BRUCE J. BERGMAN*
Carl Place

When the Mortgagor Defaults in Real Property Taxes

The author detects a certain judicial leniency in favor of mortgagors who fail to pay real estate taxes. Since this is an important subject to lenders as well as to borrowers and home owners, our readers will find the author's views significant on the subject.

Introduction

If the mortgage so provides, certain defaults by the mortgagor, whether acts of commission or omission, give the mortgagee the option to declare the entire outstanding balance of principal and interest immediately due and payable. Such a right is found in the portion or portions of the mortgage referred to as the acceleration clause or clauses.[1]

Clearly, the most common default is that in paying principal and interest, for which rather strict standards are imposed allowing the mortgagee to accelerate and foreclose.[2] Somewhat inexplicably, the standards imposed for a default in paying taxes (and related items) are more liberally employed, which can be a considerable source of consternation and uncertainty for mortgagees, while a comfort to mortgagors.

When a lender takes back a mortgage, it has a vital interest in assuring that real property taxes are paid, because the lien of a mortgage is subject to being divested by municipal taxing authorities if tax obligations are not timely discharged. Consequently, most institutional lenders will escrow for taxes so control over tax obligations is maintained.

There are instances, however, where even the institutional lender may allow the mortgagor to pay taxes directly. Moreover, some non-institutional lenders, as well as the seller of property who takes back a purchase money mortgage, may abdicate this responsibility to the owner.

Background - Tax Procedures

The danger of divestment is a peculiarly recondite area of statutory and case law, often difficult to locate. While there is a set procedure for the issuance of tax titles (which extinguish the mortgage) in RPTL Articles 10 and 11,

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* BRUCE J. BERGMAN, a partner in Roach & Bergman, Carle Place, New York, has been an Adjunct Assistant Professor of Real Estate with the Real Estate Institute of New York University, Chairman of the Real Property Law Committee of the Nassau County Bar Association and a contributing editor to *Mortgages and Mortgage Foreclosure in New York.*

[1] In the standard New York Board of Title Underwriters (NYBTU) form in wide use throughout New York State, these are paragraphs 4 and 14.

[2] *Graf* v. *Hope Building Corp.*, 254 N.Y.1 (1930); *Ferlazzo* v. *Riley*, 278 N.Y. 289 (1938); *Stith* v. *Hudson City Savings Bank*, 63 Misc. 2d 683, 313 N.Y.S. 2d 804 (1970); *Armstrong* v. *Rogdon Holding Corp.*, 39 Misc. 549, 247 N.Y. Supp. 682 (1930); *inter alia.*

scores of taxing jurisdictions have their own local codes and statutes, often subject to amendments which may be hard to find.[3] By way of example, New York City uses the in rem method. For a commercial parcel, one year[4] after the lien date for a particular tax, the property is listed "in rem," which means the City gathers all delinquent properties and files a lis pendens against them. A proceeding is begun whereby some six months later the property is deeded to the City by the City Treasurer. Although the mortgagee has a one year period to redeem the property by paying all the taxes, the mortgage has been extinguished.

A more widely used procedure is by the sale of tax liens. When taxes are unpaid for the period provided by whatever statute will be applicable, liens on delinquent parcels are advertised for sale. Ultimately, the buyer of the lien, or tax sale certificate, must give all parties so entitled by statute (owners, mortgagors, tenants, among others) "notice to redeem." If there is no redemption, the municipality issues a deed to the lien holder and again, the mortgage is extinguished.

Acceleration for Tax Defaults

Consequently, acceleration clauses take into account the necessity to provide a remedy to the mortgagee in case of a tax default. Typical of the language is the portion of the NYBTU Mortgage, paragraph 4, which 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 demand
> * * * "

Unlike the situation of a default in paying principal and interest, where notice and demand to cure a default are *not* required,[5] it is immediately apparent that a prerequisite to accelerating for a tax default is *at least* the giving of the notice required by the mortgage terms with the appropriate demand to cure within the stated period.[6] Hence, there are a number of decisions, although representing a *minority* of the cases, where a strict view of acceleration for tax defaults has prevailed.[7]

For the mortgagee to be successful, usually there must be a substantial default and an inadequate excuse for failure to pay the taxes. In one case, taxes were due on November 1. Numerous demands for payment were made through December and on January 4, a fifteen day notice was sent. After the period expired, service of the foreclosure pleadings was effected on January 29. Although the taxes were actually paid on January 30, the court upheld the acceleration.[8]

In another case, an entire year's taxes were open. The mortgagor argued depression conditions as his excuse to support the claim that foreclosure was unconscionable. The Court disagreed and allowed the foreclosure.[9] Where the excuse offered was the mortgagor's purported entitlement to a tax exemption, the argument was rejected as insufficient.[10]

Another excuse employed was essentially waiver. Although a mortgagee had indulged prior tax defaults, the notices sent were deemed clear and unequivocal and therefore the default was construed as "willful." Thus, the court found the acceleration not to be oppressive or in bad faith and relegated the sympathy concept to the legislature.[11]

Where the excuse for a full year's default in taxes was that rents had been collected by rent strikers, the foreclosure was upheld.[12]

Finally, in another ruling, three quarterly tax installments were unpaid. The mortgagee accelerated on February 23. On March 1, the mortgagor made a tax payment, but of only one overdue installment, in the meanwhile having already collected full tax payments from its tenant. Upon these facts, the court concluded that the default was continuous, uncured and sufficient basis for foreclosure.[13]

In synthesizing from reported decisions the elements necessary to uphold acceleration for tax defaults, some or all of the following factors must be found:

- Tax defaults are substantial,[14] and

[3] For example, see New York City Administrative Code §D 17-1.0, et seq.; Nassau County Administrative Code and Suffolk County Tax Act.

[4] For residential property the period is three years.

[5] *Hudson City Savings Institution* v. *Burton*, 451 N.Y.S.2d 855 (3rd Dept. 1982); *Bowers* v. *Zaimes*, 59 A.D.2d 803, 398 N.Y.S.2d 766 (3rd Dept. 1977); *Ferlazzo* v. *Riley*, *supra*, note 2; *Albertina Realty Co.* v. *Rosbro Realty Corp.*, 258 N.Y. 472 (1932); *Hothorn* v. *Lewis*, 52 App. Div. 218, aff'd 170 N.Y. 576; *Northampton Nat. Bank* v. *Kidder*, 106 N.Y. 221; *Dale Holding Corp.* v. *Dale Gardens*, 186 Misc. 940, (1945); *Pizer* v. *Herzig*, 120 App. Div. 102, 105 N.Y. Supp. 38 (1907).

[6] *Armstrong* v. *Rogdon Holding Corp.*, supra., note 2; *Jamaica Savings Bank* v. *Cohan*, 36 A.D. 2d 743, 320 N.Y.S.2d 471 (1971).

[7] *Martin* v. *Clover*, 17 N.Y. Supp. 638 (1892); *New York Baptist Mission Soc.* v. *Tabernacle Baptist Church*, 17 Misc. Rep. 699, 41 N.Y. Supp. 513 (1896); *Strochak* v. *Glass Paper Making Supplies Co.*, 239 App. Div. 312, 267 N.Y. Supp. 282 (1933); *Fifty-Second Street Operating Corp.* v. *Regus Realty Corp.*, 236 App. Div. 497, 260 N.Y.Supp. 28, aff'd 261 N.Y. 672 (1933); *East New York Savings Bank* v. *Carlinde Realty Corp.*, 54 A.D. 2d 574, 387 N.Y.S.2d 138 (1976).

[8] *Armstrong* v. *Rogdon Holding Corp.*, *supra.*, note 2

[9] *Strochak* v. *Glass Paper Making Supplies Co.*, *supra.*, note 7

[10] *Shaker Central Trust Fund* v. *Crusade for Christ, Inc.*, 26 Misc. 2d 825, 215 N.Y.S.2d (1960)

[11] *Jamaica Savings Bank* v. *Cohan*, 36 A.D.2d 743, 320 N.Y.S.2d 471 (1971).

[12] *Neubauer* v. *Smith*, 40 A.D.2d 790, 337 N.Y.S.2d 592 (1972).

[13] *Jamaica Savings Bank* v. *Avon Associates, Inc.* 178 (86) NYLJ (11-2-77) 6 Col. 3B.

[14] *Shaker Central Trust Fund* v. *Crusade for Christ, Inc.*, *supra.*, note 10; *Neubauer* v. *Smith*, *supra.*, note 12; *East New York Savings Bank* v. *Carlinde Realty Corp.*, *supra.*, note 7.

- Notice is timely and clearly given;[15] and
- Attempts to cure either do not exist or are patently insincere;[16] and
- The excuse offered for the default is not credible.[17]

When the Cases Say No

Bearing in mind the position of the majority of the Court of Appeals in *Graf* v. *Hope Building Corp.*,[18] and its progeny, the mortgage is a contract, the terms of which should be honored without intervention of judicial sympathy. Noting the aforecited cases together with those standing for the proposition that foreclosure may be based upon the non-performance of any act required by the mortgage,[19] the assumption could be made that tax defaults will be enforced in the same manner as failures to pay principal and interest, assuming proper notice is given. However, a review of reported decisions in this area reveals that by a two to one margin, the courts will not allow foreclosure for tax defaults.

The great majority of rulings perceive tax defaults variously as merely technical or less severe and acceleration therefor somehow unfair.[20] They invoke the old maxim that foreclosure is equitable in nature[21] and find justification in the fact patterns to disallow foreclosure.

Drawing in great measure from Justice Cardozo's famous dissent in the *Graf* case,[22] the obligation to pay taxes is treated differently than principal and interest. It does not require the payment of anything 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 lien. The clause authorizing acceleration for nonpayment of taxes is designed for the same ultimate purpose - to deter the mortgagor from allowing the security to become impaired, but with respect thereto, the court of equity has the power to grant relief under appropriate circumstances.

The decisions denying foreclosure show the broad approach for relief taken by the courts. In an early ruling, a sewer assessment was due in March of 1886. When it remained unpaid for thirteen months, the foreclosure was begun in April, 1887. The defendant claimed she only learned of the default the day before service of the summons and complaint, at which time payment was made, and attributed the failure to the negligence of her son. The conclusion of the court was that there could be no inference of defendant's desire not to pay taxes so that the failure to do so could not be "willful" neglect. Finding in addition "no prejudice"

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[15] *Armstrong* v. *Rogdon Holding Corp.*, *supra.*, note 2. *Jamaica Savings Bank* v. *Cohan*, *supra.*, note 11.

[16] *Strochak* v. *Glass Paper Making Supplies Co.*, *supra.*, note 7; *Fifty-Second Street Operating Corp.* v. *Regus Realty Corp.*, *supra.*, note 7; *Jamaica Savings Bank* v. *Avon Associates, Inc.*, *supra.*, note 13; *Jamaica Savings Bank* v. *Alley Spring Apartments Corp.*, 183 (64) NYLJ (4-2-80) 13 Col. 1T.

[17] *Strochak* v. *Glass Paper Making Supplies. Co.*, *supra.*, note 7; *Shaker Central Trust Fund* v. *Crusade for Christ Inc.*, *supra.*, note 10; *Neubauer* v. *Smith*, *supra.*, note 12.

[18] See note 2, *supra.*

[19] *Mills Land Corporation* v. *Halstead*, 184 Misc. 679, 56 N.Y.S.2d 682 (1945); *Applications of Cumberland Garage*, 73 N.Y.S.2d 571 (1947)

[20] *Brookman* v. *1266 Realty Corp.*, 164 (3) NYLJ (9-6-70) 11, Col. 4T; *Towbridge* v. *Malex Realty Corporation*, 198 App. Div. 656, 191 N.Y.Supp. 97 (1921)

[21] *Bieber* v. *Goldberg*, 133 App. Div. 207, 117 N.Y. Supp. 211 (1909); *Germania Life Insurance Co.* v. *Potter*, 124 App. Div. 814, 109 N.Y. Supp. 435 (1908)

[22] See also, *Bay* v. *Bay*, 9 N.Y.2d 855 (1961) where the Court of Appeals reversed the Fourth Department and rejected a foreclosure for tax defaults, adopting the dissent in the case below by Halpern, J. [11 A.D.2d 615, 200 N.Y.S. 2d 784 (1960)]

to plaintiff, the foreclosure was dismissed.[23]

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, 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.[24]

An extraordinarily sympathetic position was taken in another depression era decision. There, the mortgage contained the usual provision of acceleration for thirty day default and 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 declining to allow the foreclosure, the court relied upon the following factors: 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; principal and interest were still current; the economic conditions facing the agricultural community were especially difficult.[25]

Where the evidence demonstrated both that plaintiff had agreed to forbear in the face of a clear tax default and had failed to give notice of its intention to wait no longer, foreclosure was disallowed.[26]

Another application of equitable principles found a mortgagee sending a letter advising the mortgagor, who had failed to pay taxes, that there was an acceleration clause and asking when taxes would be paid. Defendant replied that if approved, payment would be made on August 7. When the taxes were not in fact paid on that date, the mortgagee's response was to file the foreclosure pleadings with the county clerk on August 16. On the day process was served, the taxes were finally paid. Equity granted relief. The court ruled the default to be "merely technical," no prejudice to plaintiff and plaintiff's conduct to be "oppressive."[27]

A final example of judicial leniency was a case in which the mortgage, contrary to the usual language, required no notice of failure to pay taxes. It was uncontroverted that the mortgagor neglected to pay three quarterly installments of taxes and water charges. Consequently, the mortgagor began the foreclosure. Only *after* the action was begun were the taxes paid. 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 would therefore be deemed a prerequisite. Reliance was also placed upon the default being excusable, due only to inattention, all with no damage to the lender.[28]

In analyzing the cases ruling against foreclosure for tax defaults, a recapitulation of the usual cited principles include:

- Some waiver or forbearance by the mortgagee; in other words, the mortgagee demonstrated that even *it* did not take the default too seriously;[29] and/or
- Principal and interest were otherwise current;[30] and/or
- Failure to pay taxes was not willful, but was excusable as due to venial inattention or error;[31] and/or
- Notice was not given or if given, was not unequivocal;[32] and/or
- If notice was given, no opportunity to cure was provided;[33] and/or
- There is no damage or prejudice to the mortgagee;[34] and or
- The mortgagor has tendered the arrears for taxes or has legitimately attempted to, even after foreclosure has begun.[35]

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[23] *Noyes* v. *Anderson*, 124 N.Y. 175 (1891)

[24] *Germania Life Insurance Co.* v. *Potter*, *supra.*, note 21.

[25] *York* v. *Hucko*, 146 Misc. 201, 262 N.Y.Supp. 62 (1933)

[26] *Seaman's Bank for Savings* v. *Wallenstein Realty Corp.*, 6 N.Y.S.2d 706 (1938)

[27] *Norbant Realty Corp.*, v. *A.C. Oaks, Inc.*, 116 N.Y.S.2d 215 (1952)

[28] *Lincoln Savings Bank* v. *Six Moffat Realty Co.*, 163 (57) NYLJ (3-25-80) 15, Col. 8 M.

[29] *Seaman's Bank for Savings* v. *Wallenstein Realty Corp.*, *supra.*, note 26.

[30] *York* v. *Hucko*, *supra.*, note 25; *Clark-Robinson Corporation* v. *Jet Enterprises*, 159 N.Y.S.2d 214 (1957)

[31] *Noyes* v. *Anderson*, *supra.*, note 23; *Lincoln Savings Bank* v. *Six Moffat Realty Co.*, *supra.*, note 28; *Weber* v. *Berkowitz*, 164 NYLJ (12-11-70) 20, Col. 4M.

[32] *Norbant Realty Corp.* v. *A.C. Oaks, Inc.*, *supra.*, note 27; *Bowery Savings Bank* v. *Corner Bay Shore Associates*, 46 Misc. 2d 788,260 N.Y.S.2d 457 (1965); *Lincoln Savings Bank* v. *Six Moffat Realty Co.*, *supra.*, note 28; *Calta* v. *Belkin*, 165 (18) NYLJ (1-27-71) 2, Col. 6M.

[33] *Bower Savings Bank* v. *Corner Bay Shore Associates*, *supra.*, note 32.

[34] *Norbant Realty Corp.* v. *A.C. Oaks, Inc.*, *supra.*, note 27; *Clark-Robinson Corporation* v. *Jet Enterprises*, *supra.*, note 30; *Lincoln Savings Bank* v. *Six Moffat Realty Co.*, *supra.*, note 28.

[35] *Ver Planck* v. *Godfrey*, 42 App. Div. 16 (1899); *Germania Life Insurance Co.* v. *Potter*, *supra.*, note 21; *Norbant Realty Corp.* v. *A.C. Oaks Inc.*, *supra.*, note 27; *Clark-Robinson Corporation* v. *Jet Enterprises*, *supra.*, note 30; *Calta* v. *Belkin*, *supra.*, note 32; *Karas* v. *Wasserman*, 91 A.D. 2d 812 (1982).