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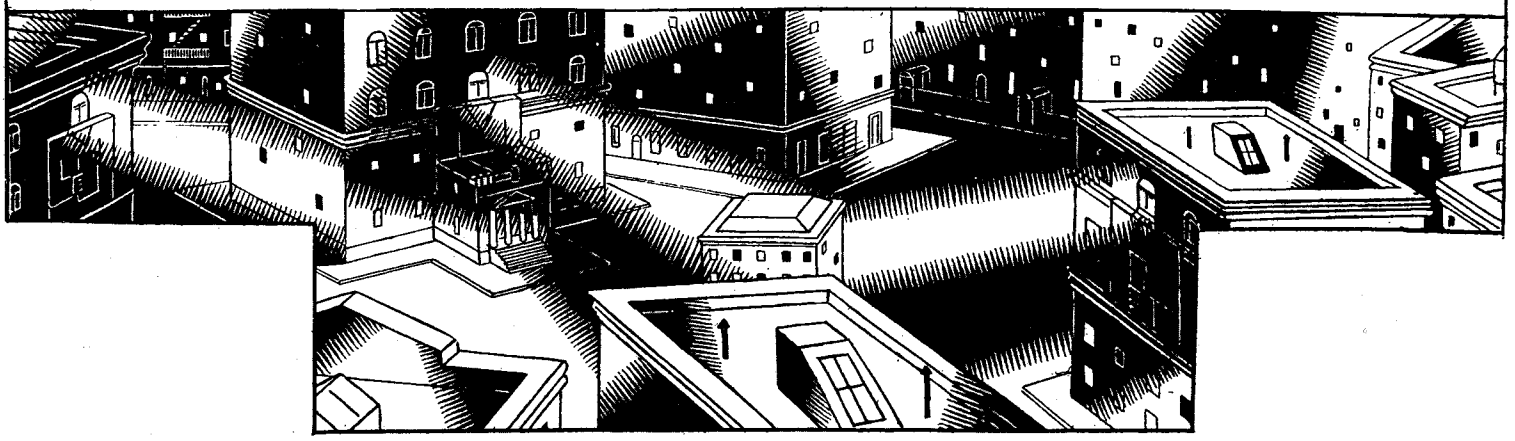
REAL ESTATE UPDATE



Common Charge Lien

Condo Attacks First Mortgage: A Creature That Wouldn't Die

MORTGAGE FORECLOSURES

BY BRUCE J. BERGMAN

EVEN CASUAL film buffs may recognize an analogy to the incessant Imhotep, the dreaded Egyptian mummy of 1930s and 1940s B movies. Once aroused, he could never be finally vanquished, returning time and again to foment mayhem upon the unsuspecting in sundry new incarnations: "The Mummy's Curse," "The Mummy's Ghost," "Return of the Mummy," et al., or perhaps ad nauseam. In a way, it is not unlike the clash between condominium boards and mortgage holders, which, although founded on a concept apparently resolved, manages repeatedly to resurface in varying garbs.

This had been a hot topic in recent years, with the observation that an adjective such as "hot" is not so often associated with the sometimes ossified pursuit of mortgage foreclosure. Distress in real estate begat confrontation between condominium associations racing to enforce common charge liens, and holders of first mortgages on a host of condominium units speeding to foreclose. Historically, that there was a battle at all arose from an unfortunately blurry phrase in the controlling statute [1] combined with an aberrant decision the first time the priority issue was litigated. [2] Although ultimately relegated to the proverbial dustbin of history, [3] that initial case emboldened the condominiums and led to a multiplicity of cases contesting the issue of priority.

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The Statute

The essence of the statute (RPL §339-z) was, and is, that a condominium common charge lien enjoys a special priority and is superior to all liens save those specifically excepted, the most prominent of which is a first mortgage. In other words, a first mortgage is senior to a condominium common charge lien.

Apparent though the statute's thrust is, a later phrase proved villainous: "[U]pon the sale or conveyance of a unit . . . unpaid common charges shall be paid out of the sale proceeds or by the grantee." If "sale" meant and encompassed a judicial sale as well as a typical commercial transaction (the condominium owner volitionally selling the unit), then the obvious stated intent of the statute to keep a first mortgage superior was sundered.

The existence of that ambiguity persuaded the first judge who viewed it that some hitherto unknown hybrid form of priority existed. [4] In turn, that opened the floodgates of litigation until four years later the Court of Appeals rendered the ultimate decision in *Bankers Trust Co. v. Board of Managers of the*

Park 900 Condominium.[5] Its dispositive finding was that RPL §339-z must be interpreted to mean that the statutory lien for common charges does not survive foreclosure of a first mortgage.[6]

Although not needed, confirmation of the *Bankers Trust* case was nevertheless forthcoming. One decision, some two months prior to the Court of Appeals ruling but subsequent to the First Department's pronouncement which was the progenitor of the Court of Appeals' version, took the first mortgage's priority for granted pursuant to standard wisdom, finding the condo liens extinguished because filed after the lis pendens.[7] Superiority of the first mortgage was mentioned generally in another case[8] and with more particularity in four others.[9]

The Decisions

In the cases specifically relying upon *Bankers Trust*, superiority of the first mortgage was found not only as to the condo lien, but to a public benefit corporation's claim for past due ground lease rent.[10] Then the Third Department held that "a first mortgage foreclosure sale, except to the extent of surplus monies, extinguishes all prior liens and vests full title in the grantee (citing RPAPL 1353[3])."[11]

Meanwhile, the First Department reiterated the position it had taken previously in its decision, which was the one appealed to the Court of Appeals.[12] The only twist which might have been new was Supreme Court's framing of the question, does a blanket mortgage to a condominium's sponsor/developer take precedence over common charge liens for the units? Because the blanket mortgage was a first mortgage, upon authority of *Bankers Trust*, the ruling was in the affirmative.[13]

Obvious and expected reaffirmations notwithstanding, nuance continued to lurk, awaiting the inevitable different fact pattern to create an apparently (but not necessarily) novel interpretation. So far, there are three situations in which condo charges may prime the first mortgage even though *Bankers Trust* remains undisturbed: (1) when the mortgage claiming superiority may not be a first mortgage; (2) when a mortgage consolidation may have failed to elevate a junior mortgage to the status of a first mortgage; and (3) when a receiver is directed to pay the common charges.

'Parkchester'

Recalling that the governing statute (RPL §339-z) maintains the priority of "a first mortgage of record" over that of the condominium common charge lien, the precise meaning of the quoted phrase becomes consequential. Such was just the issue in *Board of Managers of Parkchester Condominium North v. Richardson.*[14] There, some not so uncommon facts dissipated what should have been, and what was expected to be, the lender's priority. This time it was the condominium foreclosing its lien and naming an intended first mortgagee (Citibank) as a party defendant.

The word "intended" is used because Citibank advanced funds, obtained thereby a purchase money mortgage and remitted to the then mortgagee sums sufficient to satisfy that existing mortgage. But a satisfaction was never delivered nor, obviously, recorded. (Real estate practitioners recognize that this happens from time to time and typically remains unnoticed, and insignificant, until litigation raises priority questions.)

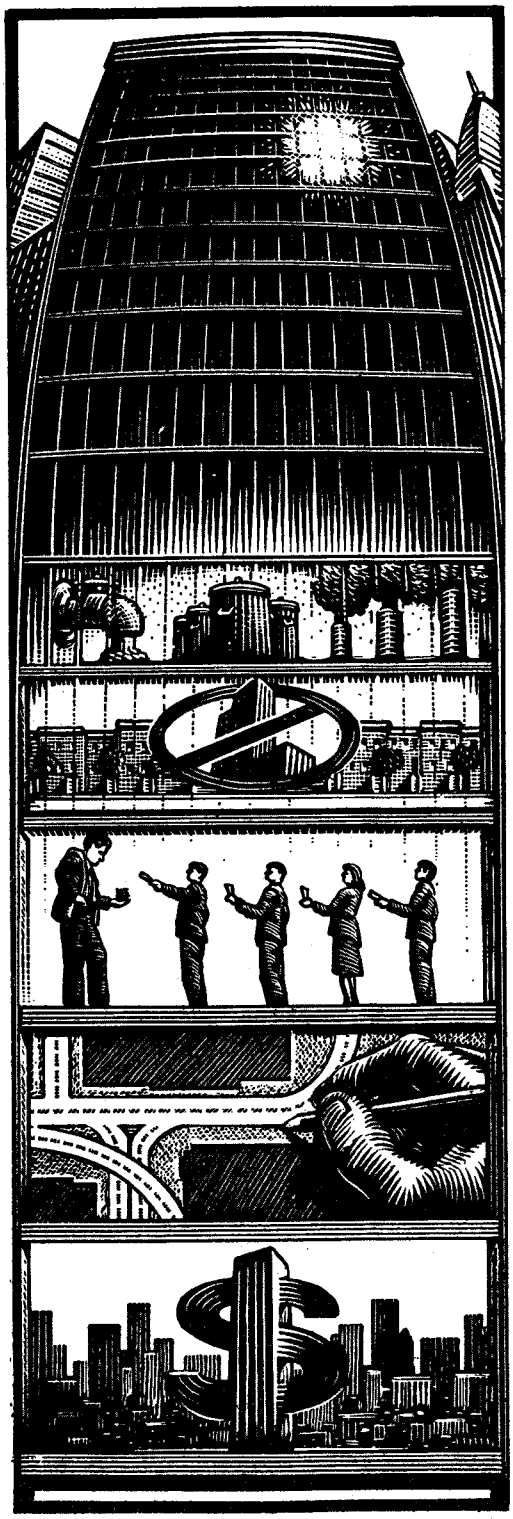

ILLUSTRATION BY JOHN MacDONALD

Examining "the record" in this case suggests that Citibank's mortgage was not, in fact, a first mortgage. Accordingly, argued the condominium, statutory priority was not afforded to the Citibank mortgage, so that the common charge lien emerged as superior.

Technically, the condominium was correct and the court, choosing to be technical, agreed. Because no one disputed that Citibank had in actuality satisfied the pre-existing mortgage, the mere record existence of a dead instrument should not change the reality and deprive protection to an authentic first mortgage, argued the bank. One could say as well that the Legislature's real intent was to avoid the bogus and reserve seniority to genuine first mortgages. After all, an unrecorded mortgage might leave room for chicanery. The court, however, interpreted the phrase "first mortgage of record" strictly, penalizing not an unrecorded first mortgage, but a recorded mortgage that was not actually first of record. So, some pebbles, or larger stones, are chipped away from the mount that is *Bankers Trust.*

'Societe Generale'

A different perspective upon when a first mortgage is actually first, arises from the consolidation of mortgages. And the issue, if there really is one, has added at least some confusion (difference of opinion might be more accurate) to the continuing joust between mortgages and condo liens. The first time consolidation was considered, the facts were straightforward, but the result was askew.[15]

In the rather infamous *Societe Generale*[16] case, a condominium unit was burdened by a first mortgage recorded in 1985. A second mortgage and a consolidation of the first and second mortgages were recorded in 1991. A lien for condominium common charges was not recorded until 1992. On these facts, the foreclosing lender moved for summary judgment, arguing that the consolidation created a single senior lien, with the condo opposing on the theory that notwithstanding consolidation, the second mortgage remained junior.

On what can be urged is misplaced interpretation of prior authority,[17] the Supreme Court ruled that the plaintiff's consolidated mortgages did not constitute a single loan and therefore the condo lien retained priority over the second mortgage,[18] or what would be denominated in these pages as the "former second mortgage." It is true enough that consolidation cannot bootstrap a later second mortgage to priority over an earlier intervening lien, but such an aphorism does not diminish the effect of a consolidation when there are no intervening encumbrances.

'Dime'

Title companies were conspicuously and understandably disquieted by *Societe General.* It simply ran counter to firmly accepted

and understood notions. A subsequent look at the question, however, brought a return to normality. [19] Both as a matter of law and practical philosophy, the Supreme Court in *Dime Sav. Bank of New York v. Levy* [20] rejected the reasoning in *Societe Generale.*

In *Dime*, the facts were essentially the same as in *Societe Generale.* In the later case, the court reasoned that the second mortgage did not discharge the original indebtedness and therefore the consolidation agreement could not lessen the priority of the first mortgage. [21]

Yes, said the court, a consolidation agreement is solely for the convenience of the contracting parties and cannot impair the priority of a lien which intervenes between the first and second mortgages. [22] In this instance, though, the condo lien did not exist when the second mortgage was executed and the plain language of the consolidation agreement evidenced an intent to create a single lien.

To be sure, the court noted, had the condo lien been extant when the second mortgage was executed, it would have retained priority. But that was not the case and to elevate a later condo lien would severely impact upon the ability of a condominium owner to refinance. To discourage this variety of borrowing merely because the homeowner had chosen to purchase a condominium was thought by the court to be counterproductive. So, whether consolidation contemplations add nuance to the formula depends upon how one gauges the wisdom of *Societe Generale* versus the *Dime* holding. Perhaps like the basic condo lien question, the ruling of an appeals court must be awaited until certainty returns.

Common Charges

The final arena which adds some shading to *Bankers Trust* revolves around a receiver's obligation to pay condominium common charges.[23] Because the lien of a first mortgage is senior to condo common charges, a too rapid analysis may suggest that a receiver appointed upon foreclosure of a superior interest need not honor a clearly junior interest. There are, however, two compelling arguments why the noted view is facile.

First, in no particular order, common charges are dedicated to the preservation and maintenance of the premises during the term of the receivership.[24] The payment of common charges has been held consistent with a receiver's obligation to preserve the premises pursuant to RPAPL §1325(2) [25] and could rationally be seen as no different than any other typical expense of running and maintaining the property, even though those charges too would be junior to the lien of the first mortgage, i.e., rent, repairs, utilities and the like.

Stated somewhat differently, because a receivership is designed to preserve property and, by generating a profit, create a fund to reduce the mortgage, a foreclosing mortgagee should not enjoy that benefit without fully paying operational expenses.[26] Indeed a basic obligation of a business conducted at premises it does not own is the payment of rent. And in a condominium, common charges are the equivalent of rent.[27]

A second support for the mandate that a receiver is to pay condominium common charges supports the proposition that *Bankers Trust* remains unassailed. The issue in *Bankers Trust* was whether a common charge lien should be paid out of the proceeds of a foreclosure sale of a first mortgage. Where the issue involves a receiver's obligation, the question is payment of common charges, from rental proceeds, and during the pendency of a foreclosure action.[28] In short, directing a receiver to pay condominium common charges is not discordant with *Bankers Trust.*

Conclusion

It is perhaps surprising that the competition between the first mortgage and the condominium common charge lien remains as volatile as it is. The result, though, is probably more refinement than anything.

Yes, receivers are likely to most often be liable for common charges, but that result does no mischief to *Bankers Trust.*

Yes, only a first mortgage derives the continuing priority over the condo lien and one court chose to construe the term "first mortgage" quite narrowly.

And, yes, mortgage consolidations may make title companies and counsel nervous when assessing relative priorities. However, certainty should return when an appeals court considers the issue.

(1) RPL §339-z.

(2) *East River Sav. Bank v. Saldivia, NYLJ,* Oct. 11, 1989, at 21, col. 4 (Sup. Ct., N.Y. Co., Lebedeff, J.)

(3) The Court of Appeals resolved the issue in *Bankers Trust Co. v. Board of Managers of the Park 900 Condominium,* 81 NY2d 1033, 600 NYS2d 191, 616 N.E.2d 848 (1993).

(4) This entire subject is discussed at much greater length and with extensive citations at "*1st Mortgage vs. Condo Lien,*" *NYLJ.*, June 16, 1993, at 5, col. 2; "First *Mortgage vs. Condominium Common Charge Lien — In Legal and Political Battle,*" 64 *New York State Bar Journal* 34 (Jan. 1992).

(5) 81 NY2d 1033, 600 NYS2d 191, 616 N.E.2d 848 (1993).

(6) Although neither the clarity or finality of the ruling needs embellishment, the decision in the First Department which the Court of Appeals affirmed was especially thoughtful and expansive, offering a more comprehensive review of the subject. See *Bankers Trust Company v. Board of Managers of Park 900 Condominium,* 181 A.D.2d 274, 584 NYS2d 576 (1st Dept. 1992).

(7) *Victoria Woods Homeowners Association v. Gonyo,* 192 A.D.2d 1107, 596 NYS2d 259 (4th Dept. 1993).

(8) *Melsten v. Board of Managers 178-184 E. Second St., NYLJ,* May 2, 1994, at 28, col. 2 (Sup. Ct., N.Y. Co., Crane, J.).

(9) *Dime Sav. Bank of New York v. Pesce,* 217 A.D.2d 299, 636 NYS2d 747 (1st Dept. 1995); *GE Capital Mort. Services v. Misevcis,* 204 A.D.2d 963, 612 NYS2d 275 (3d Dept. 1994); *Dime Sav. Bank of New York v. Kakar,* 203 A.D.2d 50, 610 NYS2d 33 (1st Dept. 1994); *Marine Midland Bank v. Valeria Associates,* N.Y.L.J., Feb. 5, 1994, at 28, col. 2 (Sup. Ct., West. Co., J.B. Lefkowitz, J.).

(10) *Dime Sav. Bank of New York v. Pesce,* supra. at note 9.

(11) *GE Capital Mort. Services v. Misevcis,* supra. at note 9.

(12) *Dime Sav. Bank of New York v. Kakar,* supra. at note 9.

(13) *Marine Midland Bank v. Valeria Associates,* supra. at note 9.

(14) *NYLJ,* Mar. 19, 1996, at 26, col. 6 (Sup. Ct. Bronx Co., Friedman, J.).

(15) *Societe Generale v. Charles & Company Acquisition,* 157 Misc.2d 643, 597 NYS2d 1004 (1993).

(16) Id.

(17) *Societe Generale v. Charles & Company Acquisition,* 157 Misc.2d 643, 597 NYS2d 1004 (1993), citing *Skaneateles Sav. Bank v. Herold,* 50 A.D.2d 85, 376 NYS2d 286 (4th Dept. 1975), aff'd 40 N.Y.2d 999, 391 N.Y.S.2d 107, 359 N.E.2d 701; *Dominion Fin. Corp. v. 275 Washington Street Corp.,* 64 Misc.2d 1044, 316 N.Y.S.2d 803 (1970).

(18) *Societe Generale v. Charles & Company Acquisition,* supra. at note 15.

(19) *Dime Sav. Bank of New York v. Levy,* 161 Misc.2d 480, 615 NYS2d 218 (1994).

(20) 161 Misc.2d 480, 615 NYS2d 218 (1994).

(21) Citing *Bank of New York v. Cerasaro,* 98 A.D.2d 902, 470 NYS2d 894.

(22) *Dime Sav. Bank of New York v. Levy,* 161 Misc.2d 480, 615 NYS2d 218 (1994), citing *Dominion Fin. Corp. v. 275 Wash. St. Corp.,* 64 Misc.2d 1044, 316 NYS2d 803; *Remodeling & Constr. Corp. v. Melker,* 65 NYS2d 738, affd. 270 A.D. 1053, 64 NYS2d 175; *Schuck v. Kings Realty Co.,* 260 A.D. 1021, 23 NYS2d 764, affd. 285 N.Y. 750, 34 N.E.2d 907; *Toner v. Ehrgott,* 226 A.D.244, 235 N.Y.S. 17.

(23) *Ezriel Equities Associates* v. *157 East 72nd Street Associates,* —— A.D.2d ——, 638 NYS2d 470 (1st Dept. 1996); *Board of Managers of Hudson View West Condominium v. Shapiro, NYLJ,* Aug. 5, 1994, at 26, col. 2 (Sup. Ct., N.Y. Co., Schlesinger, J.); *The Prudential Home Mort. Co. v. Salgado, NYLJ,* Aug. 1, 1994, at 29, col. 2 (Sup. Ct., N.Y. Co., Ramos, J.); *First New York Bank for Business v. 155 E. 34 Realty Co.,* 158 Misc.2d 658, 601 N.Y.S.2d 990 (1993); *Board of Managers of 300 West 23rd St. Condominium v. K.B. Chelsea Realty Associates, NYLJ,* Aug. 5, 1992, at 22, col. 5 (Sup. Ct., N.Y. Co., Moskowitz, J.);

(24) *Ezriel Equities Associates v. 157 East 72nd Street Associates,* —— A.D.2d ——, 638 NYS2d 470 (1st Dept. 1996); *Board of Managers of 300 West 23rd St. Condominium v. K.B. Chelsea Realty Associates, NYLJ,* Aug. 5, 1992, at 22, col. 5 (Sup. Ct. N.Y.Co., Moskowitz, J.); *First New York Bank For Business v. 155 E. 34 Realty Co.,* 158 Misc.2d 658, 601 N.Y.S.2d 990 (1993); *The Prudential Home Mort. Co., Inc. v. Salgado, NYLJ,* Aug. 1, 1994, at 29, col. 2 (Sup. Ct. N.Y.Co., Ramos, J.); see also *Board of Managers of Hudson View West Condominium v. Shapiro, NYLJ,* Aug. 5, 1994, at 26, col. 2 (Sup. Ct. N.Y.Co., Schlesinger, J.).

(25) *The Prudential Home Mort. Co., Inc. v. Salgado,* supra. at note 24.

(26) *First New York Bank for Business v. 155 E. 34 Realty Co.,* supra. at note 24.

(27) *First New York Bank for Business v. 155 E. 34 Realty Co.,* supra. at note 24.

(28) *Ezriel Equities Associates v. 157 East 72nd St. Associates,* supra. at note 24.