

Owners Can Stiff The System

Can a borrower refuse to pay real estate taxes, lose the property to the taxing authority - thereby extinguishing the mortgage - and then buy back the property on the cheap, thumbing his nose at the former mortgage holder? Maybe. It is not entirely clear in New York and may or may not be firmer in other states, but is in any event a concept to bear in mind.

So here is the frightening scenario regarding real estate taxes - and yes, it really does happen, more often than would be suspected.

The borrowers are obligated to pay real estate taxes on the mortgaged property. They fail to do so. The lender or servicer is supposed to periodically confirm in-house whether those taxes were paid, but through some glitch (the computer or human error) neglects to do so. Or this task has been outsourced but

Borrowers have figured out they can cheat governments out of taxes, lose their real estate and then repurchase it at bargain-basement prices - legally.

BY BRUCE J. BERGMAN

the tax service somehow does not perform its job.

Lenders and servicers know that they must follow with care the payment of real estate taxes on all mortgaged properties. If those taxes are in arrears long enough, the ultimate result (whether by tax lien sale and issuance of a deed or a tax lien foreclosure action) is that the borrower loses his title and the mortgage is extinguished. That is a draconian result, and must be avoided.

Generally, in most jurisdictions,

real estate taxes are superior to any mortgage, and the reasons should be apparent. Local governments, which depend upon real property taxes to function, and their ability to raise revenue cannot be adversely affected by private mortgage defaults.

Taxes take precedence

After all, if mortgages were superior to real estate taxes, some borrowers would periodically arrange "friendly" foreclosures of their property to wipe out real estate tax liabilities. The system doesn't function that way, and couldn't.

Yes, when property is lost for failure to pay taxes, the lender or servicer can still sue on the note. But it isn't so often that borrowers who have lost their property for taxes (and defaulted on the mortgage) have money or other property exposed upon which to execute.

What happens, though, when a wily borrower then goes out and buys the once mortgaged property, either at the tax lien foreclosure sale or from the taxing authority that took the property back? Does that give the lender or servicer another

shot at going after the property?

The answer (in New York) used to be yes; then it was no; then an exception said yes again, and while one new case agrees with the helpful exception, another one disagrees. A brief explanation by way of explaining the issue follows.

There was from time immemorial in New York a venerable "doctrine of the delinquent purchaser" which held that a landowner who defaults in payment of real estate taxes, and later repurchases the land at a tax sale, does not get a title better than he previously had, because no man may take advantage of his own wrong. And that makes good sense. Equity would view as fraudulent the act of a party who acquired title through defaulting upon his obligations. Under this doctrine, a lender in this situation would be saved. The mortgage apparently cut off by the tax sale survives anew.

Law changed

But in 1983, the tax law in New York changed in such a way that the courts altered their interpretation, concluded that property purchased at a tax sale must produce a final, completely

unassailable title.

That meant that a borrower who defaulted on taxes *could* buy his own property back at a tax sale free of the lender's mortgage, which had been extinguished by that tax sale. (See *Melahny vs. Hearn*.)

Troubled by this, a 1994 case in New York said that because a borrower warrants title to the property, and the mortgage also gives the lender a lien upon *after acquired* property, when that borrower buys his own property back at a tax sale, the mortgage reattaches to the property the moment it is back in the ownership of the borrower.

So although the mortgage had been extinguished by the tax lien sale, the borrower's repurchase resurrects the mortgage as a lien on the property (*Salamanca Federal Savings & Loan Association vs. Darrow*).

That was a lower court decision, and although another lower court



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