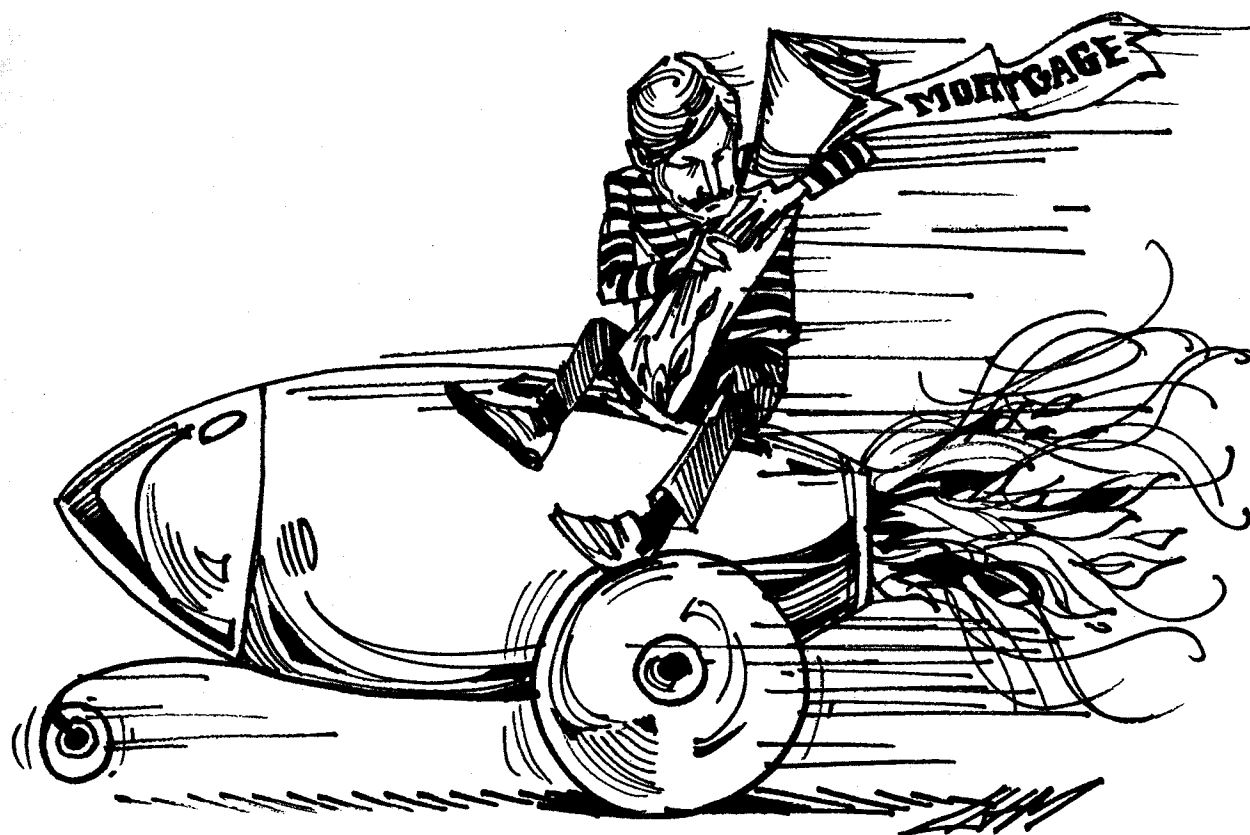


*Probably not, says this review of court rulings.*

# Can the Mortgage Be Accelerated for Unpaid Taxes?

*Bruce J. Bergman*



**W**HEN A PROPERTY OWNER finances his purchase by giving back a mortgage to a lender, the latter has a vital interest in being assured that real property taxes are paid because the lien of a mortgage may be divested by municipal taxing authorities if taxes are not timely paid. Because this is so critical, most institutions that lend to households escrow for taxes so that they retain control over tax obligations.

However, institutional lenders sometimes do allow the owner to pay taxes directly. Moreover, many non-institutional lenders, particularly private parties who take back a purchase money mortgage, abdicate this responsibility to the owner.

Although mortgagor-owners also have a vested interest in paying real property taxes, particularly when multiple taxing jurisdictions are involved, they may become delinquent in tax payments for any number of reasons. Due dates can be missed because of clerical errors, for example, or, when cash flow is a problem, an owner may have to choose between a mortgage pay-

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ment, maintenance requirements, or tax obligations and, since tax dates and procedures usually have liberal grace periods, the owner may make a conscious choice to forgo the taxes.

#### COLLECTION OF DELINQUENT TAXES

The procedures by which taxing authorities collect delinquent taxes vary among jurisdictions, but two systems predominate.

New York City, as an example, uses an "in rem" method. One year after the lien date for a particular tax on a commercial property, the property is listed "in rem."<sup>1</sup> The City gathers all properties so situated and files a *lis pendens*<sup>2</sup> against those properties. A proceeding is begun which makes it possible, approximately six months later, for the treasurer to deed the property to the City. The owner loses his property and the lien of the mortgage is extinguished. Although the owner is given a one-year period in which to redeem, the consequences of failure to pay the taxes are quite significant.

Perhaps a more common enforcement device is the sale of tax liens. After taxes are unpaid for whatever period may be provided by local statute, the taxing jurisdiction advertises liens on delinquent parcels for sale. Suppose, for example, \$100,000 of real property taxes are outstanding on an apartment complex. Anyone may buy the lien by paying the \$100,000 to the taxing authority. The lien buyer has the right to collect interest, which is usually quite substantial, plus the principal.

The property owner, mortgagee, tenant, or some other party with an interest defined by local statute may pay the principal sum plus interest to the lien buyer before the expiration of a specified period, typically one or two years. At the end of that time, the lienholder may give the parties entitled to redeem the lien one last chance to pay by sending what is in many areas referred to as a "notice to redeem." If none of these parties chooses to redeem, the treasurer (or other municipal officer given the power) issues a deed to the lienholder.<sup>3</sup> The owner loses his property and the mortgage is wiped out. The importance of paying the real property taxes is therefore quite readily apparent.

<sup>1</sup> For residential property, the period is three years.

<sup>2</sup> This is a document filed with a municipality's recording office (county clerk, city register, etc.) that serves notice to the world that title to the property is subject to a claim.

<sup>3</sup> Any discussion of tax collection procedures through all tax collection jurisdictions in the United States could not be complete without studying the specific provisions of every statute. Time periods for payments, lien dates, redemption, etc., and the nuances of the methods, differ for each city, county, or village. Our present interest is not in precise procedures, but in the effect of the failure to pay. Local statutes should always be consulted for technical requirements.

#### ACCELERATION—GENERALLY

Lenders have relied upon acceleration to protect themselves against the possibility that the mortgage's lien may be extinguished by some default of the borrower. In essence, the acceleration clause provides that the holder of the mortgage may declare the entire principal balance immediately due and payable upon the occurrence of certain events that are enumerated in the mortgage. These events may be either acts of omission or of commission by the mortgagor, including failure to pay an installment of principal or interest (or both), neglect to keep the premises insured or in proper repair, the making of unauthorized alterations or demolitions, or refusal to cure municipal violations.

The most common default is failure to pay principal and interest. When that occurs, the attentive mortgagee demonstrates his election to accelerate by some overt unequivocal act, either by sending a letter or by actually instituting the foreclosure action.<sup>4</sup>

When the courts are called upon to make judgments about defaults in principal and interest, they are virtually unanimous that a mortgagor is bound by the terms of his contract and cannot be relieved of his default in the absence of waiver, estoppel, bad faith, fraud, or oppressive or unconscionable conduct. Although this list of the factors that may grant relief appears to be extensive, these factors are not a ready source of comfort for the mortgagor.

For example, the mortgagor's typical claim of waiver argues that the mortgagee accepted late payments on a regular basis in the past and therefore caused the mortgagor to conclude that late submission would always be accepted. But this is a difficult point to prove and the courts rarely accept it. Similarly, the courts have generally ruled that accelerating the balance for default in principal and interest only one day after the grace period has expired is valid and not deemed to be oppressive or unconscionable.

Hence, although there are defenses, which may under unusual fact patterns be upheld, acceleration is quite strictly enforced when the default is a failure to make timely mortgage payments.

#### TAX DEFAULTS DIFFER FROM PAYMENTS DEFAULTS

A standard form of acceleration clause provides: "That the whole of said principal sum and interest shall become due at the option of the mortgagee: . . . after default in the payment of any tax, water rate, sewer rent or assessment for thirty days after notice and de-

<sup>4</sup> Although rarely encountered, some acceleration clauses are self-executing by their own terms, in which event no overt act to assert the election is necessary. Obviously, though, the mortgagee seeking to enforce must begin the foreclosure.

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mand. . . .” The effect of the cited language should be clear. There is a contract and the parties to the contract would expect that it means what it says. If there is default in paying any item listed *and* the mortgagee gives notice and makes demand that such item(s) be paid within thirty days *and* if compliance is not forthcoming, acceleration should be enforced.

However, the courts have not necessarily agreed. How this squares with the strict approach that courts have taken concerning principal and interest defaults is important. The courts view a clause authorizing acceleration for default in paying principal and interest as part of the prescription of the terms of payment of the *primary* obligation that must be enforced as written. It is not a penalty or a forfeiture, merely a fixing by agreement of the maturity date.

A requirement to pay taxes, however, stands upon a different footing. It involves no payment to the mortgagee. Rather, it is a collateral undertaking imposed to protect the mortgagee against impairment of his security by the accumulation of unpaid tax liens that have priority over the mortgage. Foreclosure is an equity action and a court of equity has the power to examine the circumstances and relieve from the default if it will achieve a fair result. To appreciate the divergence of mortgagee/mortgagee interests and the development of court attitudes toward enforcement of the acceleration clauses when a tax is not paid, one must examine the fact patterns in actual cases.

### SOMETIMES ACCELERATION FOR TAXES IS ALLOWED

Although the courts most assuredly treat tax defaults differently from a failure to make a mortgage payment, there has been acceleration for failure to pay taxes.

In one case, taxes were due on November 1. Numerous demands for payment were made through December. On January 4, a fifteen-day notice to pay was sent. After 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 1930s case, an entire year's taxes were unpaid. The mortgagor argued the difficult economic depression conditions as his excuse and asked the court to declare the foreclosure to be unconscionable. The court disagreed and allowed the foreclosure.

When another mortgagor's excuse was his purported entitlement to a tax exemption, the court rejected the argument.

In a more recent case, a mortgagor “willfully” continued his default in the face of timely notice to pay. Although the mortgagee had indulged prior tax defaults, the notices in this case were deemed clear and unequivocal. Hence, the court found the acceleration

not to be oppressive or in bad faith and relegated the sympathy factor to the legislature.

There was one case in which a mortgagor's excuse for a year's default in taxes was that the property's rents were collected by rent strikers and withheld from the landlord. The court was not impressed and allowed the foreclosure.

In still another case, three installments of quarterly tax were unpaid. The bank accelerated on February 23. On March 1, the mortgagor made a tax payment, but only of one overdue installment. Although it paid only the one installment, the mortgagor had already collected full taxes from its tenant. Based upon those facts, the court concluded that the default was continuous and uncured, sufficient to support a foreclosure.

Despite the evidence of the cases cited, there are even more cases in which the courts ruled against allowing the foreclosure. The cases in which foreclosures were permitted displayed some fairly consistent elements in the facts:

- The defaults were substantial.
- Notice was timely and clearly given.
- Attempts to cure either did not exist or were patently insincere.
- The excuse was not credible.<sup>5</sup>

Although not every case in which the courts allowed acceleration for taxes contained each element, most or all of these elements must be present if a mortgagee is to have any hope of foreclosing when taxes are not paid. Conversely, the owner-mortgagor may assume that a foreclosure against him will not be successful if some combination of the cited elements does not emerge from the facts of the case.

### ACCELERATION FOR TAXES IS FREQUENTLY DISALLOWED

As early as 1891, the court showed sympathy for tax defaulters. A sewer assessment was due in March 1886. Based upon nonpayment thereof, the plaintiff-mortgagee began foreclosure in April 1887. The defendant claimed she only learned of the tax default the day before service of the summons and complaint, at which time she made payment. In any event, she attributed the failure to pay to the negligence of her son. The court concluded that there could be no inference that the defendant did not desire to pay taxes, and the failure to pay was therefore not willful neglect. Finding in addition “no prejudice” to plaintiff, the court dismissed the foreclosure.

<sup>5</sup> This last factor is critical. As we will examine later, if there is a valid excuse, the courts seek to avoid foreclosure.

In a 1908 case, the tax clause in a 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, the mortgagee paid them on the following day 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, tax arrears were tendered, although rejected. In voiding the foreclosure, the court took judicial notice of the existence of a great financial depression in October 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 another depression-era decision. There, the mortgage contained the usual provision of acceleration for thirty-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 mortgagors tender the taxes.

In ruling for the mortgagors and disallowing 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 them they still had six months to pay the taxes.
- Payments of principal and interest were 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 in which the evidence demonstrated both that the plaintiff agreed to forbear in the face of a clear tax default and that it had failed to give notice of its intention to wait no longer, foreclosure was disallowed.

In another case in which the principles of equity were applied, these facts were elicited: When the mortgagor defaulted paying taxes, the mortgagee sent a letter advising that there was an acceleration clause and

asking when taxes would be paid. 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 that the default was "merely technical," that there was no prejudice to plaintiff and that plaintiff's conduct was "oppressive."

A final example of judicial leniency concerning tax defaults was a case in which the mortgage, contrary to the usual language, provided that the mortgagee could accelerate without giving mortgagor notice of failure to pay taxes. When mortgagor neglected to pay three quarterly installments of taxes and water charges, the mortgagee began the foreclosure. The taxes were then paid after the action was begun. In ruling for the mortgagor (against foreclosure) the court found that although no notice was required under the mortgage contract, it is a warning "customarily" given, and the court therefore deemed it to be a prerequisite. The court then noted that the default was excusable, due only to inattention, and it had caused no damage to the lender.

## CONCLUSION

It should be quite apparent that courts are most reluctant to permit a foreclosure based upon failure to pay taxes. They *may* permit foreclosure in cases in which the quantum of the default is significant, the failure to pay appears willful, and the borrower has made either no attempt or only a halfhearted attempt to tender tax arrears. Even if the case contains all these elements, the mortgagee is well advised to act carefully.

If the mortgage provides for notice of default and an opportunity to cure (which is usual), the mortgagee must give timely notice, clearly, unequivocally, and in writing, lest there be a question of fact as to whether an oral notice has been given. In cases in which the mortgage sets forth a period to cure (normally thirty days) any attempt to accelerate or begin foreclosure prior to expiration of the period will be premature.

Mortgagors can generally feel fairly certain that the courts will apply the following comforting concepts to their defaults. A default in paying taxes is a default of a collateral obligation to the mortgage and is only a "technical" default. Equity will provide relief if the circumstances warrant. Almost any of the following circumstances may elicit the court's sympathy and may provide relief:

- There has been a waiver or forbearance by the mortgagee;
- Principal and interest are otherwise current;
- Failure to pay taxes was not willful but was excusable as due to venial inattention or error;

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- Notice was not given or, if given, was not unequivocal;
- Notice was given but no opportunity to cure was provided;
- There is no damage or prejudice to the mortgagee; and/or
- Mortgagor has tendered the arrears or has legitimately attempted to, even after foreclosure has begun.

As previously noted, a mortgage is a contract. Normally, if the language of a contract is clear and unambiguous, it is treated as sacred. But that is obviously not the case for tax default clauses of a mortgage. There are so many factors, or combinations of factors, that courts employ to rule against foreclosure for tax defaults, that one may conclude that if a court can deny foreclosure for tax default, it will do so. This certainly takes some pressure off owners, but it is a perplexing and continuing problem for lenders.

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