

As the name suggests, zombie mortgages can be terrifying. They rise from the dead, appear without warning, and seize homes. And they are appearing now more than ever. This article explains what they are, why they are now such a problem, and twelve ways homeowners can stop foreclosures of zombie mortgages. For even more detail, see a [new Chapter 11a in NCLC's Home Foreclosures](#) [1].

## What Are Zombie Second Mortgages?

The zombie mortgages that are wreaking havoc today are second mortgages. Many were originated by predatory lenders in the years leading up to the 2007 financial crisis. During that era of frenzied lending, brokers often combined first and second mortgages in a single loan transaction. Referred to as “80-20 mortgages,” the transactions typically financed 80% of the principal balance through a first mortgage and the other 20% through a second mortgage. This kept the first mortgage within a loan-to-value ratio for easy securitization. Careless underwriting and abusive terms led to early defaults on many of these mortgages.

## Why Did These Second Mortgages Become Dormant?

Many homeowners struggled to keep up on their first mortgages through the Great Recession, often with the help of loan modifications. In the early years of the Recession, home values dropped precipitously. With so many properties deep underwater, holders of first mortgages faced reduced recoveries if they foreclosed. Second mortgagees, on the other hand, were almost certain to obtain nothing if they decided to foreclose. Not surprisingly, as many homeowners were unable to make payments on second mortgages, the owners of these loans wrote them off.

These “write-offs” were accounting devices used to reflect that the loans had ceased to be income-producing assets. The accounting adjustment did not necessarily mean that the borrowers were no longer under legal obligations to repay the debts. In most cases, unless some of the legal principles discussed in this article applied, the loan owners retained the option to change their minds and demand payment again. Borrowers did not understand this. Many thought that when their first mortgages were modified, second mortgages were covered as well. Years passed, sometimes well over a decade, and borrowers heard nothing from anyone about the second mortgages.

## Why Are Zombie Second Mortgages Coming Back to Life Now?

Zombie second mortgages are coming back to life for simple economic reasons. Now there is home equity for them to feed on. Over the past several years home values rose significantly in many parts of the country. Homes that were underwater in 2010 now stand well above water, and homeowners' equity has become an enticing target. Over the years since the Great Recession many homeowners also worked to pay down their first mortgages, further increasing their home equity.

## Who Is Foreclosing on These Second Mortgages?

The parties foreclosing on zombie second mortgages are a mix of players, with the original lenders seldom still in the picture. The parties threatening foreclosure today are often debt buyers or their collection agents. Debt buyers purchase pools of defaulted loan accounts, then opportunistically select those to foreclose. They can focus on equity-rich properties and those where they can easily pay off the first mortgage to obtain unencumbered title for themselves.

## How Does a Second Mortgage Foreclosure Work?

At the foreclosure sale of a first mortgage, the buyer typically acquires title free of any liens that attached to the property after the date the mortgage originated. In the case of a second mortgage foreclosure, the buyer at the foreclosure sale *does not* obtain unencumbered title to the property. The buyer acquires only the borrower's right to redeem the property from the first mortgage.

If a buyer at the foreclosure sale of a second mortgage wishes to do so, the buyer can pay off the first mortgage and thereby obtain title to the property. Importantly, the foreclosure of a second mortgage means that the borrower's right to redeem the property by paying off all the mortgage debts is extinguished. Under most state laws, the purchaser at the foreclosure sale of a

second mortgage can proceed to take possession of the property and evict the borrowers. Needless to say, the ability to use the powerful remedy of foreclosure gives a second mortgage debt buyer and its debt collector extremely powerful leverage.

[NCLC's Home Foreclosures §§ 11a.1.2](#) [2] [through 11a.1.4](#) [3] explore the substantive distinctions between first and second mortgage foreclosures.

## 12 Ways Homeowners Can Fight Off Zombie Second Mortgage Foreclosures

Resurrecting a long-dormant second mortgage and abruptly threatening to foreclose is a patently abusive practice. When presented with viable defenses and claims, courts should be willing to intervene to protect homeowners. New [Chapter 11a of NCLC's Home Foreclosures](#) [1] describes legal defenses and claims that give courts authority to rein in zombie foreclosures. This article summarizes the important claims and defenses.

### 1. The Statute of Limitations

Statutes of limitations can provide a powerful defense to foreclosure of a second mortgage. Under certain state laws, the expiration of the statute of limitations for foreclosure not only bars foreclosure, but also can be a basis for extinguishing the mortgage as an encumbrance on the property.

Examine your own state laws to determine the statute of limitations applicable to foreclosures. In a few states the status of the law remains unclear. [Appendix E to NCLC's Home Foreclosures](#) [4] includes summaries of the applicable limitation periods for foreclosures in most states. In many jurisdictions the statute of limitations for foreclosures is equivalent to the limitation period for enforcement of negotiable notes and other written contracts—typically six years.

Other states look to limitation periods for asserting rights in real property. These timeframes based on real property law can be considerably longer, ranging from ten to thirty years. A few states do not recognize any statute of limitations for foreclosure of mortgages or deeds of trust. More detail on individual state statutes of limitations for foreclosures is discussed in [NCLC's Home Foreclosures § 5.3.1](#) [5].

The first step is to determine the statute of limitations. The second step is to determine under a state's law when the statute of limitations begins to run. For mortgages and deeds of trust there are three potential trigger events to consider:

- The due date of each unpaid installment may start a limitation period running for collection of that installment. This limitation can preclude claims for many older installments due on a loan that was never accelerated and remained inactive for many years.
- A loan owner's acceleration of the loan makes the entire loan balance due immediately and starts the statute of limitations running for the entire debt if not paid. Factual and legal issues can arise in proving whether and when an acceleration occurred. These issues are discussed in [NCLC's Home Foreclosures § 5.3.3](#) [6].
- The loan's reaching its contractual maturity date for payment of the entire debt makes any remaining unpaid balance due immediately, and like acceleration, triggers the running of the statute of limitations for the entire unpaid sum.

[NCLC's Home Foreclosures § 11a.2](#) [7] discusses statutes of limitations with a specific focus on defending second mortgage foreclosures.

### 2. Challenging Authority to Foreclose a Second Mortgage

The party foreclosing a second mortgage must have authority to enforce the underlying contractual documents, the note and mortgage. [NCLC's Home Foreclosures Chapter 2](#) [8], [Chapter 3](#) [9], and [Chapter 4](#) [10] provide extensive analysis of authority to foreclose. The basic concepts covered there apply to second mortgage foreclosures as well.

The debt buyers who acquire pools of defaulted second mortgages are unlikely to have systems in place that larger mortgage services use to document transfers of negotiable notes and account histories. A request for information (RFI) under RESPA regarding loan ownership and possession of the relevant contract documents can build a successful challenge to a party's authority to foreclose a second mortgage. See [NCLC's Home Foreclosures § 11a.3](#) [11].

### 3. Claims under TILA and RESPA

Claims under TILA and RESPA can be raised against the owners and servicers of zombie second mortgages. Junior mortgages

are not exempt from most of the important TILA and RESPA provisions, although some requirements do not apply to HELOC loans. [NCLC's Home Foreclosures § 11a.4.1](#) [12] discusses coverage of second mortgages under TILA and RESPA.

Both TILA and RESPA allow claims for statutory penalties, compensatory damages, and attorney fees. These laws also establish an important industry standard—that owners and servicers of mortgage loans must keep borrowers regularly informed about the status of their loans. Claims under TILA and RESPA can include:

- *TILA transfer of loan ownership notices.* Effective in 2009, provisions of Regulation Z require that new owners or assignees of mortgage loans inform borrowers of a transfer of loan ownership within thirty days after a loan is sold. 12 C.F.R. § 1026.39(b), implementing 15 U.S.C. § 1641(g). These regulations are discussed in detail in [NCLC's Mortgage Servicing and Loan Modifications § 4.2.7](#) [13]. Transfer of ownership notices must provide specific information that borrowers need to understand their current payment obligations. The failure to inform borrowers of sales of their loans contributes to the expectation that there is no need take action regarding an ongoing payment obligation. See [NCLC's Home Foreclosures § 11a.4.2](#) [14].
- *RESPA notice of transfer of mortgage servicing rights.* A transfer of servicing rights for a second mortgage triggers obligations under RESPA for both the transferor servicer and the transferee servicer to provide a timely notice to the borrower. 12 U.S.C. § 2605(b); Reg. X 12 C.F.R. § 1024.33(b). [NCLC's Mortgage Servicing and Loan Modifications § 3.4.3](#) [15] discusses this requirement in detail. In addition to contact information for the new servicer, the notice must state when the new servicer will begin to accept payments. Failure to give timely notice deprives a borrower of another important tool for ascertaining the status of an account. See [NCLC's Home Foreclosures § 11a.4.2](#) [14].
- *The TILA periodic statement requirements.* Amendments to the TILA periodic statement rule were designed to prevent the surprise appearance of a long-dormant second mortgage together with unexpected claims for years of accrued interest and fees. See Reg. Z, 12 C.F.R. § 1026.41, implementing 15 U.S.C. § 1638(f). Under the rule, servicers must keep borrowers informed about the status of a second mortgage, including whether it has been charged-off or re-activated for collection, as well as who currently owns the loan and how to contact appropriate parties for up-to-date information. The rule requires heightened periodic statement disclosures when the loan is in arrears. [NCLC's Mortgage Servicing and Loan Modifications § 4.2.5](#) [16]. The initial version of this periodic statement rule went into effect in February 2014. Amendments effective in October 2017 added requirements for disclosing the charged-off status of a loan and for giving notice before collection on a charged-off loan resumed. 12 C.F.R. § 1026.41(e)(6). The amended rule bars collection of interest and fees that a lender alleges accrued after the lender gave notice of charge-off and before it gave notice of resumption of payments. 12 C.F.R. § 1026.41(e)(6)(ii)(B). See [NCLC's Home Foreclosures § 11a.4.3](#) [17].
- *TILA rescission.* A successful TILA rescission voids a lender's security interest in the borrower's real property, effectively barring a foreclosure. See [NCLC's Truth in Lending Ch. 10](#) [18]. Second mortgages may be particularly susceptible to rescission claims when they came with faulty disclosures and did not finance a home purchase. However, zombie mortgages may present statute of limitations problems unless the borrower can rely on certain recoupment principles or has access to more favorable state law rescission rights. See [NCLC's Home Foreclosures § 11a.4.4](#) [19].

TILA and RESPA claims may be limited by their respective statutes' limitation periods, although these claims in some states can be raised by way of recoupment in a foreclosure proceeding. TILA and RESPA claims also raise questions as to the proper defendant in the action. But, as described in items #5 and #6, *infra*, the TILA or RESPA violation can form the basis for contract claims under the mortgage loan agreement as well as UDAP claims, and similarly can provide support for state law negligence and fraud claims.

#### 4. The Fair Debt Collection Practices Act

The Fair Debt Collection Practices Act (FDCPA) prohibits unfair or deceptive debt collection activities. Seeking to collect a sum that is not lawfully owed or enforcing a security interest when there is not a present right to do so violates these FDCPA prohibitions. See [NCLC's Fair Debt Collection §§ 7.4.11](#) [20], [8.3](#) [21], and [8.6](#) [22]. Upon proving an FDCPA violation, borrowers can recover statutory penalties, damages, and attorney fees. Owners of zombie second mortgages and their attorneys may qualify as "debt collectors" under the FDCPA. [NCLC's Fair Debt Collection § 4.7.3.4](#) [23]. Servicers of zombie second mortgages may qualify as debt collectors as well if, as is likely, they acquired servicing rights after the loan went into default. [NCLC's Fair Debt Collection § 4.7.5.2.3](#) [24]. Some limited exceptions to FDCPA coverage may apply to certain entities when they engage only in essential non-judicial foreclosure activities and do not demand payment. [NCLC's Fair Debt Collection § 4.7.5.2.3](#) [24].

#### 5. Contract-Based Claims and Defenses

Standard loan documents contain terms that obligate lenders to comply with applicable federal and state laws if they wish to foreclose. See [NCLC's Mortgage Servicing and Loan Modification § 5.5](#) [25] (discussing requirement to comply with “applicable law” as term of standard GSE security instrument). As “applicable laws,” TILA and RESPA impose duties on lenders and their servicers to communicate with borrowers and provide them with specified information. This information includes when to make payments, how much to pay, and where to send payments. Framing these obligations as contractual conditions to a foreclosure avoids potential statute of limitations challenges and disputes over who is a proper party defendant that can arise when the borrower relies exclusively on the TILA and RESPA regulations. See [NCLC's Home Foreclosures § 11a.6](#) [26].

## 6. Defenses and Claims Based on State UDAP Statutes

Federal and state laws impose affirmative obligations on owners of second mortgages and their servicers to disclose changes of loan ownership and servicing rights as well as details about an account’s current status. Violations of TILA, RESPA, and other federal and state laws that mandate regular disclosures of loan information to borrowers can be the basis for effective claims under state unfair and deceptive acts and practices (UDAP) statutes. See [NCLC's Unfair and Deceptive Acts and Practices § 6.4.1](#) [27]. Borrowers have strong arguments that the practice of lying in wait while systematically failing to communicate before a foreclosure meets both the “unfair” and “deceptive” standard under the state UDAP statutes. See [NCLC's Unfair and Deceptive Acts and Practices §§ 4.2.15](#) [28], [4.3.3](#) [29], [4.4](#) [30]. Not all state UDAP statutes apply to financial institutions and foreclosures. However, many do and can authorize wide-ranging relief, including equitable remedies. See [NCLC's Home Foreclosures § 11a.7](#) [31].

## 7. Laches and Equitable Defenses to Second Mortgage Foreclosures

Equitable defenses to foreclosure may be available when the owner of a zombie mortgage seeks to foreclose after the account has remained inactive for many years. The foreclosure may be barred under the doctrines of unclean hands or laches. The elements of laches under a typical state law are: (1) the creditor’s knowledge of the cause of action, (2) an unreasonable delay in commencing the action, and (3) damage resulting from the unreasonable delay. Borrowers who believed their loans had been written off or modified and could not communicate with anyone about the loan for years may have foregone timely options to address the loan default, such as through loss mitigation. See [NCLC's Home Foreclosures § 11a.8](#) [32].

## 8. State Law General Foreclosure Requirements

Each state sets requirements for conduct of a valid foreclosure. The foreclosing party must typically have the right to enforce a mortgage or deed of trust and note. The party must designate a default, give specific notices, and identify the amount owed. [NCLC's Home Foreclosures § 5.5](#) [33] and [Chapter 8](#) [34] discuss procedural challenges in the context of first lien mortgage foreclosures. Investigate state laws to determine whether all procedural requirements, such as participation in settlement conferences and mediations, apply to second mortgages in the same way they do to first mortgages. To the extent that the requirements apply to second mortgages, the foreclosing party should be held to the same standards of compliance with the applicable state foreclosure laws as a first mortgagee. A discussion of general state foreclosure laws and their applicability to second mortgages is found at [NCLC's Home Foreclosures § 11a.9](#) [35].

## 9. State Laws That Specifically Regulate Second Mortgages

Thirteen states have enacted statutes specifically designed to regulate second mortgages. These statutes are discussed generally at [NCLC's Home Foreclosures § 11a.10.1](#) [36] and a state-by-state analysis is found at [§ 11a.10.2](#) [37]. Several of these statutes limit default-related charges. Others set guidelines for second mortgage loan origination and require special licensing. Violation of these origination laws may give rise to recoupment claims against debt buyers.

## 10. Bankruptcy Remedies for Zombie Second Mortgages

In addition to the reprieve from foreclosure activity through the automatic stay, bankruptcy offers homeowners who file for relief under chapter 13 the opportunity to object to a second mortgagee’s claim. The homeowner can challenge amounts owed when a statute of limitations bars all or some of the claim. Recoupment is also available despite statutes of limitations on a homeowner’s affirmative claims. When the first lien mortgage and other senior encumbrances exceed the property’s value, the homeowner can “strip off” the junior mortgage in a chapter 13 case, making the loan balance a dischargeable unsecured debt. [NCLC's Home Foreclosures Chapter 9](#) [38] discusses other ways to deal with mortgagees in bankruptcy. A discussion of bankruptcy’s application specifically to second mortgages is found at [NCLC's Home Foreclosures § 11a.11](#) [39].

## 11. Loss Mitigation Options for Junior Mortgages

Loss mitigation options created by the major federal guarantors and insurers of mortgage loans can be critically important tools for preserving homeownership. However, certain options, including many modification programs, are available only for first mortgages. Nevertheless, many forbearance options, such as those under the CARES Act, apply to all federally backed mortgages regardless of their lien position. [NCLC's Home Foreclosures § 11a.5](#) [40] outlines the major servicing options that cover junior mortgages.

## 12. Deficiency Claim Issues Specific to Second Mortgages

Second mortgages can present unique problems related to post-foreclosure deficiency claims. For example, borrowers may find that they are liable for a deficiency claim on a junior mortgage after the *senior* mortgage has been foreclosed. Nevertheless, state anti-deficiency statutes may protect borrowers from these claims. [NCLC's Home Foreclosures § 10.4](#) [41] contains a general discussion of issues related to post-foreclosure deficiency claims. [NCLC's Home Foreclosures § 11a.2](#) [7] provides state-specific examples of the scope of state anti-deficiency protections for second mortgages.

## NCLC Fair Debt Collections and Mortgage Training Conferences Will Examine Zombie Foreclosures

*Consumer attorneys take note:* Two forthcoming NCLC conferences will include sessions on zombie second mortgage foreclosures.

NCLC's Fair Debt Collections Conference will take place April 24-25, 2022, in Orlando Florida. Among other Fair Debt Collection Practices Act issues, a session will focus on using the FDCPA to combat zombie second mortgages, Information on the conference agenda, registration, and attendance options is available [here](#) [42].

NCLC's Mortgage Training Conference will take place June 23-24, 2022, in St. Louis Missouri. The conference will focus on pandemic-related mortgage foreclosure issues and include a special session focused exclusively on zombie second mortgage foreclosures. Information on the conference agenda, registration, and attendance options is available [here](#) [43].

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**Geoffrey Walsh** is a staff attorney at the National Consumer Law Center (NCLC) who focuses on foreclosure prevention, consumer bankruptcy, and other consumer credit issues. He has provided written testimony and engaged in policy advocacy at the federal and state levels on the topic of foreclosure mediation. He has served as a panelist and instructor at trainings and legal education seminars on foreclosure prevention and bankruptcy topics, and is an active member of the National Association of Consumer Bankruptcy Attorneys. Walsh is co-author of [Home Foreclosures](#) [44], [Mortgage Servicing and Loan Modifications](#) [45], [Consumer Bankruptcy Law and Practice](#) [46], Foreclosure Prevention Counseling, [Student Loan Law](#) [47], and [Credit Discrimination](#) [48]. Walsh previously worked as an attorney with Vermont Legal Aid, Inc. in Springfield, Vt. from 1991 to 2008, specializing in housing, consumer, and bankruptcy areas. From 1980 to 1991, he worked as a staff attorney with Community Legal Services, Inc. in Philadelphia, Pa., where he also specialized in housing and consumer litigation. Walsh earned his B.A. from University of Michigan and is a graduate of Temple University Law School.



**Source:** National Consumer Law Center, [], updated at [www.nclc.org/library](http://www.nclc.org/library)

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### Links

- [1] <https://library.nclc.org/nclc/link/HF.11a.01>
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