FORECLOSING MULTPLE MORTGAGES IN ONE ACTION – NO LONGER AN ISSUE

*By Bruce J. Bergman

If a lender holds more than one mortgage with the same borrower secured by the same parcel(s), and if there are no intervening liens, can those mortgages conveniently be pursued in one action? A recent case clearly says "yes"[1] and it is noteworthy because this appears to be the first time what had previously been a matter of practice (but without specific authority) has been adjudicated.

This is presented as meaningful not only because lenders can commonly hold two (or more) mortgages on the same property, but also because wily borrowers may attack the procedure and some courts may not be so sure about the efficacy of the approach. The fact is that it is correctly done with regularity but the issue had not litigated in reported cases, thereby perhaps making the methodology informally hazy.

HOW IT HAPPENS

One example is a lender who takes a $400,000 mortgage on a property worth $600,000. (The numbers could be multiplied into the millions but the concept is the same.) The borrower then requests, and is approved for an additional $50,000 loan secured by a mortgage on the same property. In the absence of intervening judgments, liens, mortgages or other encumbrances which have attached to the property subsequent to recording the original mentioned mortgage, the lender would typically consolidate the new mortgage with the initial mortgage to form a single lien. But on

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occasion, a lender will not do what is usual and be content (or without forethought) simply hold two separate mortgages, the first senior to the second.

Another commonplace scenario is a first purchase money mortgage followed by a home equity line of credit mortgage, each remaining separate. This is typical with lending institutions where the home equity loans may originate from a different department, often in a different location.

Still a third example – in the commercial realm – is a first mortgage as an acquisition loan and the second a building loan mortgage.

VARIOUS ALTERNATIVES

In the two-mortgage situation (always for this exploration with no intervening liens), it certainly appears that foreclosing both in one action is the most economical and the fastest method. But if there *are* intervening liens – and even if there are not – the circumstance presents a number of alternatives. Each leads to further explanations and having a sense of those should add helpful perspective.

- FORECLOSING THE JUNIOR ALONE

If the junior mortgage alone is foreclosed, the lender will either derive all sums due upon that obligation (thus being made whole) or will itself be the successful bidder at the foreclosure sale and succeed to title. If an outside bidder buys, that bidder takes the property burdened by the lender's senior mortgage which, of course, survives foreclosure of any junior interest. The bidder, who becomes the owner when there is a

closing after the foreclosure sale, must then either satisfy the surviving senior mortgage – thus making the lender whole for the remaining portion of the mortgage loan – or suffer divestment of title through foreclosure of the senior mortgage.

- **TWO SEPARATE FORECLOSURES**

Instead of foreclosing only the second mortgage, the lender could opt to simultaneously initiate separate foreclosures of both the first and second mortgages. The goal would be to bring the junior mortgage to a sale first. (Reversing the order of sale would damage the lender because foreclosure of the senior mortgage would *extinguish* the junior). Strategically, both foreclosures would be brought to the point where a judgment of foreclosure and sale has issued. A sale would be advertised for the junior mortgage, but the senior foreclosure would halt in place at the moment of judgment.

The impetus for prosecuting the two foreclosures at the same time is to assure that divestment of any third party bidder's title from the junior foreclosure is imminent. With that pressure, the bidder is constrained to pay the senior quickly, rather than delay, possibly seeking to flip the property, all the while refraining from satisfying the senior.

- **FORECLOSING THE SENIOR ALONE**

A lender *could* elect to refrain from foreclosing the junior mortgage and choose instead to initiate foreclosure upon the senior mortgage alone. Because holders of interests junior and subordinate to the mortgage in foreclosure are "necessary" parties, this suggests the anomalous necessity for the foreclosing senior lender to name itself in

the foreclosure in its capacity as second mortgagee. That means that at the foreclosure sale, anyone who takes title does so *free* of the lender's junior mortgage which was extinguished by the foreclosure sale. While it is to be hoped the lender will derive, in our example, $400,000 at the foreclosure sale (plus interest, costs, disbursements, allowances and, if applicable, legal fees), what has happened to the $50,000 secured by the now-extinguished junior mortgage? The simple response is that this sum is lost, which is hardly a favorable result for the lender, at least such would be the case in many instances. (It depends of course upon the equity in the property.) Hence, foreclosing solely the senior mortgage when the lender holds both a senior and junior mortgage position can be a dangerous approach which portends a loss.

If there would be a need to foreclose the senior alone (and in many instances the cases cited here remove that imperative) there can be solutions to the dilemma.

One solution is for the lender to refrain from naming itself as a party defendant as a junior mortgagee. While in its subordinate capacity the lender is indeed a necessary party, it is not an indispensable party. It retains the option to purposefully neglect to name itself as a party defendant[2]. If no one objects to that non-joinder (although hardly assured), the result is that the lender's unnamed junior interest survives the foreclosure sale and continues to encumber the property. Then the bidder at the senior foreclosure sale will be bound to satisfy what had been a subordinate mortgage or suffer foreclosure in failing to do so.

But, other defendants in the foreclosure action *can* object to the non-joinder. If the court believes the non-joinder will result in prejudice to any party, it has the authority to order joinder. In that instance the noted solution will fail.

There is yet another alternative for the lender who elects to foreclose the senior mortgage alone and at the same time name itself as a party defendant. Recalling that in the example the sum due the lender upon the senior mortgage is $400,000, and upon the junior mortgage $50,000, the lender could proceed upon the assumption that the property is genuinely worth well in excess of the mortgage sums, *i.e.*, $450,000.

At the foreclosure sale (of the senior mortgage), the lender could bid up to the $400,000 "upset price". If that is the successful bid, the lender has an apparent bargain because it then owns the property and can presumably sell it for at least what is owed to it, and probably considerably more than that. With such a property value, however, there is certainly a possibility, and perhaps a probability, that some outside bidder would wish to avail himself of an apparent bargain by bidding $400,000. Although the lender then recoups the sum due on the senior mortgage, it loses the amount owed on the junior mortgage.

The lender's riposte is to outbid everyone – *up to the aggregate due on both its mortgages* – *i.e.* $450,.000. If there are no further bids, the lender becomes the owner. At the noted bid amount, the lender has created a *surplus* of $50,000. Assuming that the most senior encumbrance on the property extinguished by the sale as the lender's

junior mortgage – which is a critical assumption – the first claimant to surplus is the lender. Thus, it owns the property, at a bargain price, *and* recoups the $50,000 surplus.

There are further permutations to different bidding scenarios but for brevity's sake those will not be explored here, especially because the efficacy of doing so is reduced by the recent case law discussed.

HIGHLIGHTING CASE CONFIRMATION

For courts which may be timorous in accepting foreclosure of two mortgages in a single action, the case cited at the outset banishes any concern. There, the bank plaintiff was foreclosing two mortgages in the action against the same property. Litigation ensued and upon summary judgment the Second Department ruled that the plaintiff had indeed established *prima facie* entitlement to judgment upon its two mortgages. The court accepted foreclosure of the dual mortgages as without issue.

A later case at the trial court level[3] emphasized the point again, opining as well that despite protest from the borrowers, "a plaintiff may seek the foreclosure of two separate mortgages held by it within the confines of one action, where both mortgages are against the same property and are claimed to be in default, and no intervening liens are filed as against the property[4]".

The methodology of foreclosing two unconsolidated mortgages in one action should be a closed matter.

[1] *Swedbank, AB v. Hale Avenue Borrower, LLC*, 89 A.D.3d 922, 932 N.Y.S.2d 540 (2d Dept. 2011).

[2] For an explanation of the distinction between necessary and indispensable parties, see 2 *Bergman on New York Mortgage Foreclosures*, Chap. 12, LexisNexis Matthew Bender (rev. 2015).

[3] *LIC Assets, LLC v. Chriker Realty, LLC*, 2011 WL 673677 (N.Y. Sup.).

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