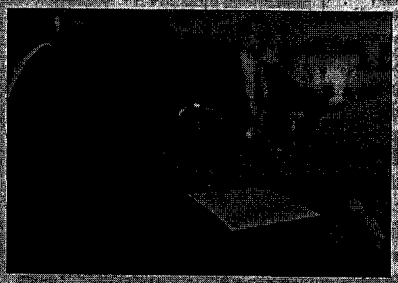
Unpaid Taxes Imperil The Mortgage

Mortgage holders can protect their interests, as well as the borrower's, by the simple action of making the payments to the tax recipients themselves.

BY BRUCE J. BERGMAN

Servicers recognize, of course, that real estate taxes have to be paid on mortgaged property. While in some states, and some areas of states, the sums can be minor, in other states the amounts can be huge. Exorbitant amounts aside, the key concept is the necessity of paying those taxes to avoid the otherwise unacceptable consequences of failure to pay.

What are those terrible consequences? Well, the borrowers lose their title. That is certainly awful,



but from the lender or servicer's vantage point, the real peril is that when the title is lost, so too is the mortgage.

Obviously, then, real estate taxes need to be paid and servicers have a vital interest in assuring this is accomplished. For first mortgages, at least, the standard method to be certain of payment is for the lender or servicer to maintain an escrow for taxes.

So long as mortgage payments continue, the tax account is funded and the mortgage holder can be sure real estate taxes are paid because it is the one actually remitting the sums to the various taxing authorities. (Of course the mortgagee could err and fail to make the payments, but that type of mistake is uncommon.)

Not infrequently, mortgage holders will outsource the tax payment function to a third party which provides that service. While errors there are likewise an exception, no system is infallible.

If for some reason the lender or servicer does not escrow for taxes, such as for special customers, among other reasons, then protection is afforded only by vigilance in obtaining tax searches to confirm whether the borrower is paying the required sums to the municipalities.

If the borrower has been neglectful, then the lender or servicer can avoid ultimate extinguishment of the mortgage by advancing the unpaid taxes.

That the borrower failed to pay those taxes (typically after notice of that default) is itself a basis to institute a foreclosure. Or the mortgagee could add the tax advance to the sum due from the borrower and, if not paid, the foreclosure cause of action becomes the more usual default in payment.

Should the lender pay the open taxes, and if so, when?

To some extent, answering these questions becomes a business decision as well as a strategic look at how long the servicer's own foreclosure (if one is to be pursued) will take.

To explain, if there is a foreclosure, and the action is likely to be completed before the taxing authority can take the property (and wipe out the mortgage), then the servicer might choose not to advance the taxes, but rather pay them out of the proceeds of the foreclosure sale. In that way, someone else actually pays the taxes, and the money to fund those sums never left the servicer's account.

Foreclosure race.

Eventually, of course, whatever efforts the taxing authority takes will run their course and then loss of the mortgage will occur. Therefore, assessing the race for the servicer to foreclose against the efforts of the taxing authority becomes very im-

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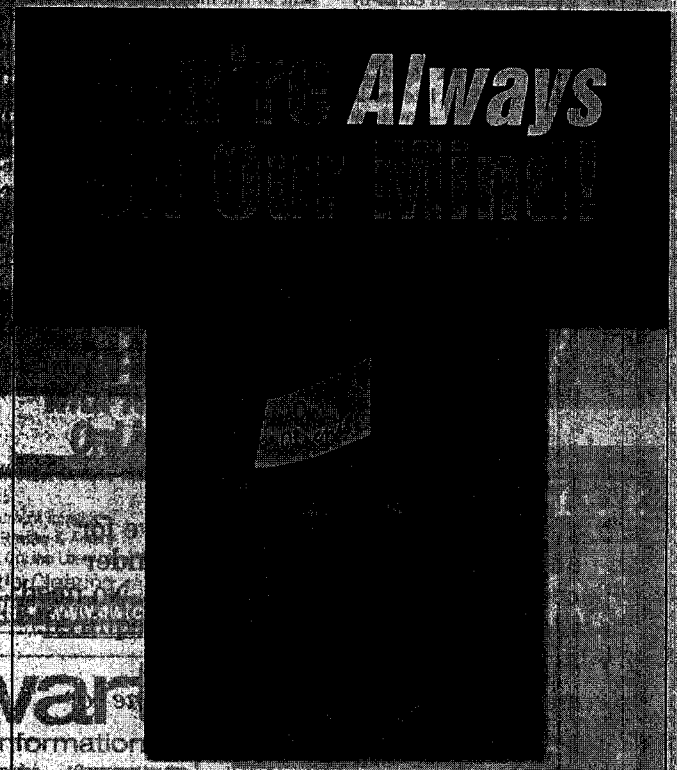
portant and a servicer may not want to take any chances. Obviously, one way or another, those taxes have to eventually be paid by someone, or the secured property will eventually

It is apparent, then, that taxes do not necessarily have to be paid sooner, rather than later. A servicer could wait until the last minute and pay at that moment to save the property and the mortgage. The issue to



weigh in this regard is the relationship between the amount of default interest accruing on the tax arrears against the rate of return borne by money remitting in the servicer's account.

To be sure, default rates upon overdue taxes will vary throughout all the taxing jurisdictions in all the states. But some rates clearly can be a burden, and therefore determining the applicable rate is a factor to consider.

Enforcing obligations

How do the taxing authorities enforce the tax obligations and ultimately take someone's property and extinguish a mortgage? This too varies, but using New York as an example, many taxing authorities sell tax liens either to outside parties or to themselves. In turn, the tax lien is enforced either by a tax lien foreclosure action or by taking title simply by sending a notice to redeem the property owner and to all parties listed as having an interest in the property, including mortgage holders.

The tax lien foreclosure method is time consuming because it is, after all, pursued in the form of a mortgage foreclosure and servicers are painfully aware of how lengthy such actions can be in New York. The notice to redeem method, on the other hand, is something measured in months after whatever applicable statutory period has expired. So these time frames as they apply whenever the issue is encountered is another relevant inquiry.

How dangerous can all this be, a servicer might ask. If municipal taxing authorities are mandated to give some notice of delinquent tax liens to mortgage holders? If the notice is sent to the mortgagee and seen by a staff member who understands the significance and then comes it through the proper channels so the necessary response issues, there is little or no danger.

Unfortunately, particularly given the volume of letters and documents received daily by typical mortgage servicers, even a paper as critical as notice of a tax default could be misplaced or otherwise go astray. Employees can make mistakes, or go on vacation or not understand the importance of a document or be substituting for someone in another department, etc.

> *The threat that failure to pay taxes imposes upon a mortgage holder is a very serious one*

Even more insidious is the instance of a mortgage that is sold for which the assignment of mortgage has not yet been recorded. (Sometimes the assignments never issue, or having been issued, are lost or misplaced, just as a tax lien notice could be.) So when the taxing authority does a search to determine who is to receive notice of unpaid taxes, that correspondence goes to the former mortgage holder, the assignor, not to the assignee.

Will it be forwarded?

Then the question becomes whether the assignor will forward the notice. Its records may show no such loan and the notice can be discarded. Or if forwarded, it can suffer the same fate it might have received had the notice been sent directly but where some employee is less than diligent. And yes, there are often various redemption periods for defaulted taxes. But if a notice is never treated with the proper level of awareness, those redemption or grace periods will ultimately expire.

In monitoring different redemption periods and different methods of enforcement, it should be apparent that each taxing jurisdiction can

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inbound customer service calls. The list is seemingly limitless, Proctor says. And it builds a rate that allows vendors to give away outsourcing. Plus, the servicer has moved a cost unit out of its operation. Price for explains, but who is paying for that? The small percentage of force-placed insurance borrowers? Investors? Those force-placed costs are piled on top of their requisite cost cases. The borrower is in a sense subsidizing those who are placed. So

I would just caution servicers to be aware of that and make sure that [illegible] they're going to be in the [illegible] Proctor says. Those costs of outsourcing are being passed on to that insurance rate? [illegible] are moving into.

[illegible] tax services. [illegible] Those services [illegible] force-placed insurance that is unlike anything else. With the former outsourced arrangements, the servicer bears the cost after weighing prices from different vendors. Conversely, by virtue of a rate that has been inflated through subsidized services, borrowers assume the brunt of force-placed insurance costs.

All things considered, a few things are certain. "We need to be vigilant about the rates and managing our catastrophe exposure," Nelson says. "We need to make sure we maintain our underwriting credibility and don't get caught up in trying to squeeze a few more pennies of profit."

Proctor offers another slice of philosophy. "The purpose of force-placed insurance should be to protect the asset of the insured, which is the bank, and provide an incentive for the borrower to go get their own insurance and take care of what they should have done originally." SM

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