged property, as of the date of the execution of the mortgage, exceeded ten acres but did not exceed 40 acres in size and was in agricultural use, as defined by Minnesota statute.

To redeem from the sale, the mortgagor must pay to either the person who purchased the property at the sale or the sheriff the sum of money for which the mortgaged premises were sold, with interest from the sale date at the rate provided in the mortgage, plus other costs recoverable by statute. These costs include (1) any taxes or assessments upon which penalties would be incurred; (2), any costs of a hazard insurance policy; (3) costs incurred to reduce a mortgagor's redemption period; (4) any fees paid to the county recorder, registrar of titles, or sheriff; (5) any reasonable fees paid to licensed real estate brokers or appraisers; (6) any deed taxes; (7) reasonable attorney fees incurred after the foreclosure sale, not exceeding one-half of the limits imposed by statute; (8) any costs incurred in maintaining the property; and (9) any interest or installment of principal upon any other mortgage, lien, or contract for deed due during the redemption period.

The sheriff may accept a less than the full amount required for redemption provided that the holder of the sheriff's certificate gives written confirmation that he or she agreed to accept a sum less than the full amount required for redemption.

The mortgagor must also provide a copy of the document giving him the right of redemption and an affidavit containing the amount owed. The mortgagor must record these items with the county recorder within 24 hours of redemption. In addition, the mortgagor will receive a certificate of redemption including the mortgagor's name, the amount paid, a description of the

foreclosure sale and the property, and a statement of the source of redemption. The certificate must be recorded within four days after the end of the redemption period.

#### **Possession of the Property During the Redemption Period**

During this redemption period, the mortgagor is entitled to remain in possession of the property. He is therefore entitled to the rents, income and profits from the property unless he has made an assignment of an interest in them. No assignment of rents and profits contained in a mortgage is enforceable under Minnesota law unless it was (1) executed after August 1, 1977; (2) secured an original loan in excess of \$100,000; and (3) not a lien on property that was entirely homesteaded as agricultural property.

#### **Waiver**

It is possible for a mortgagor to waive his right to redemption. In order for a waiver to be valid, it must be contained in a document separate from the mortgage or be executed separately. It must also be recorded by the lender.

#### **RIGHTS OF FIRST REFUSAL**

Following the expiration of the redemption period, the mortgagor's ownership rights in the property are terminated. However, with respect to certain foreclosures of agricultural property, the mortgagor continues to have certain rights of first refusal upon resale of the property by the mortgagee, as discussed above with respect to foreclosure by advertisement.

Where the real estate which has been foreclosed is agricultural and the mortgagee is a government agency, limited partnership or corporation, Minnesota law provides the mortgagor with certain rights of first refusal upon the resale of the property by the

mortgagee. The mortgagee cannot offer the property for sale or lease until it has provided written notice to the mortgagor at least 14 days in advance. When a third party buyer or lessee is found, the mortgagee must then offer to sell or lease the property to the mortgagor upon the same terms as the offer made by such third party. The mortgagor has a defined period of time within which to exercise his right of first refusal to either buy or lease the property on such terms. For leases, it is within 15 days of the mortgagee's written offer to the mortgagor, and for sales, it is within 65 days of the mortgagee's written offer to the mortgagor. If the mortgagor exercises his right of first refusal, he must fully perform the terms of the sale or lease within ten days of such exercise.

The mortgagor can elect to purchase or lease a portion of the total property involved, but only where the portion is of a size, configuration and location which does not unreasonably reduce access to or the value of the remaining property. The mortgagor is not allowed to resell the property if the sale was arranged prior to his exercise of the right of first refusal. Where the property is resold by him within 270 days of exercising the right of first refusal, there is a presumption, subject to proof to the contrary, that the sale was arranged ahead of the exercise of the right of first refusal. Where the mortgagor violates this prohibition, he will be liable for damages and attorneys' fees.

In addition to Minnesota law creating rights of first refusal, applicable federal law creates similar rights of first refusal in certain circumstances. The mortgagee must be a lender which is a part of the Farm Credit Services system. Changes in this federal law in 1996 have significantly limited the applicability of the federal law rights of first refusal.

## JUNIOR LIEN HOLDERS

Under either method of foreclosure, junior lien holders may redeem from the foreclosure sale if the mortgagor fails to do so. Such junior lien holders may redeem if they have filed for record a notice of intention to redeem. Junior lien holder give notice of their intent to redeem at least one week prior to the expiration of the borrower's redemption period. Redemption by creditors is subject to a six percent interest rate from the time of sale, unless the certificate of sale specifies a different rate.

## DEFICIENCY JUDGMENTS

If the foreclosure sale does not bring in enough money to pay off the debt, the creditor may be able to obtain a deficiency judgment against the mortgagor. If the statutory redemption period is six months, however, such a deficiency judgment can be obtained against the mortgagor only if the foreclosure was by action. No deficiency judgment can be obtained against the mortgagor if the redemption period is six months and foreclosure was by advertisement. If the redemption period is twelve months, however, a deficiency judgment can be sought. Finally, even if the redemption period is six months, a deficiency

judgment can be sought against any guarantors of the promissory note.

## SEPARATE TRACTS OF LAND

In the case of farming operations, it is common for a single real estate mortgage to cover several separate tracts of land. If the mortgaged premises consist of separate and distinct farms or tracts, the sheriff must sell such tracts separately. If the mortgaged premises include the homestead, upon demand by the mortgagor, the sheriff must first sell the non-homestead premises.

## CONCLUSION

Procedures under Minnesota law for the foreclosure and termination of real estate security agreements are complex and detailed. They prescribe specific time periods within which both parties must take certain actions. Such time periods are critical for both parties. Any person involved in such procedures should carefully examine the specific provisions of state law that apply to his case.

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