

# Mortgage Foreclosures for the General Practitioner

By Bruce J. Bergman

## Introduction—Why Read On?

A reader's first reaction to the title of this piece might be, "It isn't for me no matter what;" an unsurprising sentiment. Mortgage foreclosure is recognized as arcane and obscure, usually pursued only by specialists (and some malpractice actions against generalists who took the plunge can cool the ardor of even the boldest). Highlighting the point, foreclosures are addressed by RPAPL Article 13, a reading of which confirms all the trepidation—one certainly could not readily prosecute a foreclosure action relying on the verbiage there. Finally, this writer's three-volume treatise on the subject (which may we immodestly suggest *does* tell you how to do it) is well more than 3,000 pages in length, underscoring that there is indeed vast material to digest in this arena.

But there really are good reasons to launch into this excursion. First, demystifying the topic can render it generally more approachable. Second, even if counsel will not take on a foreclosure case, being able to sagely advise a client at the inception has considerable value. Finally, on most occasions readers encounter foreclosures where their client is a defendant: the property owner or a judgment creditor, junior mortgagee or other lienor whose interest attaches to the property burdened by a mortgage in default. Understanding how to effectively counsel them is certainly worthwhile.

So, what helpful basics can be so *briefly* imparted? We give it a try.

## What Is a Foreclosure About (And What Does It Do)?

For most mortgage lenders, two decisions are involved in making the loan—one business, the other legal. Use as an example the elemental situation of a borrower buying a \$500,000 house with \$100,000 to invest. (It would be essentially the same concept for an entrepreneur who had \$10,000,000 and needed \$40,000,000 to buy a shopping center worth \$50,000,000.) The lender asks, if the borrower fails to pay (defaults on the mortgage), will someone come to a foreclosure sale and pay \$400,000 to buy a \$500,000 house? The answer is "yes" and so the business inquiry is disposed of.

Next, for that business conclusion to always be "yes" in the future, the lender must know the *priority* of its mortgage. Assume the lender proceeds on the

assumption that its position is a *first* mortgage. A required title search will confirm this. (If other liens exist on the property they must be disposed of as a condition of the loan, either to be satisfied or subordinated.)

Once the mortgage is recorded (and except for real estate taxes and a few other uncommon super liens) it is senior to all subsequent mortgages, judgments, etc. In turn, this means that in order to maintain the business/legal status which pertained at the moment the mortgage was executed and then recorded, in any foreclosure action our lender will name in the caption and serve process upon (obtain jurisdiction over) all interest holders later in time to the mortgage.

---

*"[O]n most occasions readers encounter foreclosures where their client is a defendant: the property owner or a judgment creditor, junior mortgagee or other lienor whose interest attaches to the property burdened by a mortgage in default. Understanding how to effectively counsel them is certainly worthwhile."*

---

In that way, anyone who buys at the ultimate foreclosure sale will take title free and clear of all those subsequent liens because those interests will be extinguished by the foreclosure sale. The borrower-owner's title is conveyed (by a referee appointed in the action) and all liens are wiped out to fulfill the expectation that someone would indeed pay \$400,000 for the house worth \$500,000. All this explains why the person in your office named in the foreclosure has come to you for counsel.

## The Right to Redeem

Once the lender declares due the balance of a mortgage, then to proceed to foreclosure (discussed *infra*), it is typically too late to cure the default. It is not too late, though, to redeem, that is, pay off the mortgage in full. That sacred right is available until the moment the property is struck down at the foreclosure sale. Although this concept is usually most vital to the bor-

rower-owner, the right to redeem is available to anyone with an interest in the property.

## Steps in and Duration of the Foreclosure

Unlike litigation generally (likely to follow pleading, discovery and judgment after motion or trial) mortgage foreclosures are ritualized with specific plateaus, each of which must be achieved in order. It is possible to have a better sense of what foreclosures are about with those steps in mind:

- Collection procedures: Various calls and letters from lender to borrower seeking a cure of arrears or whatever the mortgage breach may have been.
- Acceleration: This is critical to the process. In our example, the \$400,000 is payable over the life of the mortgage (perhaps 30 years). But if the borrower defaults—fails to remit monthly installments—the mortgage will invariably authorize the lender to declare the balance due now—to accelerate—so that the monetary obligation which would have been payable over 30 years is due today. Although some mortgages as a matter of contract may allow a reinstatement of the arrears before the foreclosure judgment issues (the Fannie Mae/Freddie Mac uniform instrument for residential loans is a prime example), the law in New York is clear that absent such an agreement, after acceleration it is too late to reinstate. While lenders usually prefer to accept a cure, they are not obliged to do so, and if the borrower has been a chronic defaulter, they may choose to be rid of him.
- Foreclosure search: In order to know who those subsequent junior parties to be cut off in the action are, a search is necessary. (This allows the goal of the foreclosure to be achieved.)
- Summons, complaint and notice of pendency (*lis pendens*): These are the initial pleadings in a foreclosure. Properly drafting the complaint is a subject unto itself, but short comment upon the *lis pendens* here is meaningful. The *lis pendens* serves to bind all subsequent interest holders to the foreclosure as if they had been named and served in the action. So, if after filing the *lis pendens* the borrower sells the property, the grantee will lose the title through foreclosure even though the plaintiff knew nothing of his existence and vice versa. This applies also to all later encumbrancers.
- Default appearance or answer: Both a default and a general notice of appearance (or a notice of appearance and waiver) allow the foreclosure

action to proceed through the stages without interruptions. The notice of appearance requires a notice of motion for later stages; the notice of appearance and waiver permits progress *ex parte*. The answer, of course, raises a supposed issue and must be disposed of for the foreclosure to move forward.

- Order to appoint referee (if default) or motion for summary judgment, or trial, if contested by submission of an answer.
- Referee's computation of sum due on mortgage (*ex parte* if in default); hearing if contested.
- Judgment of foreclosure and sale: This is the stage, which finally authorizes a judicial sale of the mortgaged premises, to be advertised in a newspaper selected by the court.
- Foreclosure sale: an actual auction sale conducted by a referee appointed by the court in the judgment of foreclosure and sale, held (depending on the county) either on the steps of the supreme courthouse, in a designated room in the courthouse or on the steps of the town hall.
- Closing: If purchased by an outside bidder, usually 30 days after the auction. If bid in by plaintiff, referee signs the various papers either at the auction sale or soon thereafter, typically without necessity for a sit-down closing.

If uncontested, in Upstate New York this process consumes approximately seven to eight months. Downstate—the New York Metropolitan area—the time frames are nine to twelve months and often considerably longer. The need to publish the summons (another separate topic), a contested case, bankruptcy filings, appeals, and eve of sale (or earlier) orders to show cause can add months or years to the process.

All this leads to two practical messages. First, when the pleadings are served in a foreclosure, loss of title is hardly immediate. The defendant client should be very concerned, but should not panic about time. There is plenty more to come. Second—and unlike most other litigation—summary judgment does not end the case. It only eliminates the answer and allows the case to go on to further stages. The knee-jerk compulsion to resist summary judgment may not be necessary at all.

## Senior Interests

When the lender addressed the business and the legal decision at mortgage inception, it could have elected to take a second mortgage. For example, if there was a \$300,000 mortgage on the \$500,000 house, and the owner wanted to borrow \$100,000, the security for this

latter sum would be a junior, subordinate (in this instance, second) mortgage. But in a foreclosure upon the second mortgage the scenario of relationships is the same. Will someone pay \$100,000, and the obligation to pay the continuing paramount \$300,000 (totaling, of course, \$400,000) to buy a \$500,000 house? The answer remains in the affirmative.

All this leads also to the point that holders of interests *senior* to the mortgage to be foreclosed are not proper parties to the foreclosure (unless their apparent seniority or the extent of that priority is being challenged). So, for counsel prosecuting a foreclosure, do not name senior encumbrances as party's defendant. If counsel represents a senior lienholder named in a foreclosure of a junior mortgage, consider a motion to dismiss.

### The Critical Concepts of Deficiency and Surplus

In a mortgage transaction, the borrower executes and delivers two basic documents: the mortgage note, which is a promise to pay the debt, and a mortgage, which is the pledge of real property as security for that debt.

Because the borrower signed the note, he is personally liable for the debt and this presents dual concepts to observe. First, the lender could choose to simply sue the borrower for the debt and refrain from foreclosing the mortgage. (Generally, both an action at law on the debt and an action in equity to foreclose cannot simultaneously be prosecuted because it is an election of remedies. This is another thorny subject too long to explore here.) Second, if a foreclosure is the chosen route, if after the foreclosure sale the lender suffers a loss, the borrower could be liable for the shortfall. This is pursued in a post-foreclosure motion per RPAPL § 1371 which delineates the formula to measure the loss. It also imposes a time limit of 90 days to serve the deficiency motion, measured from the time the referee's deed is delivered.

Surplus is the happier reverse of the deficiency. A foreclosing lender is entitled to receive only what is due it pursuant to the judgment of foreclosure and sale (which in turn adopts—or changes—the earlier referee's computation of the sum due). So in our example, if \$400,000 was due the lender, but the house went up in value to \$600,000 so that perhaps \$550,000 was bid at the foreclosure sale, \$150,000 is "left over." That is the "surplus," pursued in a post-foreclosure surplus money proceeding (again another separate subject). All liens cut off by the foreclosure then claim that surplus in order of their respective priority, with the owner the last in line. (If there were no liens, the now former owner takes the entire surplus.)

This recitation of deficiency and surplus leads to two more exigent lessons. First, and rather obviously, it explains a borrower's liability, which is always important. Second, it says something truly compelling about the depth of a foreclosure defense.

With interest on the mortgage accruing daily, the longer the foreclosure action, the greater the quantum of debt. So, slowing up a foreclosure for the sake of delay alone has significant consequences. The growth of interest and legal fees added to the debt inexorably increase the likelihood of a deficiency and decrease the likelihood of a surplus.

Although these undesirable results may be more apparent for the borrower (who is personally liable for the debt), the idea applies to lienors as well. When representing a defendant in an action, an attorney's first instinct is to submit an answer. Make them prove their case. But if a junior judgment creditor, mechanic's lienor, or mortgagee has no genuine defense, imposing time onto the foreclosure merely diminishes (through accrual of interest and legal fees) the amount of possible surplus against which the lienor will claim when the foreclosure concludes. It may seem counterintuitive, but many foreclosure defendants may have a vested interest in assuring that the action proceeds as quickly as possible.

### What Is the Mortgage Debt?

From the plaintiff's side, knowing how much to pursue and collect is an integral component of the foreclosure. From the borrowers' perspective, what their potential liability will be (especially in relation to the value of the mortgaged premises) or what surplus may emerge is equally as important. These things, in turn, are dependent not only upon the value of the property, but the amount of the obligation due on the mortgage.

In addition to principal, here is a short list (there are others, not mentioned) of possible (and often likely) elements of the mortgage debt:

- Interest: From the moment of default until acceleration, interest is at the note rate. After acceleration the rate becomes 9%, unless the mortgage provides for a different rate (i.e., default rate) which it typically does. In part because a default rate cannot be usurious, such percentages can be quite high, sometimes up to 24%—all very meaningful when considering duration of the action.
- Late charges: 2% for each late installment for residential property, usually 5% in commercial cases. Accrual stops with acceleration.
- Legal fees: If the mortgage provides for legal fee reimbursement to the plaintiff in the event of

foreclosure (and most mortgages will) the clause is enforceable. (Legal fees are assessed by the court—not the referee—at the judgment stage, based upon reasonableness.) The more vigorous the defense, the greater are the legal fees incurred by the plaintiff.

- Taxes, insurance, advances: If real estate taxes are unpaid, the property could be taken by the taxing authority and so the mortgagee plaintiff will pay those sooner or later with the sum added to the debt. The lender will also pay for hazard insurance if the borrower allows the policy to lapse. Such payment is made to protect the value of the improvements. If a second or more junior mortgage is the subject of a foreclosure, a senior foreclosure threatens the junior so the subordinate lender may need to reinstate or satisfy the prior mortgage—another expenditure added to the debt. Interest on all these sums accrues at 9% unless the mortgage specifies a higher rate (such as the default rate).

## Conclusion

Although the danger of a brief overview exposes the daunting breadth of the subject,<sup>1</sup> experience suggests that understanding the goals and basics of foreclosure genuinely enables a non-specialist to play a meaningful role. This explanation may serve that function.

## Endnote

1. That there is exceptional nuance to all this should be obvious. In lieu of digesting an entire text of more detail, attention is invited to a lengthier overview in 1 Bergman on New York Mortgage Foreclosures, Chap. 2, Matthew Bender & Co., Inc. (rev. 2006).

**Bruce J. Bergman**, author of the three-volume treatise *Bergman on New York Mortgage Foreclosures*, Matthew Bender & Co., Inc. (rev. 2006), is a member of Berkman, Henoch, Peterson & Peddy, PC, Garden City, N.Y., and an adjunct associate professor of real estate with New York University's Real Estate Institute. He is also a member of the American College of Real Estate Lawyers, the American College of Mortgage Attorneys, and the USFN.

# Your CLE Classroom



- Get the best NY-specific content from the state's **#1 CLE provider**.
- Take "Cyber Portable" courses from your laptop, at home or at work, via the Internet or on CD.
- Stay at the head of your profession with outstanding CLE instruction and materials.
- Everything you need to obtain full MCLE credit is included **online** or **on CD!**

**Come click for CLE credit at:**

**[www.nysbaCLEonline.com](http://www.nysbaCLEonline.com)**

or to purchase CDs  
call 800-582-2452