BY BRUCE J. BERGMAN

(True) Purchase Money Mortgage and Usury

The twain doesn't meet on this one. Experienced real estate practitioners will immediately observe that there is no possibility of usury upon a true purchase money mortgage, so why bother with this column? Two reasons: not everyone was born knowing every established aphorism and, more significantly, this particular maxim has begotten two aberrant decisions that threaten the legal neatness we all strive to enjoy.

As to the basics, usury generally is one of the more elusive subjects in the real estate arena. But one bedrock concept to be understood is that there can be no usury in the absence of either a loan or a forbearance. That is why usury has no application to interest on default on a mortgage, or to a joint venture investment, or to an advance of funds against recovery in a lawsuit. Payment in the latter instance is uncertain, so it cannot be a real loan.

When a lender lends money to a borrower to purchase a property, it is a purchase money mortgage. But such a loan is not removed from the purview of usury. *Whether* usury might apply in any particular case is a far different question, subject to a number of variables we needn't explore here: among them, the nature of the lender (federally related? licensed mortgage banker?); the nature of the borrower (individual or corporation?); the priority of the mortgage (first or subordinate?); the character of the property (residential or commercial?); the amount of the loan (above $250,000 or $2,500,000?).

The case of a true purchase money mortgage, however, is different, and here the definition is critical: it is a mortgage executed at the time of purchase and contemporaneous with acquisition of title, or afterward, but as part of the same transaction to secure an unpaid balance of the purchase price. Because some cases have missed what should be an apparent distinction, an example in more graphic terms should be helpful. Buyer wants to purchase seller's house for $600,000. Buyer has $100,000 of his own money and has secured a $400,000 purchase money first mortgage from a lending institution, leaving a shortfall of $100,000 to complete the transaction. Buyer asks Seller to "take back" a $100,000 mortgage. Seller reluctantly agrees, but only if the interest rate is 17%. *That* is a *true* purchase money mortgage which by definition[1] is not a loan. Therefore, the 17% interest rate which exceeds the legal rate of 16% (civil usury) applicable to a loan from one person to another becomes irrelevant. There is no loan and so there can be no usury.

This should close the issue and perhaps this is a nice primer for those who may have not yet encountered the concept. Ah, but there is reason to go on. While this subject has been closed since 1968 – with inevitable nuance receiving attention from time to time over the years – a 2004 decision, *Babinsky v. Skidanov*,[2] declares that *criminal* usury can yet apply to a purchase money mortgage. Putting aside the practical consideration of charging interest in excess of 25% (the threshold of criminal usury), we ask, can such a ruling be correct?

We say no, not a chance. But if the Appellate Division says yes, that controls and so we face some variety of conundrum, and a conspicuously unfortunate one.

> We posit that there is no valid basis to hold that criminal usury can apply to a true purchase money mortgage.

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Mindful of the law outlined to this point, what could be the basis for this challenge to such a well-established principle? It seems that casual research has led to a glaring misconception. The offending *Babinsky* decision proclaims the availability of a claim of criminal usury upon a purchase money mortgage based upon citation of earlier authority: *C&M Air Systems, Inc. v. Custom Land Development Group II.*[3] In turn, *C&M* is founded upon a host of cases, all of which support the proposition that there is no usury for a purchase money mortgage and none of which cite retained applicability of criminal usury. Even *C&M*'s mention of Penal Law § 190.40 offers no authority because criminal usury by the very terms of the cited statute requires a loan or forbearance. Since the true purchase money mortgage is not a loan (as the Court of Appeals has consistently so ruled), the Penal Law plays no role.

There can be some recondite speculation as to the source of the First Department's miscue here but it is too lengthy to fit and too obscure to be very helpful. Suffice to say, we posit that there is no valid basis to hold that criminal usury can apply to a true purchase money mortgage. Where this leaves the topic is in the philosophical dilemma mentioned earlier. It can't be so, but the Appellate Division says it is; hardly helpful for real estate practitioners. ■

1. Certainly by case law: see, among other cases, *Mandelino v. Fribourg*, 23 N.Y.2d 145, 295 N.Y.S.2d 654 (1968).

2. 12 A.D.3d 271, 784 N.Y.S.2d 540 (1st Dep't 2004).

3. 262 A.D.2d 440, 440–41, 692 N.Y.S.2d 146 (2d Dep't 1999).

"In my opinion, the flimsy construction of their homes indicates the pigs' desire to be eaten."