Can You Call the Mortgage for Taxes?

By Bruce Bergman

With foreclosures at epidemic proportions, and with real property taxes an ever increasing factor in property ownership, a frequently encountered mortgage's query is whether he may foreclose because the mortgagor hasn't paid the taxes. The reverse is the equally vexing inquiry of the mortgagor as to whether he can be the object of the foreclose because he has not paid his taxes. Either way, the answer is "perhaps" (it depends upon the circumstances), although more often it is "no."

Requisite Background

Whether you are lender or borrower, when money is loaned upon real property, two documents are executed. The note or bond is the promise to pay, and the mortgage is the security for the promise. Whatever else the documents may be, they are a contract, and both parties should be able to assume that they may rely upon the enforcement of the contract according to its terms.

When there is some failure to comply with those terms, the mortgagee can be expected to invoke the acceleration clause. The standard title company form of this provision, as it relates specifically to taxes, states: "That the whole of said principal sum and interest shall become due at the option of the mortagee:... after default in the payment of any tax, water rate, sewer rent or assessment for thirty days after notice and demand..."

The most common default encountered is for failure to pay principal and interest. When that occurs, although the case law holds that the standard acceleration - unless the mortgage specifically so provides. The mortgagee must simply do some overt unequivocal act to demonstrate the acceleration. This could be a letter setting forth the accelerating or the institution of the foreclosure action itself.

In oft-quoted language, the basic view of the courts is that a mortgagor is bound by the terms of his contract and cannot be relieved of his default in the absence of waiver by the mortgagee, estoppel, bad faith, fraud, or oppressive or unconscionable conduct. Even one day after the grace period has expired, the cases have ruled that an aceleration for default in paying principal and interest is valid. Whatever waiver, bad faith, fraud, etc. are construed to be, they are rarely found to exist, and strictly insisting upon contractual rights does not usually fall into any of those categories.

The Special Situation of Taxes

If the mortgage contract provides that a failure to pay taxes after notice is a basis to accelerate and then foreclose - as is usual - the parties to the contract would assume that the language means what it says. However, the courts have not necessarily agreed. Indeed, a careful analysis of all the reported cases in this area reveals that acceleration is disallowed about twice as often as it is permitted!

The theory upon which the courts proceed was most cogently explained by Justice Cardozo in a famous dissenting opinion. His position was that a clause authorizing accelertion for default in principal and interest is part of the prescription of the terms of payment of the *primary* obligation and will be enforced as written. This does not represent penalty or forfeiture, but simply fixes the maturity date by agreement.

However, a requirement to pay taxes stands upon a *different* footing. It does not require paying anyting to the mortgagee. Rather, it is a collateral undertaking designed to protect the mortgagee against the impairment of his security by the accumulation of unpaid tax liens having priority over the mortgage. The acceleration clause as it relates to defaults in paying taxes is designed for the same ultimate purpose - to deter the mortgagor from impairing the security. Therefore, a court of equity - and foreclosure is deemed to be what is called an equiry action - has the power to examine the circumstances and relieve from the default if warranted.

Yes For Acceleration

Despite the cited judicial position, there *can* be acceleration for failure to pay taxes although the fact patterns will vary.

In a 1930 case, the taxes were due on November 1. Numerous demands were made upon the mortgagor during December to pay the taxes. On January 4, a 15-day notice to pay was sent. When the period expired. the foreclosure papers were served on January 29. Although the taxes were actually paid on January 30, the court upheld the acceleration.

In a 1933 ruling, taxes for an entire year were unpaid. The mortgagor argued the tough depression times as a basis to declare the foreclosure "unconscionable." The court disagreed and allowed the foreclosure.

Where a mortgagor offered as an excuse that taxes were unpaid because he was entitled to a tax exemption, the court rejected the argument.

In a 1971 decision, timely notice of tax default was given to the mortgagor, but he "willfully" continued his default. The fact that the mortgagee had indulged prior tax defaults was found of no moment because the notices sent in this case were clear and unequivocal. The court deemed the mortgagee's acceleraiton therefore not to be bad faith or oppressive and noted that sympathy was best left for the legislature.

Where the mortgagor's excuse for failure to pay a full four quarters of New York City real property taxes in 1971 was that all rent were collected by rent strikers, the court allowed the acceleration.

In another case, three quarterly installments of City real property taxes were open so the bank accelerated on February 23. On March 1, the mortgagor made a tax payment byt only of *one* past due installment. moreover, the mortgagor had already collected the taxes from its tenant. Therefore, the court concluded, the default was continuous and uncured, and the foreclosure was allowed.

There are other cases supporting foreclosure for tax defaults, but not many. The fairly consistent elements found where foreclosure *is* allowed are:

- tax defaults are substantial;
- notice is timely and clearly given;
- attempts to cure are either non-existent or obviously insincere; and
- the excuse is not creditable. (This latter factor is vital because as will later be discussed, if there *is* a good excuse, the courts will lean to avoid foreclosure.)

Although not every case contained each element, those are the basic minimums which have to be put forth if a mortgagee has any expectation of accelerating the balance for failure to pay taxes.

No For Taxes

Just how far the courts hasve gone to avoid foreclosure for tax defaults is best demonstrated by briefly examining some of the fact pattern in leading cases.

As early as 1891 the courts showed sympathy for tax defaults. There was a sewer assessment due in March of 1886. Based upon non-payment thereof, the plaintiff began the foreclosure in April of 1887. The defendant claimed she only learned of the tax default the day before the service of the summons and complaint at which time payment was made and that in any event, the failure to pay was attributable to the negligence of her son. The court concluded that there could be no inference of the defendant's desire not to pay taxes, and the failure to do so was therefore not willful neglect. Finding in addition "no prejudice" to the plaintiff, the forecloure was dismissed.

In a 1908 case, the tax clause in the mortgage obligated the mortgagor to discharge all taxes "as soon as they became due and payable." Taxes were due on October 7. The taxes not having been paid, on the following day the mortgagee paid them and accelerated the mortgage. The mortgagor argued that taxes were to be paid by her tenant, that she was unaware of the default on October 7, and that when she was served with process, the tax arrears were tendered, although rejected. In voiding the foreclosure, the court took judicial notice of a great financial depression in October of 1907. The court felt that the mortgagee had not dealt fairly with the mortgagor - the terms of the mortgage notwithstanding - and invoked the principles of equity in ruling against the plaintiff.

An extraordinarily sympathetic position was taken in a 1933 case. There, the mortgage contained the usual provision of acceleration for 30-day default in tax payment. The mortgagee gave oral notice of the default, which was valid pursuant to the mortgage. The resultant tax lien was sold by the county and purchased by the plaintiff. Only after the foreclosure was begun did the mortgagor tender the taxes.

In ruling for the mortgagor and declining to allow the foreclosure, the court made the following observations:

- The mortgagors were foreigners and lacked understanding of English and of governmental procedures.
- The sheriff had told they still had six months to pay the taxes.
- Principal and interst were still current.
- The economic conditions facing the agricultural community were especially difficult.
- Based upon all the factors, the tax default could not be considered willful and therefore equity would provide relief.

In a case where the evidence showed that the plaintiff agreed to forbear in the face of a clear tax default and did not give notice of his

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intention to wait no longer, foreclosure was disallowed.

Another case applying the principles of equity had these facts. A mortgagor was in default in paying taxes. The mortgagee sent a letter advising him that there was an acceleration clause and asking when the taxes would be paid. The defendant answered that if approved, payment would be made on August 7. The response was a filing of the foreclosure papers with the county clerk on August 16. On the day process was served the taxes were finally paid. Equity granted relief. The court found the default to be "merely technical," no prejudice to the plaintiff, and the plaintiff's conduct to be "oppressive."

In a 1965 case in Suffolk County, the mortgage provided that there could be acceleration for failure to pay taxes within 30 days from the date they became *due and payable.* The taxes here were due on May 10, but could be paid without penalty until May 31. The plaintiff accelerated on June 10 in the face of a clear tax default. In denying the foreclosure, the court held that thirty days had to expire from the last day the taxes could have been paid without penalty. Hence, this foreclosure was premature.

A 1979 ruling in Brooklyn is a further example of judicial leniency concerning tax defaults. Unlike the usual language, this mortgage required no notice of failure to pay taxes. Admittedly, the mortgagor neglected to pay three quarterly installments of taxes and water charges totalling in excess of $2,000. As a consequence, the mortgagor began the foreclosure and only *after* the action was started were the taxes paid. In ruling for the mortgagor, the court said that although no notice was required under the mortgage contract, it is a warning "customarily" given and there *would* be deemed a prerequsitie. In also relied upon the default being excusable due only to inattention, all with no damage to the lender.

Conclusion

It should be quite apparent that courts are loath to permit a foreclosure based upon failure to pay taxes. It *may* be permitted where the quantum or the default is significant, where the failure to pay appears willful, and where either no attempt, or a halfhearted attempt, to tender tax arrears has been made. Even assuming all those elements, the mortgagee is well advised to note these points.

- If the mortgage provides for notice of default and an opportunity to cure - which is usual - timely notice must be given, clearly, unequivocally and in writing lest there be a question of fact as to whether an oral notice has been given.

- Where the mortgage sets forth a period to cure, normally 30 days, any attempt to accelerate or begin foreclosure prior to expiration of the period will be premature.

Viewing the issue from the mortgagor's vantage point the comforting concepts are:

- A default in paying taxes is a collateral obligation to the mortgage and is only a "technical" default. Thus, equity will provide relief if the circumstances warrant.

- Almost any colorably sympathetic circumstances may provide relief where:

(i) There may have been a waiver of forbearance by the mortgagee; and/or

(ii) Principal and interest are otherwise current; and/or

(iii) Failure to pay taxes was not willful but was excusable as due to venial inattention or error; and/or

(iv) Notice was not given or, if given, was not unequivocal; and/or

(v) If notice was given, no opportunity to cure was provided; and/or

(vi) There is no damage or prejudice to the mortgagee; and/or

(vii) Mortgagor has tendered the arrears or has ligitimately attempted to, even after foreclosure has begun.

Obviously, there are so many factors, or combinations of factors, that courts locate and use to rule against foreclosure for tax defaults that one may conclude that if the court can deny foreclosure in this area, it will.

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Huberth & Peters Arranges Pennsylvania Apartment Complex Sale

Huberth & Peters, Incorporated has arranged the sale of the 224-unit apartment complex known as the Village of Pickering Run in Phoenixville, Pennsylvania. The 14 two-story buildings are approximately 12 years old and are located 30 miles northwest of Philadelphia.

The complex was purchased for $3.25 million by Pickering Run Limited Partnership for all cash above the long-term first mortgage.

The sale was negotiated by David Benney, a Huberth & Peters vice president.

Seminar Will Consider Bankruptcy Code

Strategies for handling real estate problem loans in light of the Bankruptcy Code will be examined at a seminar entitled "Bankruptcy Code and Real Estate Lenders" on Feb. uary 17 and 18 at the Grand Hyatt Hotel. The Practising Law Institute, the oldest and largest national continuing legal education organization, is the sponsor.

The seminar features a transactional analysis of the methods used to minimize economic losses including an examination of accounting and tax treatments for the various settlements that are available to both borrowers and lenders.

The faculty will focus primarily on permanent, construction, and lease-hold mortgages and will include situations in which the lenders has some form of ownership or participation interest in the appreciated value of the property. They will also cover documentation methods that take into account the Bankruptcy Code's effect on real estate transactions.

Richard A. Gitlin of Herb & Gitlin, P.C. Hartford, will chair the seminar. The faculty includes Laurence D. Cherkis of Wachtell, Lipton, Rosen & Katz, Howard J. Lazarus of Trubin Sillcocks Edelman & Knapp, Harvey R. Miller of Weil, Gotshal & Manges, Robert J. Rosenberg of Moses & Singer, and Robert A. Wayne of Robinson, Wayne, Levin, Ricciardi & LaSala (Newark).

The fee for the seminar, including the course handbook, is $350. For those unable to attend, the books sells for $30. For further information, contact Nancy B. Hinman at the Practising Law Institute, 810 Seventh Avenue, New York 10019 or call 765-5700.