



**TACKLING
OPPRESSIVE
RESTRICTIVE
COVENANTS IN
FORECLOSURE**

A RESTRICTIVE COVENANT IS A RESTRICTION on the use of one's land to preserve the value or enjoyment of adjoining land. They run with the land and are generally not extinguishable within a foreclosure action in New Jersey.¹ A classic example is a prohibition by a Homeowners' Association on the types of paint color that can be used on one's home. *Assuming arguendo* that a foreclosure could extinguish a restrictive covenant, it would impede a residential community or neighbors from effectively governing or enforcing uniformity. Therefore, when used properly, restrictive covenants can benefit a community or homeowner. Unfortunately, it has recently been discovered that certain restrictive covenants are being used in an adverse manner in New Jersey and should be removed from the record immediately.

In more than a handful of legal matters, we have identified that a restrictive covenant titled an "MVR Homeowners Benefit Agreement" has been placed on certain properties by the recording of a "Memorandum of MVR Homeowner Benefit Agreement." In these situations, homeowners receive a small sum of money titled "promotion fees" in exchange for signing an exclusive listing agreement, wherein the covenantee is granted the exclusive right to act as listing agent for any sale of the owner of the property for a term of forty (40) years, unless terminated in accordance with the agreement. Unfortunately, for foreclosing lenders, pursuant to the agreement, a foreclosure qualifies as a termination event, entitling the covenantee to a termination fee equal to three (3) percent of the greater of: (a) the property's current realtor's valuation model estimate; or (b) the fair market value of the property.² Thereby, undermining a lender's

ability to have proper recourse to address losses upon a sale. Further, the agreement constitutes a covenant running with the land and binding all future successors in interest.³ The effect of this agreement is the creation of a restrictive covenant on the land, which undermines alienability and amounts to an unreasonable and unduly oppressive cloud on title.

At first glance, notwithstanding the explicit term that the [agreement constitutes covenants running with the land...bind[ing] future successors-in-interest to title to the property] the assumption by many foreclosure attorneys could easily be that the agreement is not a traditional restrictive covenant, and therefore, can simply be extinguished through the foreclosure under the race-record theory. Ultimately, the decision will be made by underwriters issuing title insurance post-sale and in subsequent transactions and will vary on a case-by-case

1 Lawrence Joel Fineberg, Handbook of New Jersey Title Practice 635 (3d. ed. 2005) (Restrictive covenants can be extinguished by: (1) release from the covenantee; (2) abandonment or change in condition of the neighborhood; (3) final judgment in an action to quiet title or an action to determine the validity of restrictive covenants; (4) release from all parties entitled to enforce the restriction; (5) merger of ownership of all lots affected; and (6) terms of the instrument creating the covenant).

2 See *MV Realty of New Jersey, LLC v. Gabriel Block*, No. C-11-22 (Monmouth Ch. filed on Jan. 24, 2022) (Pursuant to the MVR Homeowner Benefit Agreement, a termination event is: (a) any sale or transfer where MV is not paid a commission; (b) if the property owner terminates or attempts to terminate MV's right to act as exclusive agent; and (c) the property owner is no longer the owner of the property because of foreclosure, or other transfer, whether voluntary involuntary, if said transfer was not within ten (10) days of the agreement).

3 See *MV Realty of New Jersey, LLC v. Gabriel Block*, No. C-11-22 (Monmouth Ch. filed on Jan. 24, 2022) (defining "Memorandum" is defined in the MVR Homeowner Benefit Agreement as a memorandum to the Agreement that may be recorded...).



basis. However, the problematic nature of said restrictive covenants is underscored by the bulletin issued by Chicago Title Insurance company, which advised that these restrictive covenants should be considered an exception to coverage where not discharged like any other lien on title.

Therefore, the manipulation of these restrictive covenants could circumvent the normal foreclosure process, as it is arguable that at the Sheriff's sale and any subsequent sale, the purchasing owner, whether it be an interested third party or plaintiff, would be liable for either commission⁴ or termination fee. Which could be either be either three (3) or six (6) percent of the value of the property. This is because even if a foreclosing plaintiff were able to successfully extinguish the interest of the covenantee of the restrictive covenant following a Sheriff's sale, the foreclosure qualifies as a termination event, entitling the covenantee to at minimum three (3) percent of the fair market value. Thus, the two questions yet to be decided are: (1) whether title companies will deem these traditional restrictive covenants capable of being extinguished through the foreclosure; and (2) whether irrespective of extinguishment through the foreclosure, the covenantee of the covenant will be entitled to a termination fee upon

completion of the foreclosure. Either question may result in delay to a foreclosing lender if the sole approach taken to address the issue is extinguishment through the foreclosure.

Based upon the foregoing, the pragmatic solution is to take an aggressive approach that goes beyond merely serving the covenantee of these restrictive covenants with the foreclosure complaint and seeking the entry of an order striking the covenant from the record and declaring the covenant to be unenforceable. In a recent case by Friedman Vartolo LLP, *U.S. Bank Trust National Association, as Trustee of the Igloo Series IV Trust v. Flagg*⁵, the Court agreed granting an order finding that the restrictive covenant was patently unreasonable and unenforceable under New Jersey's Davidson's test as a matter of public policy and an unduly oppressive cloud on title.

The decision in the *Flagg* case appears to be the first of its kind in the state of New Jersey and can serve as a guide for future similar situations and offering lenders the ability to avoid the uncertainties that can be raised post foreclosure sale. Notably, this does not appear to be solely a New Jersey specific issue as the state of Florida recently sought to ban the use of these types of restrictive covenants within the state.⁶ **a**

⁴ See *MV Realty of New Jersey, LLC v. Gabriel Block*, No. C-11-22 (Monmouth Ch. filed on Jan. 24, 2022) (defining the "Commission" according to the MVR Homeowner Benefit Agreement is an amount equal to six (6) percent of the total price the property is sold for. However, the Commission may not be lower than three (3), which is the current home value estimate of the property).

⁵ *U.S. Bank Trust National Association, as Trustee of the Igloo Series IV Trust v. Jocelyn Flagg*, No. F-011237-22 (Middlesex Ch. filed Oct. 20, 2022).

⁶ See Josh Fleischer and Josh Wade, Florida Sues Realty Company and Reality-Star Founder for "Swindling" Homeowners Across U.S. (Dec. 2, 2022, at 12:43pm) Florida sues realty company and reality-star founder for 'swindling' homeowners across U.S. – FOX13 News Memphis (fox13memphis.com).