Chapter 3

Mortgage Financing

§ 3:1 Basic Mortgage Principles

§ 3:1.1 Generally

Mortgage financing is an integral part of most sales and purchases of real property. This section discusses basic principles of mortgage law, and subsequent sections in this chapter analyze how buyers and sellers may handle financing issues in their contract—as they prepare for closing and at the closing itself. The following chapter (Chapter 3A) analyzes many of the clauses often found in mortgage instruments.

Two types of mortgages may be involved in title closings: (1) existing mortgages that affect the premises prior to the closing, and (2) purchase money mortgages; that is, those placed on the premises at the closing in part payment of the purchase price. Existing mortgages may be paid off at closing, or they may continue in existence, thus helping the buyer to finance the purchase. The buyer may obtain a new purchase money mortgage from a third party, usually, but not always, an institutional lender. Alternatively, the seller may provide financing in the form of a purchase-money mortgage or in another form.

In a title theory state, mortgagors only hold an equitable interest in the mortgaged property. The mortgagor is left with an equity of redemption, but legal title revests in the mortgagor on payment of the debt. The mortgagee has title, the right to possession, and absolute ownership rights in the mortgaged property. However, the mortgagor remains in possession, even though the mortgagee has all the incidents of ownership.[1]

Deeds of trust are used in some states instead of mortgages. There is little difference between the two. A deed of trust is substantially a mortgage with a power of sale. It transfers legal title from a borrower to one or more trustees for the benefit of the lender, who is called the beneficiary.[2] In states that recognize deeds of trust, the parties

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1. *In re* Turtle Creek Ltd., 194 B.R. 267 (Bankr. N.D. Ala. 1996). Some of this is not true in the bankruptcy of the mortgagor. *In re* Guardian Realty Grp., 205 B.R. 1 (Bankr. D.C. 1997); *In re* Lyons, 193 B.R. 637 (Bankr. D. Mass. 1996).
2. Springhill Laske Invs. Ltd. P'ship v. Prince George's Cnty., 690 A.2d 535, 539 (Md. 1997).

may use a mortgage, but enforcement of a mortgage requires a civil action, whereas a deed of trust may be enforced by a sale out of court.[3] Similar rules are applied to both mortgages and deeds of trust.[4] One difference is that enforcement of the deed of trust proceeds with the trustee selling the property without the protection of a judgment of foreclosure and sale, with the result that a wrongful sale may make the deed-of-trust beneficiary liable for damages.[5]

A mortgage must be supported by consideration to be enforceable, but the consideration need not move from the mortgagee to the mortgagor; it may consist of a loan to a third person.[6] A mortgage given to a related entity, to whom the mortgagor owes no debt and for which no consideration was given, is a sham and without effect on third parties.[7]

A mortgage obtained by duress is usually unenforceable. When his parents mortgaged their property to a bank that threatened to send their son to jail for check kiting, the mortgage was held unenforceable.[8] The nature of duress has changed over the years from the threat

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3. Patton v. First Fed. Sav. & Loan Ass'n, 578 P.2d 152 (Ariz. 1978) (lender must strictly comply with deed-of-trust statutes due to fewer protections for borrowers).

4. Cornelison v. Kornbluth, 116 Cal. Rptr. 902, 904–05 n.1 (Ct. App. 2d Dist. 1974), *vacated on other grounds*, 542 P.2d 981 (Cal. 1975); Rustad Heating & Plumbing Co. v. Waldt, 588 P.2d 1153 (Wash. 1979).

> A deed of trust is a security device. It transfers legal title from a property owner to one or more trustees to be held for the benefit of a beneficiary. . . . [T]he deed of trust secures repayment of the loan. If the loan is not repaid, it is through the deed of trust that the beneficiary has recourse against the property—*e.g.*, by selling the borrower's property and applying the funds received against the borrower's indebtedness.

Springhill Laske Invs. Ltd. P'ship v. Prince George's Cnty., 690 A.2d 535, 539 (Md. 1997).

5. Diaby v. Bierman, 795 F. Supp. 2d 108 (D.D.C. 2011) (lender failed to provide accurate amount to be paid to cure default); Owens v. Grimes, 539 S.W.2d 387, 390 (Tex. Civ. App.–Tyler 1976) (lender's wrong "resembles . . . a conversion of personal property").

6. Auburn Cordage, Inc. v. Revocable Trust Agreement of Treadwell, 848 N.E.2d 738 (Ind. Ct. App. 2006) (landlord mortgaged its property to secure loan to tenant to finance tenant's improvements); First Nat'l Bank & Trust Co. v. Brakken, 468 N.W.2d 633 (N.D. 1991) (mortgage given to secure loans made to mortgagor's sons, which were past due and renegotiated).

7. United States v. Klimeek, 952 F. Supp. 1100, 1114 (E.D. Pa. 1997) (given to avoid federal taxes).

8. Osage Corp. v. Simon, 613 N.E.2d 770 (Ill. App. Ct. 1993); Triad Distribs., Inc. v. Conde, 391 N.Y.S.2d 897 (App. Div. 2d Dep't 1977).

In *In re* Rochkind, 128 B.R. 520 (Bankr. E.D. Mich. 1991), a co-owner, a wife, signed a mortgage because of a threat that her husband would be

of an unlawful act, for example, a tort or a crime, to include business compulsion that leaves the victim no reasonable alternative.[9] In a Florida case in which a mortgage was given by a husband and wife to the defendant, to avoid prosecution of the wife for admitted embezzlement, the mortgage was held enforceable. The court noted the fine distinctions in other Florida cases in which the result would be otherwise.[10]

Assignment of a mortgage by a mortgagee, as collateral security, creates a pledge, not a sale, of the mortgage, vesting a defeasible title to the mortgage in the assignee, which ends on payment of the debt.[11]

A mortgage given as security for tenant's liability under a lease is not modified by modification of the lease or other changes so long as rent remains unpaid under the original lease.[12]

Generally, there is no fiduciary relation between mortgagor and mortgagee, although one may occur where one party to the relation relies heavily on the judgment of the other. A slightly dominant business position is not enough for this.[13]

When property is held in a tenancy by the entirety, a mortgage granted by one spouse is problematic. In some states, the mortgage is invalid,[14] but in New York the mortgage passes the interest of the signing spouse. On foreclosure by the mortgagee, the purchaser becomes a tenant in common with the non-signing spouse, with the right of survivorship. After the divorce of the spouses, following the making of the mortgage, a foreclosing mortgagee becomes a tenant in common of the non-signing spouse, with no right of

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driven from his law practice if the husband's debt was not paid. The mortgage was held unenforceable to her.

A dictum in *Rochkind* is to the effect that where husband and wife execute a mortgage, a separate consideration to the wife is unnecessary.

9. See *In re* Rochkind, 128 B.R. 520 (Bankr. E.D. Mich. 1991); RESTATEMENT (SECOND) OF CONTRACTS § 175(1) (1981); 13 S. WILLISTON, CONTRACTS ch. 47, particularly § 1606 (1981).
10. Franklin v. Wallack, 576 So. 2d 1371 (Fla. Dist. Ct. App. 1991). A dissenting opinion in *Franklin* discusses the "modern law," with authorities that are against the use of criminal law to collect private debts.
11. Desser v. Schatz, 581 N.Y.S.2d 796 (App. Div. 1st Dep't 1992), relying on *In re* Gilbert, 10 N.E. 148, 151 (N.Y. 1887).
12. Trans Ohio Sav. Bank v. Patterson, 590 N.E.2d 1338 (Ohio Ct. App. 1990).
13. Stern v. Great W. Bank, 959 F. Supp. 478 (N.D. Ill. 1997). In *Stern*, a bank mortgagee was held under no liability for supplying financial information of the mortgagor to the lawyer for the mortgagor's ex-wife under a subpoena.
14. *E.g.*, Richard v. Wells Fargo Bank, 418 S.W.3d 468 (Mo. Ct. App. 2013).

survivorship.[15] A mortgage purportedly signed by tenants by the entirety, but with the wife's signature forged, was treated as if signed by the husband alone.[16]

There is a current tendency to include in mortgages provisions for variable interest, which permit the mortgagee to increase the rate of interest in specified situations. These clauses have been enforced,[17] although there is dictum to the effect that they may be subject to some equitable limitations.[18]

A provision for increase in the interest rate has been held to permit multiple increases.[19] It implies no right to increase the amount of the periodic payments or to extend the maturity of the mortgage.[20] The effect of usury laws on this clause is not clear when the variable rate of interest exceeds the legal maximum for part of the time.[21]

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15. V.R.W., Inc. v. Klein, 503 N.E.2d 496 (N.Y. 1986).
16. First Am. Title Ins. Co. v. Kevlin, 610 N.Y.S.2d 361 (App. Div. 3d Dep't 1994). *Accord* Sanderson v. Heffington, 757 P.2d 866 (Or. Ct. App. 1988).
17. Miller v. Pac. First Fed. Sav. & Loan Ass'n, 545 P.2d 546 (Wash. 1976); Sec. Sav. & Loan Ass'n v. Wauwatosa Colony, Inc., 237 N.W.2d 729 (Wis. 1976). *Cf.* Roach, *The Variable Interest Rate Clause and Its Use in California Real Estate Transactions*, 19 UCLA L. REV. 468 (1972); 60 A.L.R.3d 473 (1974).

    For variations in the form of variable rate mortgages and a suggestion of their advantages, see 61 MARQ. L. REV. 140 (1977).

    For a general discussion, see Baher, *Adjustable Interest Rate in Home Mortgages: A Reconsideration*, 1975 WIS. L. REV. 742.

    Provision for repayment in an amount reflecting the difference between the Consumer Price Index between the time of the execution of the mortgage and its repayment has been held usurious. Olwine v. Torrens, 236 Pa. Super. 51, 344 A.2d 665, 90 A.L.R.3d 757 (annot. at 763) (1975).

    For a brief discussion of alternative mortgage instruments, see Kratovil, *A New Dilemma for Thrift Institutions: Judicial Emasculation of Due-On-Sale Clauses*, 12 JOHN MARSHALL J. PRAC. & PROC. 299, 312–14 (1979).
18. Miller v. Pac. First Fed. Sav. & Loan Ass'n, 545 P.2d 546 (Wash. 1976). Same, where no provision therefor in mortgage other than due-on-sale clause. Rayford v. La. Sav. Ass'n, 380 So. 2d 1232 (La. Ct. App. 1980).
19. Sec. Sav. & Loan Ass'n v. Wauwatosa Colony, Inc., 237 N.W.2d 729 (Wis. 1976).
20. Goebel v. First Fed. Sav. & Loan Ass'n, 266 N.W.2d 352 (Wis. 1978). The court noted that the mortgage specified increase of installments in other situations. The result is to create a "balloon" payment at the original mortgage expiration.
21. It has been held that the rate charged cannot exceed the maximum rate at any point during the term unless the agreement was consummated in good faith and without intent to avoid the usury laws. McConnell v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 578 P.2d 1375 (Cal. 1978), criticized in 67 CALIF. L. REV. 621 (1979).

The right of a mortgagee to make a transfer charge on a conveyance of the property has been upheld.[22] But a charge of 1% of the mortgage principle was held unreasonable and inequitable where the charge was unrelated to the mortgagee's actual cost.[23]

§ 3:1.2 Clogging the Equity of Redemption

Any provision whereby a mortgagor waives his equity of redemption, in advance of default, is void. This is said to "clog" the equity of redemption. The forbidden provision may be a covenant by the mortgagor, included in the mortgage or in a collateral agreement, undertaking to convey the property to the mortgagee promptly after a default in the mortgage. Or it may be by the mortgagor's deposit of a deed under an agreement permitting its recordation promptly after default by the mortgagor. Such devices deprive the mortgagor of the right to time or a defense ordinarily available in a foreclosure action. For the borrower's protection, the mortgagee's remedy is to foreclose, not to utilize the alternative it extracted. Courts are vigilant in striking down such techniques,[24] although there are occasional decisions that seem to go the other way.[25]

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22. Tucker v. Pulaski Fed. Sav. & Loan Ass'n, 481 S.W.2d 725 (Ark. 1972). The charge was $100. The mortgage showed that numerous records relating to payment and to insurance had to be amended. O'Connell v. Dockendorff, 415 So. 2d 35 (Fla. Dist. Ct. App. 1982); First Fed. Sav. & Loan Ass'n v. Lockwood, 385 So. 2d 156 (Fla. Dist. Ct. App. 1980); Conner v. First Nat'l Bank & Trust Co., 439 N.E.2d 122 (Ill. App. Ct. 1982).

23. The charge was unbargained for and was made as a condition of mortgagee's waiver of a due-on-sale clause. Cont'l Fed. Sav. & Loan Ass'n v. Fetter, 564 P.2d 1013 (Okla. 1977). *Contra* Pleasants v. Home Fed. Sav. & Loan Ass'n, 569 P.2d 261 (Ariz. 1977) (1% and .5% in interest).

24. Hamud v. Hawthorne, 338 P.2d 387 (Cal. 1959) (plaintiff barred by laches); Cohn v. Bridgeport Plumbing Supply Co., 115 A. 328 (Conn. 1921); Oakland Hills Dev. Corp. v. Luederc Drainage Dist., 537 N.W.2d 258 (Mich. Ct. App. 1995); Russo v. Wolbers, 323 N.W.2d 385, 390 (Mich. Ct. App. 1982); Humble Oil & Ref. Co. v. Doerr, 303 A.2d 898 (N.J. Super. Ct. 1973); Basile v. Erhal Holding Co., 538 N.Y.S.2d 831 (App. Div. 2d Dep't 1989) (waiver in open court unenforceable); Sannerud v. Brantz, 928 P.2d 477 (Wyo. 1996). *Cf.* Verity v. Metropolis Land Co., 288 N.Y.S. 625 (App. Div. 1936), *aff'd*, 10 N.E.2d 582 (N.Y. 1937). Some states codify the rule. CAL. CIV. CODE § 2953; OKLA. STAT. tit. 42, § 11.

25. In Allen v. Storie, 579 So. 2d 1316 (Ala. 1991), a mortgagee with an option to purchase was given specific performance of this option. Waiver of equity of redemption was not discussed.

    Ringling Joint Venture II v. Huntington Nat'l Bank, 595 So. 2d 180 (Fla. Dist. Ct. App. 1992), recognized the rule against clogging, but found an exception in unusual circumstances that involved delivery of a deed in escrow to nonresidential property under an agreement made subsequent to the mortgage and on further consideration.

California and Guam have statutes that invalidate contracts in restraint of redemption.[26] Cases under these statutes tend to view mortgagor-mortgagee transactions more with regard to business fairness than to the technicalities of waiver of redemption.[27]

The equity of redemption applies before foreclosure, and is to be distinguished from a statutory right of redemption, which is a debtor's right to regain property lost through foreclosure. The waiver of the latter is supported by some authority.[28]

§ 3:1.3 Disguised Mortgages

A claim that there has been an impermissible waiver of the equity of redemption has been made, and sometimes upheld, in situations more complex than those mentioned in the preceding subsection. One such example is *Humble Oil & Refining Co. v. Doerr*.[29] Humble arranged for Doerr to obtain a mortgage loan, to expand her gasoline station, larger in amount and on better terms than Doerr could. This was accomplished by a "two party lease," under which Doerr leased her property to Humble for fifteen years and Humble subleased the property back to Doerr for one year, with the understanding, but not the obligation, to continue the sublease from year to year. The amount of rent from Humble to Doerr and the subrent from Doerr to Humble was the same, and in an amount that would pay the mortgage. The lease to Humble gave it an option to buy the property at a price equal to the fair value of the property when the lease was made. Because the rents offset each other, Humble received the option without cost. When the value of the property increased substantially, Humble sought to exercise the option. The court deemed Humble the virtual guarantor of the mortgage, because the lease to Humble effected the mortgage. That was enough for the court to determine that Humble was close enough to the mortgage to make its option a clog on, that is, a waiver of Doerr's equity and therefore unenforceable. Inasmuch as actual

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26. CAL. CIV. CODE § 2889 ("All contracts for the forfeiture of property subject to a lien, in satisfaction of the obligation secured thereby, and all contracts in restraint of the right of redemption from a lien, are void."); 18 GUAM CODE § 35302 (borrowed verbatim from California Code).
27. *See* Guam Hakubotan, Inc. v. Furusawa Inv. Corp., 947 F.2d 398 (9th Cir. 1991), for a discussion of decisions in California. In *Guam Hakubotan*, a mortgagor delivered a deed to the mortgaged premises to the mortgagee on execution of an extension agreement with authority to record the deed on a mortgage default. The mortgagee's recording of this deed in accordance with this provision was held proper. It is doubtful if states following the common-law rule would reach this result.
28. *E.g.*, John Hancock Mut. Life Ins. Co. v. Bruening Farms Corp., 537 F. Supp. 936 (N.D. Iowa 1982).
29. Humble Oil & Ref. Co. v. Doerr, 303 A.2d 898 (N.J. Super. Ct. 1973).

possession of the property by Humble was never contemplated, it was in fact a loan transaction.

Humble distinguishes cases where the landlord is a joint venturer or where the transaction was a sale with an option to repurchase.[30] *Humble* is to be distinguished in cases where the intention of the parties is other than to create a mortgage, or where the relinquishment of the mortgagor's equity is subsequent to the creation of the mortgage. For example, in *MacArthur v. North Palm Beach Utilities, Inc.*,[31] plaintiff sold property to defendant-mortgagor and took back a purchase money mortgage, together with an option to buy a utility system mortgagor was to build. Plaintiff-mortgagee loaned defendant-mortgagor money for this purpose. A divided court held the purchase option enforceable. It deemed the transaction a sale with an option to repurchase and the mortgage merely incidental. The dissent viewed the utility agreement as essentially a mortgage transaction.[32]

Some American statutes validate secured parties' options to purchase the mortgaged property, provided their exercise is not conditioned on a default in the security instrument.[33]

Humble Oil & Refining Co. v. Doerr[34] was distinguished in a case with complicated facts where, although a mortgage was involved, there was no loan.[35]

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30. *Id.* In Cunningham v. Esso Standard Oil Co., 118 A.2d 611 (Del. 1955), *aff'g* 114 A.2d 380 (Del. Ch. 1955), the facts were quite similar to *Humble*, but the result was contra. Among the differences was the fact that clogging or waiver of redemption was not considered by the court. *Humble*, 303 A.2d at 914–15.

    In Hopping v. Baldridge, 266 P. 469 (Okla. 1928), the mortgagor gave the mortgagee, simultaneously with delivery of the mortgage, a ten-year option to buy oil and gas rights. In Coursey v. Fairchild, 436 P.2d 35 (Okla. 1967), the mortgagor delivered a mineral deed as consideration for a renewal of a mortgage obligation. In these cases when the mortgage was paid, the option and deed were canceled. The mortgagor was held entitled to return of his property in the form in which he mortgaged it.

31. MacArthur v. N. Palm Beach Utilities, Inc., 202 So. 2d 181 (Fla. 1967).

32. *Id.* at 187. *See* Smith v. Smith, 135 A. 25 (N.H. 1926) (son's option to purchase at death of father-mortgagor is enforceable as "collateral agreement").

33. CAL. CIV. CODE § 2906 (inapplicable to residential property with four or fewer units); N.Y. GEN. OBLIG. LAW § 5-334 (applicable to loans of $2.5 million or more).

34. Humble Oil & Ref. Co. v. Doerr, 303 A.2d 898 (N.J. Super. Ct. 1973).

35. In Blackwell Ford v. Calhoun, 555 N.W.2d 856 (Mich. Ct. App. 1996), a tenant had a first option to buy the property. Subtenant sought an option to buy the property, making the proposal prior to the expiration of the head or subleases, but to become effective after the expirations. This was to avoid the main tenant's right of refusal. *See* MILTON R. FRIEDMAN,

Inasmuch as the rule against waiver of redemption applies to mortgages, it is necessary to determine if the nature of a transaction is that of a mortgage. It has been held that in a matter of doubt a security arrangement should be deemed a mortgage to protect all parties by denying forfeiture and denying waiver of redemption.[36] Courts have established factors to determine whether a mortgage or a security transaction is involved. When a deed is made for the payment of money and is held as security, it is an equitable mortgage. The intention of the parties is determinative of this rather than the form or name of the instrument.[37] In determining this intention courts have looked to various factors, which include the following:

- the existence of a debt prior to the transaction or created as part of the transaction,
- documents entitling the grantor to redeem the property by performing specified acts within a specified time,
- the grantee gave inadequate consideration for the property and the grantor paid interest to the grantee,
- the grantor retained possession, control, and use of the property, particularly while paying no rent,
- the grantor made improvements that a tenant was unlikely to make,
- the grantee did not exercise control or ownership of the property, and
- the parties did not intend to extinguish a debt.[38]

An agreement by an owner not to encumber or transfer his property, even when accompanied by an assignment of rents, is not a lien or

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FRIEDMAN ON LEASES (5th ed., Patrick Randolph, ed. 2005) [hereinafter FRIEDMAN ON LEASES], § 15:6 (Supp. July 2013). Subtenant paid the head landlord $175,000 for the option, which was to be returned only if (1) the option was exercised and marketable title could not be conveyed, or (2) the head tenant exercised its right of refusal. Subtenant obtained specific performance, the court noting that after the option was exercised there was no equity of redemption to clog. The court also noted that substance, not title of papers, prevailed and that it still adhered to the rule of *Humble*.

36. Sannerud v. Brantz, 928 P.2d 477, 480 (Wyo. 1996).
37. Patterson v. Grace, 661 N.E.2d 580 (Ind. Ct. App. 1996).
38. *In re* UNI-RT Corp., 191 B.R. 595 (Bankr. S.D.N.Y. 1996) (extended discussion and cases in New York law of parol evidence); N.Y. REAL PROP. LAW § 320; Patterson v. Grace, 661 N.E.2d 580, 584 (Ind. Ct. App. 1996).

mortgage and may not be foreclosed.[39] It creates no lien and is not paramount to subsequent liens.[40]

A sale of real property, subject to an option in the grantor to repurchase the premises, may in some circumstances be held to be a disguised mortgage.[41] A repurchase option, with no specific time for its exercise, raises a question of the rule against perpetuities. In some states, such an option violates the rule,[42] but in others the option is valid, because the court infers that the option must be exercised within a reasonable time.[43] If the documents are ambiguous, the court may conclude that the option must be exercised within the lifetime of the optionee,[44] which is consistent with the general exclusion of the rule against perpetuities from commercial transactions,[45] and is also consistent with cases involving a lease for a term to commence after completion of a structure housing the leased premises.[46] In many states, the "wait-and-see" rule protects an option from violating the

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39. *In re* Rotehnberg, 173 B.R. 4, 19 (Bankr. D.D.C. 1994); Weaver v. Tri City Credit Bureau, 557 P.2d 1072 (Ariz. Ct. App. 1976); Tahoe Nat'l Bank v. Phillips, 480 P.2d 320 (Cal. 1971).
40. Equitable Trust Co. v. Imbesi, 412 A.2d 96 (Md. 1980) (contains form for agreement in n.1).
41. Swallow Ranches, Inc. v. Bidart, 525 F.2d 995 (9th Cir. 1975). *Cf. In re* Kassuba, 562 F.2d 511 (7th Cir. 1977). In stressing the intent of the parties, the transaction was held an outright sale. *In re* Corey, 892 F.2d 829, 837–38 (9th Cir. 1989).
42. Coxe v. Wyatt, 349 S.E.2d 75 (N.C. Ct. App. 1986) (right vested in corporation, which may have excluded possible saving limit of natural person's lifetime). *Cf.* Certified Corp. v. GTE Prods. Corp., 467 N.E.2d 1336 (Mass. 1984). A New York statute codifies the common-law rule, striking down any interest where the duration or vesting might take place later than lives in being plus twenty-one years. N.Y. EST. POWERS & TRUSTS LAW § 9-1.1; Symphony Space, Inc. v. Pergola Props., 631 N.Y.S.2d 136, 143 (App. Div. 1st Dep't 1995) (statute precludes operation of the wait-and-see rule in New York).
43. Byke Constr. Co. v. Miller, 680 P.2d 193 (Ariz. Ct. App. 1984) (seller's option to repurchase if purchaser did not begin construction of house by May 1, 1979); Coulter & Smith, Ltd. v. Russell, 966 P.2d 852 (Utah 1998) (option to buy lots must be exercised within reasonable time and thus does not violate rule against perpetuities).
44. Barnhart v. McKinney, 682 P.2d 112 (Kan. 1984) (buyer's right of refusal to buy seller's retained parcel when seller should decide to sell or vacate); Thomas v. Kiendzior, 538 N.E.2d 66 (Mass. App. Ct. 1989) (provision for alternate performances is free of the rule if either is performable during its period). RESTATEMENT (SECOND) OF PROPERTY (Donative Transfers) § 1.4 comment o (1983).
45. Hinson v. Roberts, 349 S.E.2d 454 (Ga. 1986).
46. Wong v. DiGrazia, 386 P.2d 817 (Cal. 1963); FRIEDMAN ON LEASES, *supra* note 35, § 4:1.2 (Supp. Mar. 2013).

rule against perpetuities.[47] The repurchase price must also be reasonable.[48] A repurchase option is not a covenant running with the land, and when there is no provision for its application to heirs and assigns it ends with the life of the optionee.[49]

§ 3:2 New Mortgage from Third Party

§ 3:2.1 Generally

In most transactions, the buyer requires some form of financing in order to close her purchase. In the absence of any express term in the contract dealing with financing, the baseline rule is that the buyer must pay "all cash." This means that the buyer promises to arrive at closing with the entire purchase price. The buyer takes on the risk that she will not be able to produce the cash at closing. An all-cash contract does not preclude the buyer from seeking and obtaining financing from a lender. It is just that she undertakes the risk that she cannot get financing on affordable terms, or even at all.

To reduce the risk stemming from an all-cash contract, the buyer includes a mortgage condition. The seller and the buyer have different perspectives with respect to the mortgage condition. The seller prefers broad language that obligates the buyer to accept almost any offer of a mortgage loan made by a lending institution to the buyer. The buyer, on the other hand, prefers a narrow condition that allows the buyer to withdraw from the transaction, with a full refund of earnest money, if the buyer cannot get a mortgage loan with a specifically defined set of parameters. This is the only way the buyer can control both the amount of money required to close the loan and the monthly payments on the loan.

A clause for a fixed-rate mortgage typically is reasonably specific and relieves the buyer who cannot find acceptable financing. A sample of such a clause is provided below.

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47. *See* FRIEDMAN ON LEASES, *supra* note 35, § 15:1, at 15–13 to 15–15 (Supp. July 2013).
48. The option must be reasonable as to duration, price and purpose. DeWolf v. Usher Cove Corp., 721 F. Supp. 1518, 1535–36 (D.R.I. 1989). Seller's option to repurchase when convenient, at a price to be determined at the current value at the time of the repurchase was not lost by laches after thirteen years. Wall v. Huguenin, 406 S.E.2d 347 (S.C. 1991) (distinguishing case where repurchase price was original sales price and delay over nine years).
49. *In re* Fleishman, 138 B.R. 641 (Bankr. D. Mass. 1992); Clarke v. Caldwell, 521 N.Y.S.2d 851 (App. Div. 3d Dep't 1987). Provision can be made for the covenant to run. FRIEDMAN ON LEASES, *supra* note 35, § 15:6.2[A] (Supp. July 2013).

CLAUSE 3-1

Clause for Fixed-Income Mortgage

> Buyer's obligation to close this purchase is conditioned on Buyer obtaining from a lending institution a commitment for a conventional first mortgage loan for $_____, at a fixed-interest rate not to exceed ___% per annum, payable in equal monthly installments over a term of ___ years, for which Buyer shall not be required to pay in excess of ___ points for discount, origination, or similar fees. Buyer shall apply for such a loan within ___ business days from the date hereof and shall use best efforts to obtain a loan within these guidelines, but shall not be required to apply to more than one lender. If Buyer is unable to obtain such a commitment within ___ days from the date hereof, this agreement shall terminate and the earnest money shall be returned to Buyer; provided, Buyer may, within the time above specified, choose to waive all or any of the foregoing conditions.

This "best efforts" clause is short and flexible. A more detailed explanation of the buyer's duty to seek the loan is provided below.

CLAUSE 3-2

"Best Efforts" Clause

> Buyer will endeavor in good faith to obtain a mortgage loan on said terms, shall supply any prospective mortgagee with such information as the latter shall request, shall pay the usual charges therefor, and shall execute and deliver the mortgage instruments and other papers customarily used by such institution.

Standard contract law principles govern the interpretation and enforcement of financing provisions. Reformation of an improperly drafted provision is one example. Problems with the parties' selection of numbers comes up regularly. When a mistake is made in drafting the seller financing clause, a party may seek reformation. In one case, a court granted this relief when the parties made a mathematical mistake with respect to payments required to amortize a purchase-money mortgage loan.[50]

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50. Mathis v. Wendling, 962 P.2d 160 (Wyo. 1998) (mutual mistake in contract for deed for purchase of ranch; contract clearly specified note amount, interest rate, and term; buyer required to make further payments to amortize debt).

§ 3:2.2 Buyer's Affirmative Obligation to Seek the Mortgage

Lack of mutuality does not render a contract unenforceable if the buyer is under an affirmative obligation to seek the mortgage.[51] Inasmuch as mortgages are usually obtained only by application of the borrower, a condition that a mortgage be obtained appears distinct from an obligation that the buyer make an effort to obtain the mortgage.[52] This would make all these agreements enforceable. However, it is good practice, and one probably followed by careful practitioners everywhere, to include an express obligation by the buyer to make bona fide efforts to obtain the mortgage, or to comply with whatever other conditions may be involved, and to prosecute such efforts to completion with diligence and continuity.[53] A distinction might be made between a provision entitling the purchaser to a refund of his down payment if he "shall be unable to obtain approval" and a provision "subject to" granting of approval. The former directly implies an affirmative covenant on the purchaser's part to obtain the specified

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51. The purchaser's promise to endeavor to obtain financing was held sufficient consideration in White & Bollard, Inc. v. Goodenow, 361 P.2d 571 (Wash. 1961).

52. Wooten v. DeMean, 788 S.W.2d 522 (Mo. Ct. App. 1990); Rhodessa Dev. Co. v. Simpson, 658 S.W.2d 218 (Tex. Ct. App.–El Paso 1983). Purchaser is under an implied duty to apply for the mortgage, Schottland v. Lucas, 396 So. 2d 72 (Ala. 1981). Billman v. Hensel, 391 N.E.2d 671, 673 (Ind. Ct. App. 1979); Wiggins v. Shewmake, 374 N.W.2d 111, 116 (S.D. 1985); Covington v. Robinson, 723 S.W.2d 643 (Tenn. Ct. App. 1986); Carroll v. Wied, 572 S.W.2d 93 (Tex. Civ. App. 1978); Manning v. Bleifus, 272 S.E.2d 821 (W. Va. 1980); *see also* Dodson v. Nink, 390 N.E.2d 546 (Ill. App. Ct. 1979).

"The parties quite clearly intended a binding contract to purchase, not a mere option . . . in the plaintiff to purchase without any obligation of affirmative action on his part." Stabile v. McCarthy, 145 N.E.2d 821, 823 (Mass. 1957); *accord* Abrams v. Motter, 83 Cal. Rptr. 855, 861 (2d Dist. Ct. App. 1970); Aubert v. Bourg, 259 So. 2d 103, 106 (La. Ct. App. 1972); Williams v. Cormier, 100 So. 2d 307 (La. Ct. App. 1958); Szelik v. Bonsignore, 145 N.Y.S.2d 659 (Sup. Ct. Nassau Cnty. 1955), *aff'd*, 164 N.Y.S.2d 1003 (App. Div. 2d Dep't 1957); Mezzanotte v. Freeland, 200 S.E.2d 410 (N.C. Ct. App. 1973); Aldrich v. Forbes, 391 P.2d 748, 750 n.5 (Or. 1964) (quoting this treatise); Anaheim Co. v. Holcombe, 426 P.2d 743 (Or. 1967); Jamison v. Concepts Plus, Inc., 552 A.2d 265 (Pa. Super. Ct. 1988) (application for subdivision).

Where the application is to be made on purchaser's behalf by another, purchaser is under an implied obligation to cooperate. Alois v. Waldman, 149 A.2d 406 (Md. 1959) (failure barred purchaser's recovery of down payment).

53. A purchaser who had agreed to apply for a mortgage was held to default the down payment on changing her mind and abandoning the mortgage application. Bushmiller v. Schiller, 368 A.2d 1044 (Md. Ct. Spec. App. 1977).

approval,[54] for failure of which he is liable in damages.[55] Arguably, the latter imposes no obligation to act, thus depriving the contract of mutuality, but the better reasoning is that a "subject to financing" clause also impliedly obligates the buyer to seek financing.[56]

[A] Down Payment

The dollar amount specified in the financing condition is highly important. The buyer is responsible for coming up with cash equal to the difference between the price and the specified loan amount. Institutional lenders will refuse to issue a commitment unless the buyer can demonstrate the source of the down payment. A buyer who cannot obtain a commitment for this reason is in default.[57] A mortgage condition that fails to specify the principal amount of the buyer's loan is badly flawed. A Louisiana court has held that a condition calling for the amount "to be determined" does not allow a buyer to terminate the contract.[58]

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54. Stabile v. McCarthy, 145 N.E.2d 821 (Mass. 1957); Sorota v. Baskin, 134 N.E.2d 428 (Mass. 1956); Burst v. R.W. Beal & Co., 771 S.W.2d 87 (Mo. Ct. App. 1989) (based on "availability" of financing); *accord* Glassie v. King, 360 F.2d 503 (D.C. Cir. 1965) (purchaser denied recovery of down payment); Lach v. Cahill, 85 A.2d 481 (Conn. 1951) (contract "contingent" on purchaser's ability to obtain loan); Rand v. B.G. Pride Realty, 350 A.2d 565 (Me. 1976); Norgate Homes, Inc. v. Cent. State Bank, 440 N.Y.S.2d 51 (App. Div. 2d Dep't 1981) (application to subdivide); Renovest Co. v. Hodges Dev. Corp., 600 A.2d 448 (N.H. 1991) (discusses reasonable efforts); W. Hills, Or., Ltd. v. Pfau, 508 P.2d 201 (Or. 1973).

    Where the contingency is based on purchaser's ability to obtain a loan, purchaser must allege his inability in order to recover his down payment. Sheldon Simms Co. v. Wilder, 131 S.E.2d 854 (Ga. Ct. App. 1963) (complaint held subject to demurrer).

55. *See* Widebeck v. Sullivan, 99 N.E.2d 165 (Mass. 1951).

56. Inv. Syndicates, Inc. v. Clark, 478 P.2d 752 (Wash. Ct. App. 1970) (contract made "subject to formation of group for this purchase" is not illusory; parties understood this meant subject to financing; buyer entitled to specific performance).

57. Billman v. Hensel, 391 N.E.2d 671 (Ind. Ct. App. 1979) (buyer could not persuade his parents to supply additional funds); Lynch v. Andrew, 481 N.E.2d 1383 (Mass. App. Ct. 1985) (buyers were short of funds because they had not sold existing residence; lender was willing to make bridge loan, which buyers refused to accept).

58. La. Real Estate Comm'n v. Butler, 899 So. 2d 151 (La. Ct. App. 2005). Buyers contracted to purchase a home for $770,000, giving a deposit of $12,500. A mortgage contingency specified an interest rate of 8.5% with the loan amount "to be determined." The buyers applied for a loan of 90% of the price, but were rejected. The sellers refused to return their deposit. The court held for the sellers because there was no evidence that

A contract to close when the purchaser has arranged financing agreeable to him has been held conditional.[59] It has been suggested that a reference to uncertain purchase money financing must necessarily be intended to create a condition.[60] Any doubt in these cases can be avoided by specifying whether the parties contemplate a condition or a mere postponement of the time for performance.

Even performance of the condition was held not to bar rescission of a conveyance in a case where the contract of sale was subject to the purchaser's obtaining a G.I. mortgage. Approval of such a mortgage required a termite certificate, which proved to be incorrect.[61]

An FHA mortgage may present a problem in requiring "points," the common term for a mortgage premium. A mortgagor is legally forbidden to make this payment; but this puts the seller under no obligation to pay this charge, although the contract of sale is subject to a mortgage "on F.H.A. terms."[62] But when a seller agreed, after execution of a contract of sale, to pay a mortgage company discount,

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the buyers could not obtain 8.5% financing for a smaller loan amount. It observed that the buyers inserted the words "to be determined" in the broker's form contract, stating that any ambiguity must be construed against the party who "furnished the text in question." The court also rejected the buyers' arguments that the contract was indefinite and was subject to a mutual mistake. A realtor testified that 40% of the purchase agreements in the community used the "to be determined" language, a practice that obviously ought to change in the decision's wake.

59. Locke v. Bort, 103 N.W.2d 555 (Wis. 1960). Annot., *Vendor and Purchaser: Contract Provision Referring to Purchaser's Uncompleted Arrangement for Financing the Balance of Purchase Price As Creating a Condition Precedent*, 81 A.L.R.2d 1338 (1962); *see* Gerruth Realty Co. v. Pire, 115 N.W.2d 557 (Wis. 1962).

60. Aiken, *"Subject to Financing." Clauses in Interim Contracts for Sale of Realty*, 43 MARQ. L. REV. 265, 271 (1960).

But a contract requiring purchaser to pay $2,250 cash and obtain the balance by a thirty-year conventional loan was held unconditional. Hawk v. Daugherty, 251 S.E.2d 390 (Ga. Ct. App. 1978) (purchaser not entitled to refund).

61. Wilson v. Romeos, 199 N.W.2d 208 (Mich. 1972); *In re* N. Broadway Funding Corp., 6 B.R. 133 (Bankr. E.D.N.Y. 1980).

Seller is likewise under no duty to make repairs necessary to conform the premises to F.H.A. specifications. Warriner v. Super. Ct. of Maricopa Cnty., 519 P.2d 81 (Ariz. Ct. App. 1974). *Accord* Dodson v. Nink, 390 N. E.2d 546 (Ill. App. Ct. 1979).

Contra Walsh v. Kelly, 406 N.E.2d 741 (N.Y. 1980), ruling that seller's implied agreement not to interfere with or prevent performance by purchaser of the condition specified required seller to pay the "points" to the extent that the FHA forbade payment by the purchaser.

62. Rocker v. Murphy, 322 N.E.2d 541 (Ill. App. Ct. 1975).

to enable the purchaser to obtain the specified mortgage and convert the purchaser's liability from contingent to unconditional, the seller's agreement was held supported by adequate consideration.

[B] "Reasonable Efforts"

If the contract requires the buyer, whether expressly or by implication, to make reasonable efforts to obtain a mortgage loan, there will necessarily be uncertainty about what efforts should be made.[63] What will constitute reasonable efforts is largely a question of fact and entails a showing by the party under the duty to act of activity reasonably calculated to obtain the object in question or expenditure not disproportionate in the circumstances.[64] The purchaser's personal contacts with several financial institutions were deemed "reasonable efforts," although no formal loan application was made.[65] A distinction has been drawn between reasonable efforts and good-faith efforts, the former involving an objective determination and usually greater efforts, the latter involving a subjective determination. On this basis a requirement that the purchaser proceed immediately and with diligence was not satisfied with good-faith efforts.[66] Absent specifics, a mortgage contingency clause requires only good faith.[67] "Best efforts" require more than good-faith efforts.[68]

"Best efforts" have been defined in various ways, as more demanding than due diligence, as an "unprovable standard," and as "clattersome shambles," depending on its mechanism.[69]

It would make for clarification and, from the purchaser's point of view, safety, for a contract of sale to require him to make one or a specified number of mortgage applications to lending institutions and supply them with the information they require. This would still leave open the nature of the mortgage—Will it require the mortgagee to apply insurance proceeds to repair damage? Will it contain

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63. WYDA Assocs. v. Merner, 50 Cal. Rptr. 2d 323, 330 (Dist. Ct. App. 1996). This does not consider purchaser's possible waiver of the condition before seller cancels.
64. *In re* J.B. Van Sciver Co., 73 B.R. 838, 844–47 (Bankr. E.D. Pa. 1987); Allview Acres, Inc. v. Howard Inv. Corp., 182 A.2d 793 (Md. 1962); Smith v. Currie, 253 S.E.2d 645 (N.C. Ct. App. 1979) (obtaining mortgage). Annot., *Sufficiency of Real-Estate Buyer's Efforts to Secure Financing upon Which Sale Is Contingent*, 78 A.L.R.3d 880 (1977).
65. Case v. Forloine, 639 N.E.2d 576 (Ill. App. Ct. 1993).
66. Phillipe v. Thomas, 489 A.2d 1056 (Conn. App. Ct. 1985).
67. Blass v. Miller, 588 N.Y.S.2d 940, 942 (App. Div. 3d Dep't 1992).
68. Grossman v. Lowell, 703 F. Supp. 282 (S.D.N.Y. 1989) (application to one bank and phone calls to three others insufficient).
69. *In re* Heard, 6 B.R. 876, 883–84 (Bankr. W.D. Ky. 1980).

a dueon-sale clause?, etc., or some requirement, such as that the purchaser sell an existing house or apartment that he may want available for his family.

Recovery of a down payment was denied where a bank revoked its commitment to a husband and wife after the wife filed for divorce.[70] The result was otherwise when a purchaser lost his eligibility for a mortgage when his employer relocated him to another state.[71] A purchaser whose application was rejected for insufficient income, because he executed a second contract of sale for an in-law, recovered his down payment.[72]

A contract contingent on a buyer's obtaining a $12,000 mortgage was held in the circumstances to imply his promise to make reasonable efforts to obtain a mortgage, but only on reasonable terms as to the amount and time of installment payments. A commitment subject to matters of substance beyond the scope of the contingency clause is no commitment.[73] A commitment conditioned

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70. Bruyere v. Jade Realty Corp., 375 A.2d 600 (N.H. 1977). The bank relied on two wage earners for its security. *Contra* Stevens v. Cliffs at Princeville Assocs., 684 P.2d 965 (Haw. 1984) (wife not a co-purchaser).
71. Carmichael v. Lambert Constr. Co., 487 So. 2d 1367 (Ala. Ct. App. 1986).
72. Maynard v. Bazazzdegan, 732 S.W.2d 950 (Mo. Ct. App. 1987).
73. Sala v. Hay, 415 P.2d 330 (Colo. 1966); Lach v. Cahill, 85 A.2d 481 (Conn. 1951) (purchase of home by young veteran in modest circumstances); Antonini v. Thrifty-Nifty Homes, 76 So. 2d 564 (La. Ct. App. 1955); Tieri v. Orbell, 162 A.2d 248 (Pa. Super. 1960).

A contract subject to purchaser obtaining a mortgage implies an obligation on purchaser to reasonable efforts for this. Warstler v. Cibrian, 859 S.W.2d 162 (Mo. Ct. App. 1993).

A condition that purchaser obtain a twenty-year mortgage was held not complied with by an offer of a twenty-five-year mortgage with right of prepayment. Donato v. Baltrusaitis, 290 N.Y.S.2d 659 (Sup. Ct. Queens Cnty. 1958).

A condition that seller have an existing mortgage extended requires only reasonable efforts to obtain the extension. Sorota v. Baskin, 134 N.E.2d 428 (Mass. 1956).

The ordinary conditional contract of sale does not require purchaser or seller to satisfy extraordinary conditions imposed by a lender. Kimbrough v. Belk & Co., 256 S.E.2d 119 (Ga. Ct. App. 1979) (sale of purchaser's property); Dodson v. Nink, 390 N.E.2d 546 (Ill. App. Ct. 1979) (repairs by seller); Crane v. Mulliken, 408 N.E.2d 778 (Ill. App. Ct. 1980) (delivery of leases and financial records on sale of shopping center); McKenna v. Rosen, 570 A.2d 1277 (N.J. Super. Ct. 1990); Farrell v. Janik, 542 A.2d 59 (N.J. Super. Ct. 1988) (same); Kressel, Rothlein & Roth v. Gallagher, 547 N.Y.S.2d 653 (App. Div. 2d Dep't 1989) (sale of purchaser's house; citing New York cases); Clarke v. Hartley, 454 N.E.2d 1322 (Ohio Ct. App. 1982) (sale of purchaser's property); Tighe v. Wilson, 427 N.E.2d 531 (Ohio Ct. App. 1980) (FHA requirement of appraisal).

on a purchaser's selling his property is not a firm commitment.[74] A long-term loan is implied.[75] A buyer is not required to accept two mortgages;[76] or to accept a single mortgage for a lesser amount and obtain the balance elsewhere;[77] or to guaranty a corporate mortgage;[78] or to agree to a due-on-sale clause.[79] He need not accept terms more onerous than those specified in the contract;[80] or use a corporate applicant instead of himself to avoid usury laws.[81] Neither does the purchaser need to mortgage any property other than that involved in the sale.[82] A purchaser may refuse to sign and deliver to a seller a purchase money mortgage that was made, inter alia, additional security for the seller's debt to a third party.[83] A condition that a purchaser obtain a lending institution mortgage permits him to reject a loan from an unincorporated group with no evidence of financial responsibility.[84] A buyer's failure to make written

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Requirements that purchaser sell his house and also verify his monthly income were held not unreasonable. Welkind v. Hall, 503 A.2d 779 (N.H. 1985). The problem presented by this case is to trap a purchaser into a forfeiture for guessing wrong. Purchaser may have valid reasons for keeping his present house—for other members of the family or for speculation.

A contract specifying that purchaser apply for a loan at 10% interest was not broken by applying for 10.5% loan on terms otherwise the same. Clearly, a lender refusing 10.5% would have refused 10%. Herbage v. Smoddy, 864 S.W.2d 695 (Tex. Civ. App. 1993).

74. Finkelman v. Wood, 609 N.Y.S.2d 655 (App. Div. 2d Dep't 1994) (citing New York cases).
75. Rand v. B.G. Pride Realty, 350 A.2d 565 (Me. 1976), 78 A.L.R.3d 873 (1977).
76. Merritt v. Davis, 265 So. 2d 69 (Fla. Dist. Ct. App. 1972); Slack v. Munson, 61 So. 2d 618 (La. Ct. App. 1952). *Cf.* Di Benedetto v. Di Rocco, 93 A.2d 474 (Pa. 1953). *But see* Burris v. Craven, 477 A.2d 627 (Vt. 1984).
77. Finke v. Lemle, 252 P.2d 869 (Kan. 1953). *See also* Makris v. Nolan, 335 A.2d 655 (N.H. 1975).
78. Educ. Placement Serv., Inc. v. Watts, 789 S.W.2d 902 (Tenn. Ct. App. 1990).
79. Maccaro v. Andrick Dev. Corp., 311 S.E.2d 91 (S.C. 1984).
80. Williams v. Enmon, 380 So. 2d 144 (La. Ct. App. 1979). An obligation to apply for a fixed rate mortgage, with a right to apply for any other kind, permitted purchaser to cancel the contract on rejection of the fixed rate. Carrol v. Harry, 402 S.E.2d 357 (Ga. Ct. App. 1991).
81. Young v. Koehl, 417 So. 2d 24 (La. Ct. App. 1982) (alternate decision).
82. Kinmonth v. Griffith, 304 P.2d 494 (Kan. 1956). *But see* Lynch v. Andrew, 481 N.E.2d 1383 (Mass. App. Ct. 1985).
83. W. Bay Realty Corp. v. Gad-Sal Realty Corp., 392 N.Y.S.2d 83 (App. Div. 2d Dep't 1977).
84. Asplund v. Marjohn Corp., 168 A.2d 844 (N.J. Super. Ct. 1961). *Accord* Dawson v. Malloy, 428 So. 2d 297 (Fla. Dist. Ct. App. 1983) (conditioned on institutional mortgagee's permitting purchaser to assume existing mortgage); Woods v. Austin, 347 So. 2d 897 (La. Ct. App. 1977); Berman v. Rife, 644 S.W.2d 574 (Tex. Civ. App. 1982).

application for a mortgage, as required by his contract, was deemed immaterial and insufficient to prevent recovery of his down payment, where he had made a bona fide oral application that failed because of inadequate income.[85]

A purchaser's failure to notify a seller of failure to obtain a mortgage within the time specified, therefore, is the subject of contrary results. Some courts overlook a purchaser's delay on the ground that time is not of the essence. Others note the harm to a seller of keeping his property off the market while the purchaser gambles with the property.[86] A purchaser's notice within the required time ends the contract.[87] A purchaser's suggested changes in the contract thereafter is a counteroffer without effect by itself.[88] The cases do not agree if time is of the essence in giving notice in this

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85. Bellina v. Graybar, 532 So. 2d 847 (La. Ct. App. 1988); *accord* Elghanyan v. Mundy, 639 N.Y.S.2d 175 (App. Div. 2d Dep't 1996) (purchaser rejected because of business losses); Gast v. Miller, 541 N.E.2d 497 (Ohio Mun. Ct. Hamilton Cnty. 1988); *see* Saltzman v. McCombs, 281 P.2d 394 (Nev. 1955). *Compare* Giba v. Bastian, 229 A.2d 93 (Md. 1967) (buyer excused from obligation to apply for rezoning when be received professional advice it would fail).

86. That is, purchaser's time to give notice of failure was not of the essence. Foelsch v. Eaton, 180 N.Y.S.2d 757 (App. Div. 2d Dep't 1958), *modifying and aff'g* 172 N.Y.S.2d 243 (Sup. Ct. Nassau Cnty. 1958). *Cf.* Zuk v. Irion, 171 N.Y.S.2d 465 (Sup. Ct. Nassau Cnty. 1958). A requirement that purchaser give written notice was waived by acceptance of parol notice. Dellicarri v. Hirschfeld, 619 N.Y.S.2d 816 (App. Div. 3d Dep't 1994). *Contra* Thakral v. Mattran, 509 N.E.2d 772 (Ill. App. Ct. 1987).

Purchaser's application within twenty-two days, instead of a required six days, was held immaterial when purchaser's income would have justified rejection of a mortgage. Nicholls v. Pitoukkas, 491 N.E.2d 574 (Ind. Ct. App. 1986). Such delay may keep property off the market longer than seller intends.

Purchaser was under no implied obligation to notify seller of the rejection, resulting in substantial loss to seller. Meaux v. Adams, 456 So. 2d 670 (La. Ct. App. 1984). *Contra* Perrino v. Hogan, 572 N.Y.S.2d 523 (App. Div. 3d Dep't 1991).

Foelsch, 180 N.Y.S.2d 757, *modifying and aff'g*, 172 N.Y.S.2d 243, holds time is not of the essence but must be deemed overruled by *Cortesi*, 534 N.E.2d 313, *modifying* 524 N.Y.S.2d 874, which remanded the case to determine if notice to seller was given within the required time. *Cf.* Zuk v. Irion, 171 N.Y.S.2d 465 (Sup. Ct. Nassau Cnty. 1958).

See also Merrill Lynch Realty/Carll Burr, Inc. v. Skinner, 63 N.Y.2d 590 (1984).

Churgin v. Hobbie, 635 N.E.2d 1280 (Mass. App. Ct. 1995), reviewing Massachusetts cases, holds an extension of time to close title is no extension of time to give notice of failure to obtain a mortgage commitment. Purchaser's deposit was forfeited.

87. *In re* Stafford's In The Field, Inc., 162 B.R. 29 (Bankr. D.N.H. 1996).

88. *Id.*

situation.[89] Recent cases have required purchasers to comply with some reasonable requirements not mentioned in the contract of sale.[90] A purchaser's arbitrary failure to apply for a mortgage[91] or an application on terms different from those specified in the contract[92] makes the contract unconditional.

A purchaser is not to be penalized for making a truthful application, although his candor makes rejection virtually certain,[93] and where rejection is certain, a purchaser was not required to await formal rejection.[94] A buyer was held to have broken the contract by stopping his check for the down payment within three days, after one bank had rejected his application for a mortgage. Subsequent efforts to obtain a loan after the breach were deemed immaterial.[95]

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89. Faulkner v. Millar, 460 S.E.2d 378 (N.C. 1995) (time not of essence in reporting feasibility study, partly dictum).

90. Lynch v. Andrew, 481 N.E.2d 1383 (Mass. App. Ct. 1985) (requires purchaser to accept bridge loan on existing house; *i.e.*, a temporary loan, to have enough money to complete transaction); Fry v. George Elkins Co., 327 P.2d 905 (Cal. Dist. Ct. App. 1958) (2% prepayment premium during first three years); Farrell v. Janik, 542 A.2d 59, 62 (N.J. Super. Ct. 1988) (dictum re termite inspection and certificate of employment); *see also* cases in *Lynch*, 481 N.E.2d at 1386; cases in 78 A.L.R.2d 880 (1977).

91. Cobbs v. Fred Burgos Constr. Co., 477 So. 2d 335 (Ala. 1985); Schottland v. Lucas, 396 So. 2d 72 (Ala. 1981); Smith v. Tiblier, 374 So. 2d 685 (La. Ct. App. 1979); Hendel v. Scheuer, 541 N.Y.S.2d 40 (App. Div. 2d Dep't 1989) (purchaser loses down payment); Gasparino v. Rigatti, 554 N.Y.S.2d 696 (App. Div. 2d Dep't 1990); Hamilton v. Harborview Dev. Partners, 359 S.E.2d 516 (S.C. Ct. App. 1987).

92. Price v. Bartkowiak, 715 F. Supp. 76 (S.D.N.Y. 1989) (larger mortgage and longer term); Goldberg v. Charlie's Chevrolet, Inc., 672 S.W.2d 177 (Mo. Ct. App. 1984) (application for larger financing than specified); Post v. Mengoni, 604 N.Y.S.2d 186 (App. Div. 2d Dep't 1993) (application for larger mortgage than specified); Silva v. Celella, 545 N.Y.S.2d 367 (App. Div. 2d Dep't 1989); Smith v. Evans, 620 S.W.2d 627 (Tex. Civ. App. 1981).

But a contract conditioned on purchasers obtaining a mortgage "not less than ____" permitted application for a larger mortgage and recapture of a down payment for failure. Slamow v. Delcol, 594 N.E.2d 918 (N.Y. 1992). This language is virtually an open invitation to purchaser's breaking the contract at will.

93. M.F.&G. Trading Co. v. Jensen, 107 S.E.2d 441 (Va. 1959); Holst v. Guynn, 696 P.2d 632 (Wyo. 1985) (purchaser informed V.A. of loss of employment).

94. Levine v. Robin, 277 N.Y.S.2d 474 (App. Div. 2d Dep't 1967) (house lacked certificate of occupancy).

95. Bayon v. Pettingill, 77 So. 2d 202 (La. Ct. App. 1955). Purchaser's cancellation of a check for a down payment after one day entitled seller to a judgment for the amount of the check. Korabel v. Natoli, 619 N.Y.S.2d 833 (App. Div. 3d Dep't 1994).

[C] Conditions

If a contract is subject to a purchaser's obtaining a mortgage, the existence of other adequate assets of the purchaser is irrelevant.[96]

A purchaser may well provide that his obligation to seek a loan will be satisfied if he retains a specified broker—a party qualified in this specialized field—to obtain the loan, whether or not the broker succeeds.[97] Generally, whether the purchaser acted in good faith is a jury question.[98] A seller may terminate the contract after the specified time has run,[99] but may not obstruct or delay a purchaser's efforts and then cancel the contract on the basis of the purchaser's failure to timely perform.[100] A contract conditional on a purchaser's receiving

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96. Kelly v. Terrill, 268 N.E.2d 885 (Ill. App. Ct. 1971) (purchaser recovered down payment).

97. The contract may name a mortgage broker who is qualified to arrange the type of loan needed, or the listing or selling broker. Frequently, the broker who effects the sale of a home obtains the mortgage as a matter of course and without compensation other than his sales commission.

    A New Jersey statute has been construed to deny a broker a right to a commission for obtaining a home loan if he represents either party to the transaction for compensation. N.J. REV. STAT. § 45:15-17(i) (1990); Mortg. Banker's Ass'n v. N.J. Real Estate Comm'n, 491 A.2d 1317 (N.J. Super. Ct. 1985) (extended discussion of mortgage practice). Similar statutes elsewhere may lead to similar results.

98. Murphy v. Morse, 100 S.E.2d 623 (Ga. Ct. App. 1957); Osten v. Shah, 433 N.E.2d 294 (Ill. 1982); Honkomp v. Dixon, 422 N.E.2d 949 (Ill. App. Ct. 1981) (application to one institution); Falk v. Goodman, 163 N.E.2d 871 (N.Y. 1959).

    Under a contract that was subject to purchaser's obtaining a $35,000 mortgage, purchaser's application to one bank for a $40,000 loan and his inquiry at a second bank was held no bona fide effort. Beekay Realty Corp. v. Cayre, 256 So. 2d 539 (Fla. Dist. Ct. App. 1972).

99. Hanson v. Moeller, 376 N.W.2d 220 (Minn. Ct. App. 1985); Opton Handler Gottlieb Feller Landau & Hirsch v. Patel, 610 N.Y.S.2d 26 (App. Div. 1st Dep't 1994) (same; down payment of $100,000 forfeited); Ferlita v. Guarneri, 524 N.Y.S.2d 94 (App. Div. 2d Dep't 1988) (purchaser's time to obtain mortgage). *Accord* Levine v. Trattner, 516 N.Y.S.2d 43 (App. Div. 2d Dep't 1987) (two-and-a-half month delay). *But cf.* Lang v. Blumenthal, 609 N.Y.S.2d 336 (App. Div. 2d Dep't 1994) (delayed application immaterial; time not of essence).

    A clause permitting either purchaser or seller to cancel after forty-five days was deemed for the benefit of both and could be waived by purchaser, who elected to cancel. Foster v. Lall, 516 N.Y.S.2d 570 (Sup. Ct. Queens Cnty. 1987).

    But time to obtain a mortgage commitment has been held not of the essence, Kakalik v. Bernardo, 439 A.2d 1016, 1019–20 (Conn. 1981), same as in delivery and acceptance of a deed.

100. Merrill Lynch Realty/Carll Burr, Inc. v. Skinner, 63 N.Y.2d 590 (1984); Schwartz v. Donnenberg, 168 N.Y.S.2d 31 (Sup. Ct. Nassau Cnty. 1957)

an FHA mortgage within fifteen days was held to permit the purchaser to rescind after fifteen days, despite subsequent FHA approval.[101] One purchaser recovered his down payment in a case involving a contract conditioned on his obtaining a mortgage in six weeks, where he obtained a timely commitment, but the lender changed his mind during a delay caused by the seller's defective title.[102] If a purchaser fails to obtain a mortgage commitment within a specified period, he may cancel the contract, and the fact that a commitment is subsequently available is immaterial.[103] In this situation, a seller has also been held authorized to cancel despite the purchaser's suit for specific performance.[104] A purchaser's right to a refund of the down payment if he did not succeed in getting a mortgage within fifteen days was not waived by continuing his efforts thereafter.[105] But where a purchaser accepted a later commitment and scheduled a closing, he could no longer withdraw without being in breach of contract.[106] A purchaser entitled to a refund of his down payment in this situation was held entitled to interest thereon.[107]

[D] Mortgage Terms

A contract "subject to necessary financing," or with similar language, is unsatisfactory because of the uncertainty it may generate. It has been held to make a contract void for indefiniteness unless the surrounding circumstances show what the parties had in mind.[108]

(seller delayed inspection by mortgage appraiser); Meyer v. Custom Manor Homes, 167 N.Y.S.2d 112 (App. Div. 4th Dep't 1957) (seller failed to comply with agreement to apply for mortgage); RESTATEMENT (SECOND) OF CONTRACTS § 245 (1981); 3A A. CORBIN, CONTRACTS § 767 (1960).

101. Soudelier v. Whitney, 141 So. 2d 91 (La. Ct. App. 1962). *Accord* Gardner v. Padro, 517 N.E.2d 1131 (Ill. App. Ct. 1987).

102. Patterson v. Marchese, 173 N.Y.S.2d 759 (Sup. Ct. Westchester Cnty. 1958), *aff'd*, 196 N.Y.S.2d 903 (App. Div. 2d Dep't 1960).

103. Sainato v. Hormozdi, 448 N.Y.S.2d 240 (App. Div. 2d Dep't 1982); Zigman v. McMackin, 177 N.Y.S.2d 723 (App. Div. 2d Dep't 1958); Weschler v. Winter, 190 N.Y.S.2d 828 (N.Y. Sup. Ct. Nassau Cnty. 1959).

104. McDonald v. Cullen, 559 P.2d 506 (Or. 1977).

105. Abramson v. Briardale Builders, Inc., 156 N.E.2d 607 (Ill. App. Ct. 1959); Baumann v. Brittingham, 759 S.W.2d 880 (Mo. Ct. App. 1988).

106. Loper v. O'Rourke, 382 N.Y.S.2d 663 (Dist. Ct. Suffolk Cnty. 1976) (purchaser sought withdrawal by reason of matrimonial problem). *Accord* Keliher v. Cure, 534 N.E.2d 1133 (Ind. Ct. App. 1989).

107. Holst v. Guynn, 696 P.2d 632 (Wyo. 1985).

108. Garner v. Brown, 171 S.E.2d 391 (Ga. Ct. App. 1969); Perkins v. Gosewehr, 295 N.W.2d 789 (Wis. 1980) (subject to commitment for $52,000 void for indefiniteness); Gerruth Realty Co. v. Pire, 115 N.W.2d 557 (Wis. 1962), noted in 46 MARQ. L. REV. 388 (1963). *Accord* Miracle Revival Ctr. Move of God Church v. Kindred, 615 S.W.2d 257 (Tex. Civ. App. 1981). *Contra In re* Flannery, 11 B.R. 974 (Bankr. E.D. Pa. 1981).

It has also been held to permit the purchaser alone to determine what is "necessary" for him, subject to good faith on his part.[109] The same is

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See also Locke v. Bort, 103 N.W.2d 555 (Wis. 1960).

Under a contract "contingent on the Buyer obtaining a mortgage at his terms," buyer unsuccessfully sought a $21,000 mortgage and then, at seller's suggestion, unsuccessfully tried another bank. Buyer recovered his down payment. The contract was held conditional, despite the failure to fill in the blank, largely on the basis of practical construction by the parties. Grayson v. LaBranche, 225 A.2d 922 (N.H. 1967) (citing text). Failure to fill in these blanks does not make the contract unenforceable. Allen v. Smith, 508 N.Y.S.2d 331 (App. Div. 3d Dep't 1986).

A contract subject to "favorable financing" was held enforceable. Hunt v. Shamblin, 371 S.E.2d 591 (W. Va. 1988).

A contract contingent on an FHA mortgage, and providing for payment of $20,350 from the FHA loan, contemplates a mortgage in that amount. Parker v. Averett, 151 S.E.2d 475 (Ga. Ct. App. 1966).

Requiring purchaser to give notice, by a specified time, of failure to obtain a mortgage makes this time of the essence, so seller can promptly seek another purchaser. Tator v. Salem, 439 N.Y.S.2d 497 (App. Div. 3d Dep't 1981). *Accord* R&R Insurers & Builders, Inc. v. Fink, 205 S.E.2d 297 (Ga. 1974) (though closing scheduled for later date); Mouhelis v. Thomas, 419 N.E.2d 956 (Il. App. Ct. 1981) (purchaser lost job). *Contra* Kakalik v. Bernardo, 439 A.2d 1016 (Conn. 1981) (seller, with informal actual knowledge, sought subterfuge to renege). *See also* Kelly v. Doran, 458 A.2d 962 (Pa. Super. Ct. 1983) (issue whether seller waived notice).

"Subject to adequate financing" is satisfied if financing is available in a nearby community. Moore v. Moore, 603 S.W.2d 736 (Tenn. Ct. App. 1980).

109. Mezzanotte v. Freeland, 200 S.E.2d 410 (N.C. Ct. App. 1973) ("satisfactory financing"); Reese v. Walker, 151 N.E.2d 605 (Ohio Mun. Ct. Cincinnati 1958); Kovarik v. Vesely, 89 N.W.2d 279 (Wis. 1958).

Any indefiniteness in this situation is cured, sufficiently for purchaser to have specific performance against seller, when purchaser obtains financing. Highlands Plaza, Inc. v. Viking Inv. Corp., 467 P.2d 378 (Wash. Ct. App. 1970). *See generally* Aiken, *"Subject to Financing" Clauses in Interim Contracts for Sale of Realty*, 43 MARQ. L. REV. 265 (1960). *Contra* Nodolf v. Nelson, 309 N.W.2d 397 (Wis. 1981).

A contract subject to purchaser's obtaining a mortgage of "not more than $10,000" was deemed intended to permit the purchaser to determine the amount he needed, but not in excess of $10,000. Zigman v. McMackin, 177 N.Y.S.2d 723 (App. Div. 2d Dep't 1958).

Compare Mobil Oil Corp. v. Wroten, 303 A.2d 698 (Del. Ch. 1973) (and authorities collected); 1 A. CORBIN, CONTRACTS § 149 (1963); 3A *Id.* § 644 (1960).

Every contract imposes on each party a duty of good faith and fair dealing in its performance and enforcement. RESTATEMENT (SECOND) OF CONTRACTS § 205 (1981) (and authorities cited).

A contract of sale conditioned on purchaser obtaining a mortgage of "at least $ ____" permitted him to apply for a larger mortgage and recover his down payment for failure. Slamow v. Delcol, 571 N.Y.S.2d 335 (App. Div. 2d Dep't 1991). This clause gave purchaser a virtual revocable purchase option.

true of "suitable financing."[110] But once the purchaser has made a determination he is bound thereby, as where he files an application for a loan and sets forth therein the specific terms that will be acceptable to him.[111] In one case, a purchaser determined a mortgage of $3,000, plus the sale of certain shares, would be sufficient. The mortgage proved available, but the shares failed to produce the expected sum. The purchaser's inability to complete the sale was held to be his fault.[112] A contract subject to obtaining financing "reasonable" to the borrower is construed objectively and governed by what others similarly situated would consider reasonable.[113] But a contract subject to a purchaser's obtaining "satisfactory" financing was held to be subjective. The court distinguished between a condition existing before any performance and "satisfaction" after a thing has been constructed or repaired.[114] A purchaser's "ability" to obtain financing for $16,000 has been held to involve not only the amount to be borrowed but the rate of interest and length of time for amortization to fit his circumstances, as well as a responsible lender. Parol evidence of this was deemed competent.[115] Parol evidence was also held competent to determine

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110. Gildea v. Kapenis, 402 N.W.2d 457 (Iowa Ct. App. 1987) (and cases discussed).
111. Kovarik v. Vesely, 89 N.W.2d 279 (Wis. 1958).
112. Barber v. Crickett [1958] N.Z.L.R. 1057, noted in 34 N.Z.L.J. 16, at 241 (1958).
113. Connell v. Avon Garage Co., 137 A.2d 765 (Pa. 1958); Kleiman v. White, 476 S.W.2d 375 (Tex. Civ. App. 1972) (not reasonable to require loan of 100% of value of land and improvement). *But see* Stone Mountain Props. v. Helmer, 229 S.E.2d 779 (Ga. Ct. App. 1976), where a contract subject to obtaining railroad's approval for a spur line, satisfactory to purchaser, was held lacking in mutuality on the ground that "satisfaction" was wholly in purchaser's control; Hansen v. Circle Lake Dev. Corp., 260 N.W.2d 609 (Neb. 1977) (contra conditional on "financing" held ambiguous; purchaser recovered down payment despite commitment for a 70% mortgage). The "satisfaction cases" generally take two lines. (1) Those allowing a subjective determination, usually involving feelings or taste, with the decision completely reserved to the party given the right of determination. It is said that a court may not inquire into the reason for the determination. But a court may find that a waiver has occurred, possibly when a flagrant abuse is found. (2) Those allowing an objective determination, easily judged by a reasonable man standard; *e.g.*, operative fitness or mechanical utility. This line is preferred by courts when appropriate. Matters of financial concern fit into either line, more frequently into the second. These are apt to require consideration of the circumstances. It is possible to give one party complete discretion despite an objective situation. See the cases discussed in Forman v. Benson, 446 N.E.2d 535 (Ill. App. Ct. 1983).
114. Watkins v. Williamson, 869 S.W.2d 383 (Tex. Civ. App. 1993).
115. Tieri v. Orbell, 162 A.2d 248 (Pa. Super. Ct. 1960). The court noted that a twenty-year mortgage on a $20,000 house is usual. *Accord* Reese v. Walker, 151 N.E.2d 605 (Ohio Mun. Ct. Cincinnati 1958).

the intention of the parties in inserting into a contract the phrase "obtain maximum loan."[116]

On the other hand, a contract of sale subject to a purchaser's ability to secure a mortgage for $10,500 for ten years was held invalid for failure to specify the interest rate or terms of payment.[117] A contract subject to the "best obtainable" first mortgage was held not to authorize the purchaser to obtain a mortgage large enough to permit him to pocket part of its proceeds and diminish the value of a junior purchase mortgage to be delivered to the seller.[118] A contract "subject to bank financing" was held in the circumstances to mean for 65% of the purchase price.[119] A condition for a mortgage at a fixed rate of interest is not fulfilled by one with an adjustable rate.[120]

[E] Lenders

A seller has no claim against a prospective lender who revokes its commitment to the purchaser. Any incidental benefit that would otherwise accrue to the seller does not make him a creditor or donee contract beneficiary.[121]

An applicant for a mortgage must usually make a deposit with the lender, which is often referred to as a standby or commitment fee. This is generally not returnable if the loan fails to close, unless the failure is the lender's fault. The deposit may be regarded as consideration for an option agreement, consideration for the expenses of the loan, or an enforceable provision for liquidated damages. A liquidated damages provision is enforceable if reasonable in amount, because of the difficulty of fixing precise damages—.5% to 3% is in this category.[122] In one case there was no operational language indicating the nature of

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116. Marlatt v. La Grange, 357 P.2d 927 (Colo. 1960). The court found $14,000 or $14,475 as the maximum loan. Unable to obtain this, purchaser recovered his down payment.
117. Scott v. Lewis, 112 Ga. App. 195, 144 S.E.2d 460 (1965); Neiss v. Franze, 101 Misc. 2d 871, 422 N.Y.S.2d 345 (Sup. Ct. 1979) (provision for conventional mortgage).
118. Antonelli v. Senate Realty Corp., 230 F. Supp. 776 (D.D.C. 1963).
119. Makris v. Nolan, 335 A.2d 655 (N.H. 1975) (purchaser applied for $416,000, bank granted $340,000 loan, purchaser not obliged to accept second mortgage loan from seller for difference). The court called this kind of drafting a "plague."
120. Zepfler v. Neandross, 497 So. 2d 901 (Fla. Dist. Ct. App. 1986) (interest at no more than 13.5% not satisfied by one at 13% subject to increase with 2.5% "cap").
121. Khabbaz v. Swartz, 319 N.W.2d 279 (Iowa 1982).
122. *See* Woodridge Place Apartments v. Wash. Square Capital, 965 F.2d 1429 (7th Cir. 1992) (discussing cases); Annot., *Enforcement of Provision in Loan Commitment Authorizing Lender to Charge Standby, Commitment Fee or Similar Deposit*, 93 A.L.R.3d 1156 (1979).

the fee and that the commitment was conditioned on 93% occupation of the property. Occupancy was not that high. It was held that failure of performance of a condition was no breach of contract, and return of the deposit was ordered.[123]

The possibility of an applicant's forfeiture of a commitment or standby fee makes it advisable for the applicant to know what the prospective mortgage and related instruments will provide. If the contract of sale requires a purchaser to accept a mortgage with the mortgagee's "usual provisions," the applicant has little leeway. Do the usual terms provide for a fixed or sliding rate of interest or a due-on-sale clause? Must the mortgagee apply the proceeds of insurance or an award in partial condemnation to restoration of the property or may he use them to reduce the amount of the mortgage? Does the mortgagor have a right of partial or full prepayment of the mortgage and on what terms? Where a substantial loan on commercial property is involved, the majority of the terms of the prospective mortgage and related instruments should be settled at an early stage.

A lending institutional mortgagee has also been held liable to a purchaser for misrepresentation or failure to disclose information.[124] A lending institution has been held not liable to a purchaser-mortgagor for allegedly negligent review of commercial leases. The review was deemed for the institution's benefit, not the purchaser's.[125]

Purchasers often obtain residential purchase-money mortgages through mortgage brokers. When a borrower gets a loan through a mortgage broker, the borrower often pays an interest rate in excess of the lender's "par" or market rate. The lender pays the value of the excess—the yield spread premium—to the broker. Such payments arguably constitute illegal referral fees under the Real Estate Settlement Procedures Act (RESPA). In 1999 and 2001, the Department of Housing and Urban Development (HUD) issued policy statements, supportive of the lending industry, allowing the practice if: (i) the total compensation of the broker was for services performed, and (ii) that compensation was reasonably related to the services provided. The Ninth Circuit has validated the HUD policy statements.[126]

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123. Woodbridge Place Apartments, 965 F.2d 1429.

124. Miles v. Perpetual Sav. & Loan Co., 388 N.E.2d 1364 (Ohio 1979) (collecting authorities on agency and fiduciary relations).

125. Yousef v. Trustbank Sav., 568 A.2d 1134 (Md. Ct. Spec. App. 1990).

126. In Schuetz v. Banc One Mortg. Corp., 292 F.3d 1004 (9th Cir. 2002), *cert. denied*, 537 U.S. 1171 (2003), a mortgage borrower brought a class action challenging yield spread premiums. In enacting the policy, HUD did not follow formal rulemaking procedures, including notice to the public and the invitation of comments. The Ninth Circuit refused to certify the class action, reasoning the HUD policy statement was entitled to deference

§ 3:2.3 Single or Multiple Loan Applications

The sample clause set forth above in section 3:2 (Clause 3-1, Clause for Fixed Mortgage) states that "Buyer shall not be required to apply to more than one lender." If the parties agree that the buyer should make more than a single application, the language in Clause 3-3 below can be substituted.

CLAUSE 3-3

Clause Allowing Buyer to Apply to More Than One Lender

> If Buyer's bona fide application to two lending institutions for such mortgage shall be rejected, Buyer shall be deemed unable to obtain such commitment.

If the buyer knows where he will apply for a loan when the contract is signed, it is appropriate to name the lender in the contract. This limits the buyer's obligation to make only one application. Similarly, if the buyer is willing to use a particular broker to shop for the loan, the contract may limit the buyer's obligation to deal with only that broker.[127]

Many contracts employ financing clauses that do not specify whether the buyer is obligated to make more than one loan application. This prejudices both parties because their rights are not clearly defined. This drafting weakness is especially bad for the buyer, who may prefer a refund of the earnest money after a single rejection, but finds a recalcitrant seller who refuses to release the money.

Judicial results are uncertain when the clause does not say whether the buyer has to apply to more than one lender. A buyer cannot be expected to apply to every available lending institution, but courts interpreting clauses that fail to specify the number of applications have

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under Chevron U.S.A., Inc. v. Natural Res. Def. Council, 467 U.S. 837 (1984). The court focused on Congress's explicit grant to HUD of authority to interpret RESPA and HUD's expertise in the home lending industry.

127. The contract may name a mortgage broker who is qualified to arrange the type of loan needed, or the listing or selling broker. Frequently, the broker who effects the sale of a home obtains the mortgage as a matter of course and without compensation other than his sales commission.

A New Jersey statute has been construed to deny a broker a right to a commission for obtaining a home loan if he represents either party to the transaction for compensation. N.J. REV. STAT. § 45:15–17(i) (1990); Mortg. Banker's Ass'n v. N.J. Real Estate Comm'n, 200 N.J. Super. 584, 491 A.2d 1317 (1985) (extended discussion of mortgage practice). Similar statutes elsewhere may lead to similar results.

often required more than one application.[128] Sometimes when a buyer's first application is rejected, the seller or broker recommends another lender. The buyer's failure to try the recommended source may support a finding that the buyer has not diligently sought financing.[129]

On the other hand, a single unsuccessful loan application sometimes suffices to allow the buyer to terminate and recover the earnest money. Usually, the buyer prevails by introducing evidence that further applications would have been futile.[130] Particular language of the financing condition may support this conclusion. For example, a sloppily drafted contract mixed the plural and the singular, requiring the buyer to make "truthful and proper applications to a lending institution designated by the Seller."[131]

Usually the issue of whether the buyer must apply to more than one lender is a question of fact, rather than a matter of law to be resolved by summary judgment.[132] Only rarely have courts discussed which party has the burden of proving that the buyer could or could not

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128. *E.g.*, Brewster v. Yockey, 153 So. 2d 489 (La. Ct. App. 1963) (single application insufficient under condition that buyer obtain "a Homestead or conventional loan of $11,500 over a period of twenty or twenty-five years").

129. Fry v. George Elkins Co., 327 P.2d 905 (Cal. Ct. App. 1958) (two unsuccessful applications not sufficient when broker told buyer that lender who had existing mortgage on home was willing to refinance for buyer on terms specified in contract); Smith v. Vernon, 286 N.E.2d 99 (Ill. App. Ct. 1972) (three banks rejected buyer; one other bank offered to lend a lower amount than buyer wanted; seller's attorney arranged for buyer to apply from another lender, but buyer refused to follow through).

130. Luttinger v. Rosen, 316 A.2d 757 (Conn. 1972) (buyer applied to only institution in community that would make the large loan specified in the contract); Woods v. Austin, 347 So. 2d 897 (La. Ct. App. 1977) (bank rejected buyer's application due to her deceased husband's bad credit); Rand v. B.G. Pride Realty, 350 A.2d 565 (Me. 1976) (buyer dealt with the bank that was most likely to finance land to be developed as summer boys' camp); D'Ambrogio v. Morgenstern, 516 N.Y.S.2d 447 (Sup. Ct. 1987) (single application sufficient when buyers were turned down for insufficient income, even though twelve days remained in forty-five-day contract period for buyers to obtain financing); Gast v. Miller, 541 N.E.2d 497 (Ohio Mun. Ct. 1988) (bank rejected application because buyer's income was not sufficient).

131. Cohen v. Turnpike Dev. Corp., 213 N.Y.S.2d 245 (Sup. Ct. 1961) (first lender designated by seller issued a commitment for amount less than specified in contract).

132. Honkomp v. Dixon, 422 N.E.2d 949 (Ill. App. Ct. 1981) (question of fact as to whether "reasonable efforts" required buyer to make more than one application); Johnson v. Werner, 407 N.Y.S.2d 28 (App. Div., 1st Dep't 1978) (question of fact whether buyer, whose application for VA mortgage was denied, should have then applied for conventional mortgage).

obtain the requisite mortgage loan, and the courts have split.[133] The better rule is to place the burden on the buyer, who has peculiar knowledge of his income, credit history, and the steps he has taken with respect to contacting lenders.

An illustrative case is *Myers v. Kayhoe*,[134] wherein a home purchase contract had a mortgage contingency calling for a $245,000 loan upon specified terms. The buyers agreed to "make written application for the financing herein described" within five days of the making of the contract. The buyers timely applied to an institutional lender, who rejected the application, giving as a reason its conclusion that the original appraisal of the property overstated its value. The lender was willing to lend only $225,000. The buyers did not make another loan application and declined an offer made by the seller's broker to arrange financing for the full amount on the terms specified in the contract. The court held that the buyers were entitled to a refund of their deposit. The court interpreted the contract to require that the buyers make only one loan application for the described financing. The court recognized that, in the absence of an express contract provision, a buyer may have had an implied obligation to make more than one application, but any such obligation was displaced by the parties' contract.

§ 3:2.4 Waiver of Mortgage Condition

The buyer may waive a mortgage condition by accepting a loan for a shorter term than the one specified in the contract.[135] The buyer may negotiate with the lender over issues not addressed in the financing condition, but a buyer breaches if he withdraws the application because those negotiations fail. Buyer may also waive, and put himself in default under the contract, if he relies unsuccessfully on obtaining other financing.[136] Likewise, if he applies for a larger mortgage than specified in the contract of sale.[137] A buyer may be estopped to set up

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133. Tipton v. Harden, 197 S.E.2d 746 (Ga. Ct. App. 1973) (buyer has burden); Gast v. Miller, 541 N.E.2d 497 (Ohio Mun. Ct. 1988) (seller has burden).
134. Myers v. Kayhoe, 892 A.2d 520 (Md. 2006).
135. Lipscomb v. Chadbourne, 378 So. 2d 147 (La. Ct. App. 1979) (ten years rather than specified twenty-year term).
136. Williams v. Ubaldo, 670 A.2d 913 (Me. 1996); Connell v. Parlavecco, 604 A.2d 625 (N.J. Super. 1992). Rice v. Buie, 687 N.Y.S.2d 52 (App. Div. 1st Dep't 1999) (contract provided for standard $600,000 mortgage loan; buyers defaulted by applying for larger loan that included amounts for renovation).
137. Post v. Mengoni, 604 N.Y.S.2d 186 (App. Div. 2d Dep't 1993). *But see* Katz v. Simon, 627 N.Y.S.2d 763 (App. Div. 2d Dep't 1995), where the result was contra. There, purchaser applied for a larger loan but the bank decided to give only a smaller loan than that specified.

the condition, as by accepting a mortgage of $16,000 where the contract is conditioned upon his obtaining a larger mortgage.[138] If the condition is the obtaining of a mortgage from a third person, the buyer may waive the condition by offering cash.[139]

The right to waive may be qualified by a court if its exercise would lead to unintended prejudice. A Massachusetts case (1) made a contract conditional on purchaser's obtaining a theatre license, and (2) provided for a purchase money mortgage, with amortizations payable only after the theatre opened. The court held (2) inapplicable after purchaser waived the condition and thereby made it uncertain if a theatre would ever open.[140] In one case the contract was conditioned

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138. Loda v. H.K. Sargeant & Assocs., Inc., 448 A.2d 812 (Conn. 1982); Appel v. Cusumano, 142 N.Y.S.2d 443 (Sup. Ct. 1955).

139. Blanton v. Williams, 70 S.E.2d 461 (Ga. 1952); De Freitas v. Cote, 174 N.E.2d 371 (Mass. 1961); Fleischer v. McCarver, 691 S.W.2d 930, 934 (Mo. Ct. App. 1985); Ross v. Eichman, 529 A.2d 941 (N.H. 1987); Cwiakala v. Giunta, 92 A.2d 849 (N.J. Super. 1952); Huntington Mining Holdings, Inc. v. Cottontail Plaza, Inc., 433 N.Y.S.2d 824 (App. Div. 2d Dep't 1980); *see also* Kenney v. Wedderin, 56 So. 2d 550 (La. 1951).

The fact that purchaser received financing from a source other than that contemplated by the contract of sale is no defense to seller. Mezzanotte v. Freeland, 200 S.E.2d 410 (N.C. Ct. App. 1973); Renouf v. Martini, 577 S.W.2d 803 (Tex. Civ. App. 1979). A contract contingent on purchaser's ability to get a mortgage from a specified institution was held no bar to purchaser's getting a loan elsewhere, where the specified institution was seller's mortgagee and insisted on a $1,192.50 prepayment premium. Rowan v. Ell-Dav Corp., 364 N.Y.S.2d 393 (Sup. Ct. Suffolk Cnty. Dist. 1975).

Purchaser may elect to take a third-party mortgage in an amount less than that specified in the contract of sale. Doryon v. Salant, 142 Cal. Rptr. 378 (2d Dist. Ct. App. 1977); Friedman v. Chopra, 533 A.2d 48 (N.J. Super. Ct. App. Div. 1987).

In Nikora v. Mayer, 257 F.2d 246 (2d Cir. 1958), a contract was to "cease and terminate" if purchaser failed to obtain a mortgage within a specified time. This was held to make the contract self-terminating despite purchaser's offer of cash. This literal interpretation disregards the fact that the condition was for purchaser's benefit. *See* 3A A. CORBIN, CONTRACTS § 761 (1960) and other authorities in this section. *Nikora* was also based on another ground. The *Nikora* result can be avoided by giving the purchaser an express option to offer cash in this situation. In accord with *Nikora* is Dale Mortg. Bankers Corp. v. 877 Stewart Ave. Assocs., 518 N.Y.S.2d 411 (App. Div. 2d Dep't 1987). *Contra* Friedman v. Chopra, 533 A.2d 48 (N.J. Super. Ct. App. Div. 1987).

The Wisconsin practice and authorities are discussed at length in Raushenbush, *Problems and Practices with Financing Conditions in Real Estate Purchase Contracts*, 1963 WIS. L. REV. 566.

140. E.M. Loews, Inc. v. Deutschmann, 147 N.E.2d 832 (Mass. 1958). Under a contract to purchase, subject to (1) acquiring adjoining properties and (2) rezoning for an apartment house, which required purchaser to apply for rezoning, purchaser was held excused from making such application in the

upon the buyer's obtaining an FHA commitment for development of the premises. Upon failing to obtain the commitment the buyer offered to pay for the property in cash. In view of the fact that the seller owned other property in the neighborhood that would benefit from the consequences of FHA development, it was held that the condition was for the benefit of both parties and that it could not be waived by one party alone.[141]

When seller takes back security for part of the purchase price, any condition that may impair his security is deemed for his benefit as well

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face of professional advice that the application would fail and give the properties a "black mark," a conclusion in which the adjoining owners concurred. Giba v. Bastian, 229 A.2d 93 (Md. 1967). *Cf.* Hing Bo Gum v. Nakamura, 549 P.2d 471 (Haw. 1976).

141. Woodlark Constr. Corp. v. Callahan, N.Y.L.J., Jan. 8, 1948, at 113, col. 5, *aff'd*, 89 N.Y.S.2d 67 (App. Div. 2d Dep't 1949). A similar contract was involved in Miller v. Moylan, 72 So. 2d 380 (Fla. 1954), where a broker sued a seller for a commission. It was held that the purchaser properly waived a condition that he obtain an FHA mortgage. There was no evidence that the seller owned neighboring property or would be benefited otherwise by the mortgage. Seller was not permitted to take a purchase money mortgage where the contract contemplated a V.A. mortgage. Weschler v. Winter, 190 N.Y.S.2d 828 (N.Y. Sup. Ct. Nassau Cnty. 1959). *Compare* Lamb v. Staples, 72 S.E.2d 219 (N.C. 1952), where a contract of sale was conditioned on the buyer's obtaining, within thirty days, a release of a federal tax lien affecting the premises. A failure to obtain the release until after thirty days was held to excuse the seller and permit him to accept a better offer from a third person.

A purchaser has been denied the right to waive where performance of the condition would improve seller's purchase money security. It was so held where a contract was to be void if purchaser did not have the property rezoned by a specified date. Metz v. Heflin, 201 A.2d 802 (Md. 1964); Jones v. Saah, 275 A.2d 165 (Md. 1971); where the condition was purchaser obtaining a water easement on adjoining property, Lehman v. Williamson, 533 P.2d 63 (Colo. Ct. App. 1975); and likewise with respect to a contract subject to a condition that part of the property be exchanged for property of a third person. The exchange would be of some slight advantage to seller's purchase money deed of trust, Scheffres v. Columbia Realty Co., 223 A.2d 619 (Md. 1966); *accord* Isaacson v. G.D. Robertson & Co., 192 P.2d 486 (Cal. Dist. Ct. App. 1948); Annot., 39 A.L.R.3d 362, 391 (1971).

Purchaser was not permitted to waive a condition that seller obtain approval of a subdivision of that part of his property contracted to be sold to purchaser, because of its effect on seller's remaining property. Uscian v. Blacconeri, 340 N.E.2d 618 (Ill. App. Ct. 1975). Same: Poquott Dev. Corp. v. Johnson, 478 N.Y.S.2d 960 (App. Div. 2d Dep't 1984); Lynlil Land Dev. Corp. v. Deluca, 553 N.Y.S.2d 185 (App. Div. 2d Dep't 1990) (permit for "cluster housing"); Dan Bunn, Inc. v. Brown, 590 P.2d 209 (Or. 1979).

A contract of sale provided for closing on a specified date but with monthly adjournments, for no more than six months, until purchaser's property would be taken under a prospective condemnation. This

as the purchaser's. This may, among other matters, bar purchaser's right to waive provisions in a proposed paramount mortgage.[142] Some New York cases hold that despite a statement that the contingency is for the benefit of both parties, the purchaser may alone cancel the contract.[143] Some other New York cases hold that a mortgage contingency clause is for the benefit of seller as well as purchaser, and that seller alone may cancel for purchaser's failure to obtain a mortgage.[144]

Making the contract of sale subject to purchaser's obtaining a mortgage is for the purchaser's benefit. Giving the purchaser a specified time for this is for the seller's benefit. A seller need not keep the property off the market indefinitely. If the seller deems the condition for his benefit as well as for the purchaser, the seller should include in the contract a provision forbidding waiver of the condition without the consent of both.

§ 3:2.5 Seller Financing As Substitute for Institutional Loan

A contract of sale may be subject to a buyer's obtaining a mortgage from a third party, on specified terms, with an express proviso that if the purchaser fails to obtain such mortgage within a specified time, the seller will be privileged to take back a purchase money mortgage on the same terms.[145] If the seller's financing is acceptable to the buyer in case a third-party loan is unavailable, the optional clause shown below is appropriate.

CLAUSE 3-4

Clause for Seller Financing

> Notwithstanding the foregoing provisions of this paragraph, if Buyer shall give notice of an inability to procure a mortgage from a lending institution on the aforementioned terms, Seller may, within five days after notice from Buyer thereof, give Buyer notice of an election, which is hereby conferred on Seller, to

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arrangement would permit use of the condemnation award to replace the property to be taken. Purchaser's election to waive this condition was held to make the contract unconditional and with no lack of mutuality. Safeway Sys. v. Manuel Bros., Inc., 228 A.2d 851 (R.I. 1967).

142. Fleischer v. McCarver, 691 S.W.2d 930, 934 (Mo. Ct. App. 1985) (citing other examples of forbidden waiver).

143. W.W.W. Assocs., Inc. v. Giancontieri, 548 N.Y.S.2d 580 (App. Div. 2d Dep't 1989).

144. *See id.* at 584 *et seq.*

145. Sillur Realty Corp. v. Lirco Realty Corp., 128 N.Y.S.2d 800 (Sup. Ct. Queens Cnty. 1954). *Accord* Kimbrough v. Belk & Co., 256 S.E.2d 119 (Ga. Ct. App. 1979); Dodson v. Nink, 390 N.E.2d 546 (Ill. App. Ct. 1979).

> accept a purchase money mortgage, and a mortgage note [bond] to be secured thereby, in said amount and on said terms. In this event the form of the mortgage instruments shall conform to _____ [insert reference to forms to be used].

When the contract fails to authorize or exclude the possibility of the seller stepping in to provide the described financing, judicial results have varied. Some courts allow the seller to avoid the condition and bind the buyer by offering to take back a purchase money mortgage on terms no more onerous than those contemplated in the contract.[146] But this is not invariably true. A purchaser may prefer to borrow from a bank or other lending institution, with its established practices, than from a private lender. The latter, a court might note, may be a rougher creditor.[147]

In *Glassman v. Gerstein*,[148] a purchaser, whose contract was conditioned on his getting money from a lending institution, was held

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146. Duncan v. Rossuck, 621 So. 2d 1313 (Ala. 1993); Berlinger v. Moffitt, 82 N.Y.S.2d 833 (N.Y. Sup. Ct. Queens Cnty. 1948); Kovarik v. Vesely, 89 N.W.2d 279 (Wis. 1958). *See* Raushenbush, *Problems and Practices With Financing Conditions in Real Estate Purchase Contracts*, 1963 WIS. L. REV. 566, 576 (describing why some Wisconsin brokers were critical of *Kovarik* decision).

A purchaser who had sought a twenty-year mortgage was not required to accept a seller's offer to take an eleven-year and seven-month mortgage, which would entail substantially larger payments. Tieri v. Orbell, 162 A.2d 248 (Pa. Super. Ct. 1960).

A purchaser who failed to obtain a contemplated mortgage was not required to accept in lieu thereof an installment contract under which the deed would be withheld until full payment. Seller's proposal was not the equivalent of ownership in fee, subject to a mortgage. Christmas v. Cooley, 406 P.2d 333 (Colo. 1965).

147. *See* Dawson v. Malloy, 428 So. 2d 297 (Fla. Dist. Ct. App. 1983); Gardner v. Padro, 517 N.E.2d 1131, 1134 (Ill. App. Ct. 1987); Berwick v. Daniel W. Keuler Realtors, Inc., 595 A.2d 1272, 1276 (Pa. Super. Ct. 1991). In Kovarik v. Vesely, 89 N.W.2d 279 (Wis. 1958), the court noted that the source of the financing was not a material part of the transaction. *See also* W. Bay Realty Corp. v. Gad-Sal Realty Corp., 392 N.Y.S.2d 83 (App. Div. 2d Dep't 1977), and Makris v. Nolan, 335 A.2d 655 (N.H. 1975).

Purchaser need not give mortgage to seller. Gardner v. Padro, 517 N.E.2d 1131 (Ill. App. Ct. 1987); Macho Assets, Inc. v. Spring Corp., 513 N.Y.S.2d 180 (App. Div. 2d Dep't 1987); Senese v. Litz, 471 N.Y.S.2d 401 (App. Div. 3d Dep't 1984). Nor need purchaser agree to seller's guaranteeing purchaser's mortgage to a third party. Seller's threat to forfeit down payment for purchaser's refusal was held coercion, making seller liable for treble damages. Wilder v. Squires, 315 S.E.2d 63 (N.C. Ct. App. 1984).

A lending institution has been defined as an enterprise organized for the purpose of making loans. *See Gardner*, 517 N.E.2d at 1134–35.

148. Glassman v. Gerstein, 200 N.Y.S.2d 690 (App. Div. 2d Dep't 1960).

entitled to reject seller's offer of a mortgage on even better terms where he claimed an unwillingness to accept private financing. Perhaps seller should expressly reserve a right to accept a mortgage in this situation if consummation of the transaction is sufficiently important to him.

The same court, in a 3-2 decision, permitted a seller to give a mortgage on terms similar to those specified in the contract. The contract was subject to purchaser's securing a mortgage, no reference to "institution" being made. But purchaser agreed to apply to lending institutions. On his failure, seller had the option to secure the mortgage. The dissent argued that seller could not "secure" a mortgage from himself, and that references in the contract to processing costs and escrow deposits, and provision for closing title at the office of an institution, all reflected the parties' intentions.[149]

A purchaser who agreed to apply to an institution was held under no duty to accept a mortgage from seller on conditions customarily different from those given by institutions.[150]

§ 3:2.6 Commitment Fees

Applicants for large commercial mortgage loans often must pay the lender a substantial commitment fee, which may be refundable if the applicant closes the loan in accordance with its terms. This practice may have resulted from an inclination of some applicants with a commitment from one institution to go shopping around thereafter for a better deal and, if successful, to abandon the first institution. In the majority of cases, the institution may retain the payment if the applicant fails to close in accordance with the commitment terms.[151] But there is a substantial amount of relevant litigation, partly because of ambiguous language in some commitments, and also a fee of .5% to 3% offers a tempting quest. If the fee is characterized as damages or liquidated damages this may give the applicant a chance to dispute the amount of the damages or the enforceability of a liquidated damages clause. If the clause states that it is consideration

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149. Marino v. Nolan, 266 N.Y.S.2d 65 (App. Div. 2d Dep't 1965), *aff'd*, 219 N.E.2d 291 (N.Y. 1966).

150. Katz v. Chatelain, 321 So. 2d 802 (La. Ct. App. 1975).

151. Woodridge Place Apartments v. Wash. Square Capital, 965 F.2d 1429, 1435 (7th Cir. 1992).

Many commitment letters require leases to meet with lender's satisfaction, and cases on this tend to give the lender broad discretion. *See* Draper, *Tight Money and Possible Substantive Defenses to Enforcement of Future Mortgage Commitments*, 50 NOTRE DAME L. REV. 603 (1975). In other situations, satisfaction clauses have been given disparate meanings. In this situation the borrower might well endeavor to specify some standards; *i.e.*, term, market rent, and financial status of tenant, to avoid giving the lender unlimited discretion.

for mortgagee making the obligation, retention of the payment is clearly enforceable. The clause may also be enforced as a "standby fee," although the actual segregation of the proceeds of the loan, except possibly in construction loans, has been said to be "a common misconception among borrowers and lawyers."[152] As stated by Wolf:

> Each year an investment company reviews its cash-flow, its investment portfolio, its policy borrowings and decisions are reached as to how much money is to be lent and from where the funds are to come. The usual technique is to meet commitment requirements out of the cash-flow from prior investments and maturing obligations. If necessary, short-term paper can be sold or, if further necessary, money can actually be borrowed by the lender at a prime rate for a brief period until the lender has the funds to repay the loan.[153]

If the payment is for an option, it is clearly nonrefundable unless the mortgagee commits a breach. But if it is an option, the mortgagee is bound, but not the borrower, who may walk away from the deal if he is willing to lose his payment. In *Woodridge Place Apartments*,[154] the applicant received a commitment for a mortgage loan, subject to the property having an occupancy of at least 93%. The mortgagee refused to make the loan because the occupancy was less. The applicant then sued for return of the advance payment of $139,500. The court noted it was not clear whether the commitment was an option, permitting retention of the fee, or a bilateral contract, which was subject to a condition precedent; that is, occupancy. The court cited cases going both ways on this issue.[155] Here it found no bad faith in seeking occupancy, construed the ambiguity against the draftsman, and gave the applicant a refund with accrued interest. It has been suggested that this can be avoided by a simple commitment clause such as the one below.

CLAUSE 3-5

Commitment Clause

> Borrower is to deliver to lender the sum of $___, as part of the consideration for the issuance of this commitment and for the lender's obligation to loan the money in question, but this sum

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152. Wolf, *The Refundable Commitment Fee*, 23 BUS. LAW. 1065 (1968) [hereinafter Wolf], at 1069.
153. *Id.*
154. Woodridge Place Apartments v. Wash. Square Capital, 965 F.2d 1429, 1435 (7th Cir. 1992).
155. *Id.* at 1437.

shall be returned if the loan is consummated in accordance with the terms of this commitment.[156]

The possibility of an applicant's forfeiture of a commitment or standby fee in the case of a substantial mortgage on commercial property is far more serious than in the case of a prospective loan on a house. A failure of the loan to close will probably make impossible an acquisition of the property or prevent other contemplated payments. In this connection, there are provisions of the proposed mortgage that could presumably be negotiated when the application and commitment payments are made. The borrower will want grace periods after notice before acceleration of the debt for monetary defaults (nonpayment of principal or interest, failure to pay taxes, or supply insurance) as well as non-monetary defaults (failure to repair, cure violations, or other matters where time necessary for completion is uncertain).[157] The borrower will also want provisions dealing with fire and casualty insurance[158] and partial condemnation[159] to provide that their proceeds may be used for restoration of the property. Other matters cannot be negotiated that soon and may leave the applicant at a risk that should be mitigated. Insofar as the mortgage commitment reserves the right to pass on appraisals of the property, leases, mortgagor's title, and other items, the mortgagee should be required to make its determination as early as possible and, if possible, before the mortgagor pays any loan charges or becomes subject to any risk of forfeiture of any of these charges.

§ 3:2.7 Lender's Revocation of Commitment

There is a split of authority as to whether a standard financing condition, such as the sample clause set forth above in section 3:2 (Clause 3-1, Clause for Fixed Mortgage), protects the buyer from a revocation of the commitment by the lender. When the contract has a mortgage condition, usually the contract language does not expressly address the effect of revocation of the loan commitment. Nor does the typical contract state whether buyer's obligation to purchase is conditioned on closing of the loan. In the absence of such language, courts generally allow the buyer to rescind and recover her earnest money if she was not at fault,[160] but there are contrary

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156. Wolf, *supra* note 152, at 1074.
157. *See infra* section 3A:1.4.
158. *See infra* section 3A:1.2[B].
159. *See infra* section 3A:13.
160. Ne. Custom Homes, Inc. v. Howell, 553 A.2d 387 (N.J. Super. Ct. Monmouth Cnty. 1988); Kapur v. Stiefel, 695 N.Y.S.2d 330 (App. Div. 1st Dep't 1999) (summary judgment not appropriate for either party when lender

decisions.[161] States that generally protect the buyer from the lender's revocation come out differently if revocation is due to the buyer's fault. Then the seller may retain the earnest money.[162]

A pro-buyer "loan funding" clause, which can be added to the clause set forth in section 3:2 above (Clause 3-1, Clause for Fixed Mortgage) is shown below.

CLAUSE 3-6

Pro-Buyer Loan Funding Clause

If Buyer obtains a commitment for a mortgage loan from a lending institution (whether or not the loan described in the commitment meets the specifications stated above), Buyer's obligation to close this purchase is conditioned on the lender disbursing the loan proceeds at closing. If for any reason the lender fails or refuses to disburse the loan proceeds at closing, Buyer shall have the right to terminate this agreement, with the earnest money returned to Buyer.

§ 3:3 Continuation of Existing Mortgage

§ 3:3.1 Planning and Drafting Considerations

Sometimes a buyer finances the purchase in part by taking over the seller's existing mortgage or mortgages. Great care must be taken

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revoked mortgage commitment due to buyer's loss of job; buyer's fault or bad faith is issue of fact); Lane v. Elwood Estates, Inc., 298 N.Y.S.2d 751 (App. Div. 2d Dep't 1969), *aff'd*, 268 N.E.2d 805 (N.Y. 1971) (purchaser lost job); Patterson v. Marchese, 173 N.Y.S.2d 759 (Sup. Ct. Westchester Cnty. 1958), *aff'd*, 196 N.Y.S.2d 903 (App. Div. 2d Dep't 1960) (seller's bad title); Rosen v. Empire Valve & Fitting, Inc., 553 A.2d 1004 (Pa. Super. Ct. 1989).

Northeast distinguishes between interpretation and construction. It notes that the contract at issue made no express reference to the possibility of obtaining a commitment and its subsequent rejection. The court concluded that its holding could not be based on interpretation, which refers to the words used. Following *Corbin*, it rules that construction, which refers to the contract as distinguished from its words, fills in the gaps in the contract with respect to which the parties had no contemplation or intent. 3 A. CORBIN, CONTRACTS § 534, at 11 (1960); FRIEDMAN ON LEASES, *supra* note 35, § 26:3 (Supp. July 2013).

161. Malus v. Hager, 712 A.2d 238 (N.J. Super. Ct. App. Div.) (lender revoked commitment because borrower was terminated from employment; court held seller did not have to refund buyer's deposit), *cert. denied*, 719 A.2d 642 (N.J. 1998).

162. Keliher v. Cure, 534 N.E.2d 1133 (Ind. Ct. App. 1989); Bruyere v. Jade Realty Corp., 375 A.2d 600 (N.H. 1977) (purchaser's divorce eliminated one income).

when the price clause refers to the buyer assuming or taking subject to an existing mortgage. A purchase price of $12,000 "subject to a mortgage of $5,000" has resulted in at least two lawsuits on whether the recited price was over and above the existing mortgage; that is, whether the cost to the purchaser was $12,000 or $17,000. In one case the buyer was held entitled to credit for this amount against the sum payable to the seller.[163] But another case concluded that the phrase might mean the contrary and, for this reason, held the contract too indefinite for specific performance.[164]

A contract was held unenforceable where the recited purchase price was subject to an "existing loan."[165] For a similar reason, a contract requiring purchaser to "assume" existing assessments was held ambiguous.[166]

A sample clause that avoids the problem of ambiguity as to total price is provided below.

CLAUSE 3-7

Clause for Taking Subject to Mortgage

The purchase price is $250,000, payable as follows:

(1) $20,000 on the signing of this contract, by check subject to collection.

(2) $150,000 by taking subject to an existing first mortgage in that amount.

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163. Didriksen v. Havens, 68 A.2d 163 (Conn. 1949). A mortgage is ordinarily part of the purchase price unless the contract provides otherwise. Vickers v. Horster, 451 P.2d 7 (Okla. 1969) (mortgage taken subject to is ordinarily part of price unless contract provides otherwise).

An installment sale, subject to specified mortgages, required purchaser to pay a purchase price of $35,000 in installments, after which a deed was to be delivered. Seller was held to have no claim against purchaser for the amount of mortgage payments made by seller between the date of the contract and the delivery of the deed. Fye v. Cox, 263 N.W.2d 725 (Iowa 1978). *See also* Garner v. Metro. Life Ins. Co., 262 S.E.2d 544 (Ga. Ct. App. 1979).

In a more complicated version of this situation a divided court gave seller recovery for unjust enrichment. Wolford v. Tankersley, 695 P.2d 1201 (Idaho 1985).

164. Williams v. Manchester Bldg. Supply Co., 97 S.E.2d 129 (Ga. 1957). Terms of sale that included "subject to mortgage" were held to indicate the purchase price was the amount paid to the seller, plus the amount of the mortgage. Del Rio Land, Inc. v. Haumont, 514 P.2d 1003 (Ariz. 1973).

165. Morgan v. Hemphill, 110 S.E.2d 780 (Ga. Ct. App. 1959). McDonald v. Moore, 790 P.2d 213 (Wash. Ct. App. 1990), held the same with respect to an option included in a will to buy for $40,000 subject to a mortgage.

166. Wright v. Lowe, 296 P.2d 34 (Cal. Dist. Ct. App. 1956).

(3) $50,000 by Purchaser's purchase money note and mortgage.

(4) $30,000 on the delivery of the deed, in cash or by Purchaser's certified check to the order of Seller, drawn on a bank which is a member of the Clearing House.

(5) In no event shall Seller be required to accept an endorsed check.

This clause provides for a purchaser's credit for the amount of a first mortgage, and also for a payment at the closing of cash and a purchase money junior mortgage, each in a specified sum. It may leave uncertain whether the cash or the purchase money mortgage is to be reduced if the closing adjustments give the purchaser a net credit,[167] or if the purchaser is to be credited with insurance moneys paid to a seller for fire damage,[168] or, on the other hand, that one is to be increased if the first mortgage is reduced by amortization between the date of the contract and of the closing.[169] This uncertainty may be avoided by specifying the effect of these. If the purchase money mortgage is to be made to a third person, rather than to the seller, and in a specified sum, there would appear to be no doubt that any variation should apply to the cash payment.

Where an existing mortgage requires amortization, the contract should provide that if, in the interim between contract and closing, the mortgage is reduced by one or more payments, the amount of cash payable by the purchaser at the closing shall be increased by an amount equal to such principal payments.[170] The purchaser should

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167. Mann v. Wolff, 226 N.E.2d 263 (Mass. 1967), upheld seller's right to receive the cash payment in full and apply the credit in reduction of the purchase money mortgage. This was based on a preliminary agreement that provided: (a) for a purchase money mortgage of "approximately $5,000," whereas the other sums were specific; and (b) for execution of a mutually satisfactory definitive agreement.

168. Larstan Indus., Inc. v. Res-Alia Holding Co., 232 A.2d 440 (N.J. Super. Ct. App. Div. 1967) (proceeds of insurance applied to reduced mortgage).

169. A contract of sale was held unenforceable for indefiniteness in this situation. Moog v. Palmour, 155 S.E.2d 692 (Ga. Ct. App. 1967). An additional factor in the *Moog* contract was the absence of a closing date, which made it uncertain what amortizations would accrue under the first mortgage in the interim. Georgia is apparently more ready than other states to nullify a contract for uncertainty.

170. A contract of sale contained the unusual provision that the purchase price should be reduced by the amount of amortizations made by the seller between the date of the contract and "the date affixed herein for the closing." Several adjournments were agreed to by stipulations under which the adjustments would be "as of the date of consummation." During the adjourned periods seller made amortizations of almost $14,000. Purchaser was held entitled to no credit for these. Ditmars-31 St. Dev. Corp. v. Punia, 235 N.Y.S.2d 796 (App. Div. 2d Dep't 1962).

see that this provision is limited to payments required under the mortgage and does not permit the seller to prepay otherwise.

The buyer may, and should, ascertain the terms and verify the amount owing on an existing mortgage, unless the mortgage is to be satisfied by the seller on or before the closing. If the form of mortgage is unsatisfactory, there is ordinarily nothing the buyer and seller can do about it. In a rare case the mortgagee may be induced to modify the mortgage in connection with a conveyance. The form of the purchase money mortgage will be governed by the contract of sale.

In view of the fact that some mortgages, particularly those affecting residential properties, permit the mortgagee to accelerate payment of the mortgage debt upon a sale of the property, it is in order for a purchaser to ask a seller to represent in the contract whether the mortgage or any related instrument authorizes acceleration of payment or a modification of its terms by reason of a change of ownership of the mortgaged property.[171] A clause for this purpose follows.

CLAUSE 3-8

Representation that Mortgage has no Due-on-sale Clause

> Seller represents that no mortgage affecting the premises hereby agreed to be sold is required to be paid, in whole or in part or to be modified in any way, by reason of this contract or the conveyance hereby provided for.

Under most mortgages, the mortgagee may require an owner to make necessary repairs. A buyer taking subject to or assuming a mortgage sometimes asks the seller to certify whether any such requirement has been made.

If the sale is to be subject to an existing mortgage, the contract should so state and should identify the mortgage by at least the book and page of its recordation. This is sufficient to charge the buyer with knowledge of its terms.[172] These terms must be examined. The mortgage may cover

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171. A fraudulent misrepresentation respecting a due-on-sale clause rendered seller liable for damages. Home Sav. & Loan Ass'n v. Schneider, 469 N.E.2d 585 (Ill. App. Ct. 1984).

172. Baucher v. Stewart, 122 N.Y.S. 202 (App. Div. 2d Dep't 1910); Blanck v. Sadlier, 47 N.E. 920 (N.Y. 1897); G. DAVIS, MARKETABILITY OF TITLE IN NEW YORK 377–78 (1916); *see generally* Annot., 57 A.L.R. 1253, 1394–99 (1928). *Cf.* Baker v. Leight, 370 P.2d 268 (Ariz. 1962).

more property than the property to be sold. If this should be true, the mortgage may become in default by matters over which the purchaser will have no control, such as nonpayment of taxes or waste in connection with the other premises. Occasionally, a bizarre provision will be found in the mortgage, such as payment in gold.[173]

But even routine provisions may have significance. In one case, a contract of sale provided for a purchase money mortgage to be in the form printed by a specified title company. This form permitted acceleration for failure to maintain buildings in repair. Because the buildings were dilapidated, the mortgage was virtually callable at-will.[174] Generally speaking, however, a default in existence at the time a mortgage is given may not be relied on to accelerate maturity unless the mortgage expressly so provides.[175]

Among the clauses to be noted are the maturity of the mortgage, interest rate, mortgagee's right to accelerate for breach, a due-on-sale clause,[176] the owner's right to prepay the mortgage in whole or in part, and any other provision that may be unusual generally or of special interest to the buyer. Any prospective financing for new construction or otherwise may be prevented by lack of a right to prepay an existing mortgage.[177]

An agreement to take subject to or to assume a mortgage charges the buyer with knowledge of all the terms of the mortgage, but not where these are incorrectly described in the contract of sale.[178] A material misdescription of the mortgage excuses the buyer from performance. Mortgages differing in amount or maturity, or with higher interest rates than those described in the contract, excuse the buyer.[179] A buyer was

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173. Blanck v. Sadlier, 47 N.E. 920 (N.Y. 1897).
174. Sanka Classics, Inc. v. Atlanta Terra Cotta Co., 79 N.Y.S.2d 748 (App. Div. 1st Dep't), *aff'd*, 83 N.E.2d 150 (N.Y. 1948).
175. Houser v. Heider, 350 P.2d 422 (Or. 1960); 59 C.J.S. *Mortgages* § 495(4)(a) (1949).
176. For a discussion of due-on-sale clauses, see *infra* section 3A:2. *See also* Home Sav. & Loan Ass'n v. Schneider, 469 N.E.2d 585 (Ill. App. Ct. 1984).
177. For a discussion of prepayment, see *infra* section 3A:9.
178. *See* Annot., 26 A.L.R. 528, 532 (1923).
179. Crooke v. Nelson, 191 N.W. 122 (Iowa 1922) (dictum that later maturity immaterial); Weiner v. Simons, 166 N.E. 765 (Mass. 1929); Maxey v. Quintana, 499 P.2d 356 (N.M. 1972) (upholds complaint for fraud where FHA mortgage represented as V.A. mortgage; FHA cost ½% more for insurance); Schmidt v. Reed, 30 N.E. 373 (N.Y. 1892) (three-year mortgage described in contract of sale as five-year mortgage; purchaser need not accept security in lieu of extension of mortgage); Rabinowitz v. Marcus, 123 A. 21 (Conn. 1923). *Cf.* Goldblatt v. Rosenwasser, 86 N.Y.S.2d 684 (App. Div. 2d Dep't 1949), *aff'd*, 93 N.E.2d 490 (N.Y. 1950); Keitel v. Zimmermann, 43 N.Y.S. 676 (Sup. Ct. N.Y. Cnty. 1897).

excused by a reference in the contract to mortgage payments, which omitted a requirement of monthly tax deposits, and by a reference to a right of prepayment, which failed to mention a limit of prepayment of 20% in any one year.[180] An incorrect reference in the contract to the subordination clause in a junior mortgage excuses the buyer.[181]

Likewise, an agreement to take subject to a mortgage "with the usual clauses" when the mortgage provides for assignment of rents to the mortgagee on breach, right to accelerate on actual or threatened demolition of buildings, and an obligation by the mortgagor to give an "estoppel certificate."[182] And, a seller's agreement to obtain an extension of an existing mortgage, effected by an agreement with similar provisions.[183] A purchaser was also excused by the presence of a "Brundage clause" in a mortgage.[184] In view of the present form statutory mortgage in New York and in some other states, most of these provisions would undoubtedly be held "usual" today.[185]

In *Baker v. Leight*,[186] a contract of sale referred to a mortgage, which purchaser was to assume, of approximately $52,000, "payable at approximately $518.39" per month, but did not mention an option in the mortgage to accelerate full payment if the property was sold. In an action by purchaser for recovery of his down payment, a judgment for defendant was reversed and the case remanded for a new trial. The court wrote: "Had the agreement merely said, 'The buyer buys subject to the mortgage,' or 'The buyer assumes and agrees to pay the mortgage,' then the buyer would be charged with full knowledge of the terms and conditions of the mortgage. However, when the seller expressly contracts that the buyer will be privileged to pay the mortgage at approximately $518.39 per month, then the buyer is entitled to rely on the contract so far as the seller is concerned."[187] In a similar situation, a purchaser, who agreed to assume a 6% mortgage, recovered his down payment when the mortgagee would waive his right of acceleration only if the interest rate were raised.[188]

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180. Star Apartment, Inc. v. Martin, 204 F.2d 829 (5th Cir. 1953).
181. Tiffany Realty Co. v. Estey Constr. Corp., 166 N.E. 319 (N.Y. 1929); Ruckstuhl v. Healy, 225 N.Y.S. 570 (App. Div. 1st Dep't 1927).
182. Elterman v. Hyman, 84 N.E. 937 (N.Y. 1908).
183. Schiff v. Tamor, 93 N.Y.S. 853 (App. Div. 2d Dep't 1905).
184. Groden v. Jacobson, 114 N.Y.S. 183 (App. Div. 2d Dep't 1908).
185. Compare, in this respect, Frank v. Frank, 108 N.Y.S. 549 (App. Div. 2d Dep't 1908). A similar question arises with respect to the form of purchase money mortgage to which the seller is entitled where the contract of sale is not specific in this regard.
186. Baker v. Leight, 370 P.2d 268 (Ariz. 1962).
187. *Id.* at 270.
188. Lane v. Bisceglia, 488 P.2d 474 (Ariz. 1971).

In some cases, courts have excused inaccurate descriptions of the mortgage to be assumed or taken subject to when the inaccuracy appeares to be minor in nature.[189]

The many cases relieving the buyer when the contract misdescribed the mortgage demonstrate that it is risky for a seller to attempt to recapitulate the terms of a mortgage. It is preferable to identify the mortgage in the contract of sale by its recordation date and either attach a copy to the contract or exhibit a copy to and have the same initialed by the buyer. An agreement to take subject to a mortgage "due and payable August 1, 1952" does not include an installment payment mortgage.[190] And an agreement to take subject to a past due mortgage does not require the buyer to take subject to a foreclosure action.[191] A failure to mention the existence of an assignment of rents to the mortgagee was held to excuse performance by the buyer.[192]

The buyer should have a copy of an existing mortgage for present examination and future reference. In the absence of a copy, the terms may be examined on the public records. This may be insufficient, however, because there may be other terms included in the note or bond secured by the mortgage. Sometimes the maturity of the mortgage will appear only in

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189. An agreement to sell subject to a mortgage is not broken by the existence of two mortgages aggregating the sum specified. Greenfield v. Mills, 107 N.Y.S. 705 (App. Div. 2d Dep't 1907); *see* Thackaberry v. Kibbe, 119 N.E. 897 (Ill. 1918); Haberer v. Kunstman, 194 Ill. App. 306 (1915). *But see* Park v. Johnson, 7 Allen 378 (Mass. 1863). Miller v. Milwaukee Odd Fellows Temple, 240 N.W. 193 (Wis. 1932), refused to abrogate a contract of sale that understated somewhat the amount owing on a mortgage, on the ground that the difference could be credited to the buyer in the closing adjustments. A reference to a 4½% mortgage, due in six months, as 4% was held immaterial in face of seller's offer to credit buyer with the difference, which amounted to $8.75. Kauflin v. Turek, 277 S.W.2d 540 (Mo. 1955). Keitel v. Zimmermann, 43 N.Y.S. 676, refused to abrogate a contract to sell subject to a 5% mortgage, where the mortgage called for 6%. The record showed that no more than 5% had been exacted for a considerable period. It did not appear that the mortgage was not due, nor did the contract of sale require the mortgage to remain on the property. The court ruled that the sum to be paid, rather than the rate originally fixed, was the only practical matter to be considered.

190. J.O. Constr. & Dev. Corp. v. Cuendet, 108 N.Y.S.2d 782 (App. Div. 1st Dep't 1951) (alternate ground of decision).

191. Wacht v. Hart, 105 N.Y.S. 78 (App. Div. Sup. Ct. 1907), *aff'd*, 92 N.E. 1105 (N.Y. 1910); Dorf v. Bossert Terminal, Inc., 59 N.Y.S.2d 732 (Mun. Ct. Manhattan 1946) (tax foreclosure). *But see* Lynch v. Volckening, 171 N.Y.S. 991 (Cnty. Ct. Kings Cnty. 1918).

Compare Heidi Assocs. v. Lawyers Title Ins. Co., 495 N.E.2d 350 (N.Y. 1986).

192. Star Apartment, Inc. v. Martin, 204 F.2d 829 (5th Cir. 1953).

the note or bond.[193] Furthermore, as a result of clerical error, there may be a repugnance between the mortgage and the accompanying note or bond. Inasmuch as in legal theory the latter is the debt and the mortgage merely the security thereof, any repugnance is resolved in favor of the bond or note, despite the fact that the mortgage alone will be found in the public records.[194] It is, therefore, insufficient to rely on the mortgage alone.

A purchaser was charged with knowledge of a due-on-sale clause in a mortgage note that was incorporated by reference in a recorded mortgage.[195] The same was held with respect to a requirement for a prepayment premium incorporated only in the note.[196]

If the mortgage and other instruments were executed at the same time and as part of the same transaction, these instruments are construed together to give effect to the intentions of the parties.[197] Nevertheless, a failure to incorporate expressly the provisions of one instrument in another has resulted in a provision that is

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193. The mortgage may state it is security for the payment of a specified sum "in accordance with the terms of a certain mortgage bond. . . ." One reason for withholding the due date from the record is to prevent raiding by competing mortgagees seeking investments. Some lending institutions do not record extension agreements for this reason.

194. *In re* Sweatte, 76 B.R. 822 (Bankr. W.D. Okla. 1987); Brown v. First Nat'l Bank, 75 So. 2d 141 (Ala. 1954); Blalock v. Blalock, 288 S.W.2d 327 (Ark. 1956); Griswold State Bank v. Milne, 416 N.W.2d 109 (Iowa 1987); Frenzel v. Frenzel, 152 N.W.2d 157 (Iowa 1967); Comer v. Hargrave, 598 P.2d 213 (N.M. 1979); Samples v. Robinson, 275 P.2d 185 (N.M. 1954); Adler v. Berkowitz, 173 N.E. 574 (N.Y. 1930), noted in 31 COLUM. L. REV. 328 (1931); First Interstate Bank v. Rebarchek, 511 N.W.2d 235, 241 (N.D. 1994).

This rule was held limited to the parties to the mortgage. A purchaser from the mortgagor was held bound by a prepayment privilege in the mortgage that was conditioned on payment of a premium, rather than on a comparable clause in the mortgage bond that contained no such condition. This was on the ground that the mortgage had met the purchaser's eye. Manhattan Coll. v. Staten Island Sav. Bank, 265 N.Y.S.2d 251 (Civ. Ct. Bronx Cnty. 1965).

The acceleration provision in a mortgage was held controlling in view of a provision reading "anything in said note or herein to the contrary notwithstanding." Grier v. M.H.C. Realty Corp., 274 So. 2d 21 (Fla. Dist. Ct. App. 1973).

195. Provident Fed. Sav. & Loan Ass'n v. Realty Ctr., Ltd., 428 N.E.2d 170 (Ill. App. Ct. 1981); Wood v. LaFleur, 408 So. 2d 37 (La. Ct. App. 1981).

196. Leisure Villa Investors v. Life & Cas. Ins. Co., 527 So. 2d 520 (La. Ct. App. 1988).

197. Metro. Life Ins. Co. v. Monroe Park, 442 A.2d 503, 509 (Del. Super. Ct. 1982); Boyette v. Carden, 347 So. 2d 759 (Fla. Dist. Ct. App. 1977); Gonzales v. Tama, 749 P.2d 1116 (N.M. 1988); Comer v. Hargrave, 598 P.2d 213 (N.M. 1979); 55 AM. JUR. 2D *Mortgages* § 176 (1971); 59 C.J.S. *Mortgages* § 156 (1949).

enforceable; for example, acceleration, in one instrument and not in another.[198]

The purchase price payable by the buyer at the closing will be credited with the amount of an existing mortgage. If this has been reduced by part payment to a sum less than that appearing on record (and the record will probably not show such payment), this credit of the buyer will be less and the cash payable by him will be greater. The purchaser should have reasonable proof of any such payments.[199]

On the other hand, the mortgage may secure more than its recorded principal by reason of interest arrears or advances made by the mortgagee for taxes, insurance, discharge of prior liens,[200] or by a "dragnet" clause. A mortgage whose principal has been reduced may have been increased, pursuant to an "open end" statute, which permits further advances by the mortgagee for repairs or improvements, or to discharge taxes.[201] If the premises are subject to a mortgage, therefore, the contract of sale should require the seller to obtain a certificate from the mortgagee, in recordable form, stating the amount of unpaid principal and accrued interest, the maturity, and the existence of any prepayment right.[202] Banks, insurance companies, and other institutional lenders will often refuse to give more than a letter to such effect.

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198. Abdul-Karim v. First Fed. Sav. & Loan Ass'n, 451 N.E.2d 618 (Ill. App. Ct. 1983) (due-on-sale clause in mortgage permitted acceleration and foreclosure of mortgage, but ineffective to enforce personal liability on note). *Accord* White v. Miller, 54 N.W. 736 (Minn. 1893).

199. "The plaintiff was, of course, entitled to conclusive evidence of this reduction [in the rate of interest]. He was not bound to accept the defendant's assurance that it had been done." Campbell v. Prague, 39 N.Y.S. 558, 560 (App. Div. 1st Dep't 1896).

200. Plaintiff-grantee, who paid the full purchase price, after credit for (1) $35,425, the sum apparently owing on a mortgage, and (2) $5,000 by way of a purchase money mortgage, discovered after receipt of the deed that an informal arrangement for partial accumulation of interest resulted in $14,000 of interest arrears. Plaintiff's remedy consisted of cancellation of the purchase money mortgage and a judgment for the remainder. Blaylock v. McMillan Farms, Inc., 214 So. 2d 456 (Miss. 1968). The situation would have been avoided if an estoppel letter had been obtained from the mortgagee before the closing.

201. Wellfleet Sav. Bank v. Swift, 162 N.E.2d 799 (Mass. 1959).

202. A form of contract formerly in use in the City of New York contained the following clause for this purpose:

> If there be a mortgage on the premises the seller agrees to deliver to the purchaser at the time of delivery of the deed a proper certificate executed and acknowledged by the holder of such mortgage and in a form for recording, certifying as to the amount of the unpaid principal and interest thereon, date of maturity thereof and rate of interest thereon, and the seller shall pay the fees for recording such certificate.

This should be sufficient from a responsible party, except where the mortgagee includes in the letter a statement that it is not to be bound thereby or that the letter is not to operate as an estoppel.[203] An owner is not entitled to a statement of the sum owing on a mortgage either by implication[204] or by any provision usually found in a mortgage. It may be noted, by way of analogy, that a lease that the tenant intends to mortgage generally anticipates a customary requirement of a leasehold mortgagee by requiring the landlord to give an assurance of the status of the lease. A New York statute entitles an owner of real property who has signed a contract to sell or has received a written mortgage commitment, to a statement from the holder of a mortgage on the property of the amount of the mortgage debt.[205] A mortgagee that submitted a "pay-off letter" that understated the amount due was entitled to recover the difference on the ground of a mistake of fact and unjust enrichment, as distinguished from a mistake of law.[206] One that overstated the amount and refused a refund was held liable in damages.[207]

A grantee of property with knowledge of a mortgage who assumes or takes subject to the mortgage is estopped to assert a lack of consideration or usury.[208]

The clause made no reference to a right of prepayment.
Seller's failure to comply with this requirement, or at least tender an acceptable substitute, permitted purchaser to rescind. Grace v. Nappa, 389 N.E.2d 107 (N.Y. 1979).

203. For a mortgagee's statement of amount due as an estoppel, see Annot., 90 A.L.R. 1432 (1934).

204. Pavanello v. Adikas, 139 N.Y. L.J. 11, Feb. 4, 1958 (Sup. Ct. 1958).

205. The statement must include the amount of unpaid principal, the date to which interest has been paid, and the itemized amounts claimed to be unpaid for principal and interest. The statement may be in letter form if the mortgagee is a lending institution, the State of New York, or a subdivision or agency thereof. Otherwise, it must be in recordable form. N.Y. REAL PROP. LAW § 274-a.

206. First Wis. Trust Co. v. Schroud, 916 F.2d 394 (7th Cir. 1990). The letter omitted deferred interest of over $105,000, a matter known to the mortgagor.

207. Griffith v. Porter, 817 S.W.2d 131 (Tex. Civ. App. 1991). This was under the Texas Deceptive Trade Practices Act.

208. Eurovest, Ltd. v. Segall, 528 So. 2d 482 (Fla. 3d Dist. Ct. App. 1988). Normally, a grantee who assumes or takes subject to a mortgage cannot raise the defense of usury. However, the court in Seidel v. 18 E. 17th St. Owners, Inc., 598 N.E.2d 7 (N.Y. 1992), recognized an exception when the grantee is closely related to the original borrower. In *Seidel*, the borrower obtained a loan to purchase a loft building, which it planned to convert to cooperative housing. Pursuant to this plan, it formed a cooperative housing corporation and conveyed the property to that corporation. The corporate grantee was allowed to assert usury.

§ 3:3.2 Distinction Between Assumption and Taking Subject to Mortgage

There are two ways of treating an existing mortgage at the closing. The conveyance may be subject to the mortgage, in which event it remains as a lien upon the premises without imposing any personal liability on the grantee,[209] or it may be assumed by the buyer. The contract of sale determines which is to occur.[210] If an existing mortgage is to continue after a sale, the contract should indicate whether the sale is to be merely subject to the mortgage or whether the purchaser is to assume personal liability for payment of the mortgage debt, as well as liability on the mortgage covenants.

The majority rule, that a grantee "subject" to a mortgage is not impliedly liable thereon, was adopted by statute in New Jersey.[211]

In Pennsylvania, a conveyance by a mortgagor subject to a mortgage makes the grantee an indemnitor of the grantor, but this liability does not extend to any third person.[212]

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209. Bayou Land Co. v. Talley, 924 P.2d 136, 152 (Colo. 1996); Walther v. Comm'r, 316 F.2d 708 (7th Cir. 1963); *In re* Emerald Oil Co., 807 F.2d 1234 (5th Cir. 1987) (Louisiana law); Bernhardt v. Hemphill, 878 P.2d 107, 110 (Colo. Ct. App. 1994); Cassidy v. Bonitatibus, 497 A.2d 1018 (Conn. App. Ct. 1985) (parol evidence of assumption must be clear); Adams v. George, 812 P.2d 280 (Idaho 1991); Dorothy Edwards Realtors, Inc. v. McAdams, 525 N.E.2d 1248 (Ind. Ct. App. 1988); First State Bank & Trust Co. v. Seven Gables Inn, 501 So. 2d 280, 290 (La. Ct. App. 1986); Meco Realty Co. v. Burns, 200 A.2d 869 (Pa. 1964); Hussey v. Ragsdale, 831 S.W.2d 279 (Tenn. 1993).

Neither is the grantee liable, under the majority rule, to indemnify the mortgagor against the mortgagee. People *ex rel.* Banner Land Co. v. State Tax Comm'n, 155 N.E. 84, 85 (N.Y. 1926); Smith v. Truslow, 84 N.Y. 660 (1881); 2 S. WILLISTON, CONTRACTS §§ 382, 383 (3d ed. 1959); 1 C. WILTSIE, MORTGAGE FORECLOSURES §§ 218, 220 (5th ed. 1939); 2 L. JONES, MORTGAGES § 942 (8th ed. 1928); 5 H. TIFFANY, REAL PROPERTY § 1435 (3d ed. 1939); Annot., 111 A.L.R. 1114, 1124 (1937); 1917C L.R.A. 592, 594–95.

"Subject to" a mortgage was held to impose liability thereon in unusual circumstances. Rogers v. Niforatos, 394 N.Y.S.2d 473 (App. Div. 3d Dep't 1977) (transferees were attorney and accountants of transferor).

A reference to the "property subject to a mortgage" may merely refer to certain property as a form of description. Regan v. ITT Indus. Credit Co., 469 So. 2d 1387 (Fla. Dist. Ct. App. 1984).

210. A buyer's agreement, included in the contract, to assume a mortgage, may be merged by a deed that makes no provision for assumption. Bayou Land Co. v. Talley, 924 P.2d 136, 152 (Colo. 1996). The cases are split.

211. N.J. STAT. ANN. § 46:9-7.1 (1990) (overruling Max v. Beckelman, 169 A. 640 (N.J. Ch. 1934)).

212. Naffah v. City Deposit Bank, 23 A.2d 340 (Pa. 1941).

Maryland has adopted an implied assumption rule. A buyer who receives a credit against the purchase price for the amount of the mortgage debt is held, as against his grantor, to have assumed the mortgage by implication.[213] This implication is negated in a wraparound mortgage situation when the wraparound mortgagee agrees to make payments on the preexisting mortgage.[214]

A buyer's agreement, included in the contract, to assume a mortgage, may be merged by a deed that makes no provision for assumption. The cases are split.[215]

Assumption of a mortgage creates an obligation to pay the interest as well as the principal, even without express reference to interest.[216] The difference should be noted between an assumption of payment, which renders the grantee personally liable only for payment of principal and interest, and an assumption generally of the mortgage, which makes the grantee personally liable as well on all the mortgagor's covenants, such as covenants of title.[217]

A grantee's assumption may be effected by the deed conveying the premises. In the absence of statute the grantee's mere acceptance of a deed with a clause reading, substantially

> Subject to a certain mortgage . . . which the grantee hereby assumes and agrees to pay.

is an effective assumption by the grantee, although the deed is executed only by the grantor. The statute of frauds is inapplicable because this is an original undertaking by the grantee and not an agreement to answer for the debt, default, or miscarriage of another.[218] And, for the same reason, a parol assumption of a mortgage is valid

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213. Brice v. Griffin, 307 A.2d 660 (Md. 1973) (grantor-mortgagor recovered against grantee amount of mortgage installment payment made by grantor).

214. Daugharthy v. Monritt Assocs., 444 A.2d 1030 (Md. 1982). For discussion of wraparound mortgages, see *infra* section 3:5.4.

215. *See* Bayou Land Co. v. Talley, 924 P.2d 136, 152 (Colo. 1996).

216. Kendrick v. Garrene, 96 So. 2d 58 (La. 1957).

217. Silverstein v. Brown, 138 N.Y.S. 848 (App. Div. 1st Dep't 1912).

218. Moss v. Minor Props., Inc., 69 Cal. Rptr. 341 (2d Dist. Ct. App. 1968); Hafford v. Smith, 369 S.W.2d 290 (Mo. Ct. App. 1963); Fed. Nat'l Mortgage Ass'n v. Carrington, 374 P.2d 153 (Wash. 1962); Beacon Fed. Sav. & Loan Ass'n v. Panoramic Enters., Inc., 99 N.W.2d 696 (Wis. 1959); RESTATEMENT (SECOND) OF CONTRACTS § 123 (1981); *see* Milton R. Friedman, *Creation and Effect of Personal Liability on Mortgage Debts in New York*, 50 YALE L.J. 224, 226 *et seq.* (1940).

This is part of a general rule that binds a grantee, by acceptance of a deed and possession, to perform a covenant on grantee's part included in the deed. Mearida v. Murphy, 435 N.E.2d 1352 (Ill. App. Ct. 1982).

and enforceable.[219] But in New York the assumption must, by statute, be in writing.

The existence of an assumption in the deed, or the recordation of such deed, is not conclusive evidence of an assumption of a mortgage by a grantee. If the covenant was unknown to the grantee, it may not be enforced by the mortgagee, and the grantee may obtain reformation in a foreclosure or separate action.[220] The presumption that a purchaser has notice of everything in the deed under which he buys is not applied to a mortgage assumption clause. This is deemed a collateral undertaking and no part of the grant.[221]

The possibilities of mistake, misunderstanding, and fraud in connection with grantee assumptions of mortgages, which are not evidenced by the grantees' signatures, led to a statute enacted in New York in 1938. This statute requires a grantee's assumption of a mortgage to be by written instrument, stating the amount of the debt, signed and acknowledged by the grantee.[222] This is usually carried out by having the grantee, as well as the grantor, execute and acknowledge a deed that includes this recital. The statute also protects a grantee who does not execute an assumption clause from liability for property taxes paid out of the proceeds of a foreclosure sale.[223]

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219. Dieckman v. Walser, 168 A. 582 (N.J. Ch. 1933) (overruled by N.J. REV. STAT. § 46:9-7.1 (enacted 1947)). *But see* Weiner v. Hroch, 196 N.W.2d 907, 908 (Neb. 1972); CAL. CIV. CODE § 1624(a)(6). *Accord* Kam, Inc. v. White, 675 S.W.2d 459 (Mo. Ct. App. 1984).

220. Consol. Realty Corp. v. Dunlop, 114 F.2d 16 (D.C. Cir. 1940); Fishback v. J.C. Forkner Fig. Gardens, Inc., 30 P.2d 586 (Cal. 4th Dist. Ct. App. 1934); Ludlum v. Pinckard, 136 N.E. 725 (Ill. 1922); Beaver v. Ledbetter, 152 S.E.2d 165 (N.C. 1967); Marrow v. Marrow, 454 S.E.2d 853 (N.C. Ct. App. 1995); Milton R. Friedman, *Creation and Effect of Personal Liability on Mortgage Debts in New York*, 50 YALE L.J. 224, 227 (1940).

Pioneer Sav. & Trust, F.A. v. Ben-Shosen, 826 P.2d 421 (Colo. Ct. App. 1992), held it was an issue of fact whether a grantee intended to assume the mortgage and that the mortgagee, a third party, could not assert the parol evidence rule. *Contra* Muhlig v. Fiske, 131 Mass. 110 (1881).

221. Blass v. Terry, 50 N.E. 953 (N.Y. 1898) (mortgagee must prove grantee accepted deed with knowledge of assumption clause); Genesee Valley Nat. Bank & Trust Co. v. Bolton, 290 N.Y.S. 913 (App. Div. 4th Dep't 1936).

222. N.Y. GEN. OBLIG. LAW § 5-705. *See* 13 ST. JOHN'S L. REV. 215 (1938); Milton R. Friedman, *Creation and Effect of Personal Liability on Mortgage Debts in New York*, 50 YALE L.J. 224, 226–28 (1940).

The statute as enacted in 1938 was limited to assumptions of mortgages thereafter executed. A 1953 amendment makes it applicable to any mortgage executed prior to the time of the conveyance. The amendment does not apply to assumption by deed between 1938 and 1953.

223. St. Denis v. Blakesley, 896 N.Y.S.2d 180 (N.Y. App. Div. 3d Dep't 2010) (deed had assumption clause but was not executed and acknowledged by grantee, who bought the property at foreclosure).

A mortgage clause that requires any transferee to assume the mortgage does not make a grantee of the premises liable per se.[224] Similarly, a mortgage provision that purports to make the mortgagor's liability run with the land does not bind a grantee who has not expressly assumed the mortgage.[225]

§ 3:3.3 *Liabilities After Assumption*

A grantee's assumption of an existing mortgage inures to the benefit of and may be enforced by the mortgagee, without releasing the mortgagor or prior obligor.[226] Grantee's assumption is no release of the mortgagor from personal liability on the mortgage.[227]

In New York[228] and some other states[229] the mortgagee may enforce the assumption against the grantee only if the grantor is liable on the mortgage, whereas many states enforce this assumption regardless of the grantor's liability.[230] Some states have statutes that make an assuming grantee liable irrespective of his grantor's liability.[231]

The rule that denies a mortgagee's right to enforce a grantee's assumption, absent liability on his grantor's part, may be predicated on two different theories. Under the modern theory of third-party

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224. Brakhausen v. Cont'l Ill. Nat'l Bank & Trust Co., 120 N.E.2d 649 (Ill.), *cert. denied*, 348 U.S. 897 (1954).
225. Weaver v. King Cnty., 437 P.2d 698 (Wash. 1968).
226. Bayou Land Co. v. Talley, 924 P.2d 136, 152 (Colo. 1996); W. Point Corp. v. New N. Miss. Fed. Sav. & Loan Ass'n, 506 So. 2d 241 (Miss. 1988); First Ind. Fed. Sav. Bank v. Hartle, 567 N.E.2d 834 (Ind. Ct. App. 1991); Beaver v. Ledbetter, 152 S.E.2d 165 (N.C. 1967).
227. Berg v. Liberty Fed. Sav. & Loan Ass'n, 428 A.2d 347 (Del. 1981); Glenn v. Maddox, 253 S.E.2d 835 (Ga. Ct. App. 1979); State *ex rel*. LeFevre v. Stubbs, 642 S.W.2d 103 (Mo. 1982); Blackman v. Pael, 396 S.E.2d 128 (S.C. Ct. App. 1990).
228. Vrooman v. Turner, 69 N.Y. 280 (1877); Milton R. Friedman, *Creation and Effect of Personal Liability on Mortgage Debts in New York*, 50 YALE L.J. 224, 234 (1940).
229. Dail v. Campbell, 12 Cal. Rptr. 739 (4th Dist. Ct. App. 1961).
230. Somers v. Avant, 261 S.E.2d 334 (Ga. 1979). The Restatement has adopted this position. RESTATEMENT (THIRD) OF PROPERTY (MORTGAGES) § 5.1(c)(1) (1997).
231. CONN. GEN. STAT. § 52-75: "Whenever any real property encumbered by mortgage or lien is conveyed subject to the mortgage or lien and there is a provision in the conveyance that the grantee shall assume and pay the encumbrance, the holder of the mortgage or lien may, upon the nonpayment of the encumbrance, maintain an action in his own name upon the grantee's promise, without obtaining an assignment thereof from the grantor of the property." *See* Schneider v. Ferrigno, 147 A. 303 (Conn. 1929) (statute applies to make remote grantee liable after break in chain of assumptions). VA. CODE § 55-22; Bankers Mortg. Corp. v. Jacobs, 613 F. Supp. 1579 (E.D. Va. 1985) (mortgagee not required to foreclose before suing assuming grantee).

contracts, New York and other states enforce the rights of a creditor-beneficiary, but not those of a donee-beneficiary. The same result follows under the older theory of equitable subrogation. Under this theory an assuming grantee becomes, as to his grantor, the principal debtor and the latter takes the position of a surety.[232]

Successive assuming grantees form a chain of liability, the last grantee being the principal debtor and the others liable as sureties.[233] The assumption is in the nature of an indemnity for the grantor, and the creditor (mortgagee) becomes entitled to the benefit of the security received by the surety. Similarly, any such surety is subrogated to the rights of the mortgagee against subsequently assuming grantees.[234] As heretofore mentioned, there is a split of authority with respect to a mortgagee's right to enforce the mortgage debt against an assuming

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232. Milton R. Friedman, *Creation and Effect of Personal Liability on Mortgage Debts in New York*, 50 YALE L.J. 224, 230–41 (1940). If the conveyance to an assuming grantee is not an absolute conveyance; *e.g.*, a conveyance for security only, and with no intent that the debt become the debt of the grantee, the mortgagee has no right of enforcement against the grantee. *See id*.

233. *In re* Quinco Corp., 389 F.2d 900 (6th Cir. 1968); *In re* Jordan, 199 B.R. 68, 70 (Bankr. S.D. Fla. 1996); Swanson v. Krenik, 868 P.2d 297 (Alaska 1994); Sw. Sav. & Loan Ass'n v. Ludi, 594 P.2d 92 (Ariz. 1979); Everts v. Matteson, 132 P.2d 476 (Cal. 1942); Moss v. McDonald, 772 P.2d 626 (Colo. Ct. App. 1988); Wagoner v. Brady, 223 N.Y.S. 99 (App. Div. 3d Dep't 1927); Langman v. Alumni Ass'n, 442 S.E.2d 669 (Va. 1994).

A mortgagor who redeemed the mortgaged premises from foreclosure recovered against an assuming grantee a sum equal to the excess of his proper payment for redemption above the value of the property he obtained thereby. Konoff v. Lantini, 306 A.2d 176 (R.I. 1973), following Jacobs v. Kupperstein, 153 A. 656 (Conn. 1931). *See* Foremost Life Ins. Co. v. Dep't of Ins., 395 N.E.2d 418, 424 (Ind. Ct. App. 1979).

Query: How would this claim of mortgagor be affected by statutes limiting or barring recovery on the mortgage debt after foreclosure?

A mortgagee's application of proceeds of credit insurance, on the life of the mortgagor, to satisfy the mortgage, was held to revive the mortgage and subrogate the estate of the mortgagor, as a surety, against an assuming grantee of the property. Betts v. Brown, 136 S.E.2d 365 (Ga. 1964), noted in 43 TEX. L. REV. 580 (1965).

234. State *ex rel.* LeFevre v. Stubbs, 642 S.W.2d 103 (Mo. 1982); First Interstate Bank, N.A. v. Nelco Enters., Inc., 822 P.2d 1260, 1262 (Wash. Ct. App. 1992).

A mortgagor, who had not paid the mortgagee, recovered a judgment against an assuming grantee, but the proceeds were to be in trust for the mortgagee. Riedle v. Peterson, 560 N.E.2d 725 (Mass. App. Ct. 1990).

"[T]he liability for the mortgage debt is cast upon the grantees in the inverse order of assumption." Swanson v. Krenik, 868 P.2d 297, 300 (Alaska 1994), quoting Milton R. Friedman, *Discharge of Personal Liability on Mortgage Debts in New York*, 52 Yale L.J. 771, 774 n.13 (1943). In *Swanson*, the first grantee claimed that a second assuming grantee made both the mortgagor and the first grantee co-sureties because they were both

grantee if some intermediate owner of the mortgage property is not liable. Where this is true, some courts note, there is no liability that can be the subject of indemnification.

An assumption of an entire mortgage by a grantee of a portion of the mortgaged premises makes the portion so conveyed a primary security for the mortgage and the unsold portion a secondary security.[235] The assuming grantee is under a duty to protect the unsold premises and is liable for a breach.[236] If in this situation the mortgagor is compelled to pay the mortgage debt, he is subrogated to the rights of the mortgagee as against the grantee of the part of the mortgaged premises[237] and may recover judgment against the grantee for the money so paid.[238] If the portion not so conveyed is applied under compulsion of law toward payment of the mortgage debt, the mortgagor or his successor may recover against the grantee for the value of the land so taken.[239] If the grantee of part of the mortgaged premises assumes the entire mortgage by parol, his successors may not be subjected to these consequences. Subsequent owners and lienors of the premises acquired by the assuming grantee are not bound by a mortgage assumption that is unknown to them. In this situation, all the parcels covered by the mortgage are required to contribute to the mortgage debt in proportion to their relative values.[240]

An agreement extending the mortgage made between the mortgagee and a grantee of part of the mortgaged property, who has assumed the entire mortgage, may release the mortgagor from liability on the mortgage debt but does not generally release the unsold property from

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liable to the mortgagee and, therefore, their liability was split. The court held the mortgagor was a subsurety with a right over against the first grantee. RESTATEMENT OF SURETY § 145, comment a (1941). *Accord* Langman v. Alumni Ass'n, 442 S.E.2d 669 (Va. 1994).

235. Cobb v. Osman, 433 P.2d 259 (Nev. 1967).

236. Sanders v. Lackey, 439 S.W.2d 610 (Tenn. Ct. App. 1968).

237. Markarian v. Morazines, 144 A. 265 (N.H. 1929). *Compare* Betts v. Brown, 136 S.E.2d 365 (Ga. 1964).

238. McRae v. Pope, 42 N.E.2d 261 (Mass. 1942).

239. Russell v. Pistor, 7 N.Y. 171 (1852); *see* Milton R. Friedman, *Creation and Effect of Personal Liability on Mortgage Debts in New York*, 50 YALE L.J. 224, 248–49 (1940).

The mortgagor or subsequent "surety" who is forced to pay the mortgage debt is subrogated to the rights of the mortgagee. Toler v. Baldwin Cnty. Sav. & Loan Ass'n, 239 So. 2d 751 (Ala. 1970).

Proceeds of credit life insurance, maintained on the life of the mortgagor, were awarded to the mortgagor's children rather than to the assuming grantee. *Toler*, 239 So. 2d 751. The case is odd in that the mortgagee waived a right to apply the money in reduction of the mortgage and, further, the grantee had inadvertently paid premiums on the credit life insurance.

240. Mo. Home Sav. & Loan Ass'n v. Allen, 452 S.W.2d 109 (Mo. 1970).

the lien of the mortgage.[241] A variation of this occurred when part of the mortgaged property was sold to *X* by a warranty deed and thereafter the mortgagee released the mortgagor and its guarantor from personal liability on the mortgage debt. The releases were held to discharge the property of *X* from the lien of the mortgage. The basis for this was the court's reasoning that the releases prevented *X* from paying off the blanket mortgage and thereby becoming subrogated to the mortgagee's rights against the mortgagor, who is the primary debtor.[242] The converse of this occurs when an owner gives a blanket mortgage on one or more parcels of land and subsequently conveys portions of the property subject to the lien of the mortgage. This makes the respective parcels liable for the payment of the blanket mortgage in the inverse order of their alienation. The last parcel sold or encumbered by the mortgagor is subject first to satisfaction of the blanket mortgage.[243] This does not apply in the face of evidence of a contrary intention.[244] Some jurisdictions follow a rule of

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241. Seale v. Berryman, 49 P.2d 997 (Ariz. 1935); Pearson v. Smith, 273 N.E.2d 179 (Ill. App. Ct. 1971). *But see* Annot., 101 A.L.R. 618 (1936).

For release of mortgagor by agreements between mortgagee and subsequent owner of mortgaged property, see Milton R. Friedman, *Discharge of Personal Liability on Mortgage Debts in New York*, 52 YALE L.J. 771 (1943).

242. MGIC, Fin. Corp. v. H.A. Briggs Co., 600 P.2d 573 (Wash. Ct. App. 1979). In *MGIC*, the blanket mortgage secured $1.42 million and covered land in two counties. The property conveyed to *X* was one lot, for a price of about $8,000, with no credit thereon by reason of the mortgage (facts amplified by counsel). The releases of the mortgagor and the guarantor were given in connection with conveyance of most of the mortgaged property to the mortgagee in lieu of foreclosure. If the deed to *X* had been expressly subject to the mortgage, or if *X* had assumed the mortgage or received some credit therefor against the purchase price, the result would presumably have been contra. *See also* 5 H. TIFFANY, REAL PROPERTY § 1495 (3d ed. 1939); *id.* § 1435 n.26.

243. See the detailed discussion and authorities in *In re* Dan Hixson Chevrolet Co., 20 B.R. 108, 111–13 (Bankr. N.D. Tex. 1982); Hill v. Lane, 848 P.2d 43 (Okla. Ct. App. 1933).

Inverse order of alienation is a form of marshalling assets. But *Hill* rejected marshalling of assets in favor of sale in order of inverse alienation.

244. Maurer v. Arab Petroleum Corp., 135 S.W.2d 87 (Tex. 1940) (opinion adopted). This intent is demonstrated when a subsequent grantee or mortgagee assumes the paramount mortgage. 53 AM. JUR. 2D *Marshalling Assets* § 64 (1970). The amount of consideration paid by a grantee is also evidence of intent. Payment of full consideration, for instance, would indicate the inverse sale rule should not apply. See the discussion and authorities in *In re* Boswell Land & Livestock, Inc., 86 B.R. 665 (Bankr. D. Utah 1988). There is authority that when a grantee takes subject to a mortgage, as part of the consideration, the doctrine of inverse order of alienation does not apply. *In re* Oxford Dev. Ltd., 67 F.3d 683 (8th Cir. 1995); 4 J. POMEROY, EQUITY JURISPRUDENCE §§ 1224–25 (4th ed. 1941).

apportionment, under which each parcel conveyed subsequent to the mortgage is prorated between the parcels according to their respective values.[245] If a mortgagor conveys part and retains part of the mortgaged property, the retained part is almost always the first to be subjected to payment of the mortgage debt.[246]

The chain of liability that is created by successive assuming grantees of the property may be reversed by a reconveyance of the property to a former owner. Reconveyance by an assuming grantee to his grantor, for a consideration that reflects a deduction for the amount of the mortgage, makes the grantee-former-owner again primarily liable.[247] In the cases cited for this, the grantees receiving back the property did not expressly reassume the mortgage. This has no significance under the "primary fund" or "primary security" doctrine, which means merely that a mortgagor (or successive obligor) who pays the mortgage debt may resort to the mortgaged property for reimbursement. Any other rule would give unjust enrichment to a grantee who acquired property subject to a mortgage and with credit therefore against the purchase price. In this situation, the grantee is regarded as having assumed payment of the mortgage to the extent of the value of the land.[248]

A grantee's assumption, as has been said, inures to the benefit of the mortgagee. Cases have arisen with respect to the right of a mortgagor-grantor (or a subsequent obligee who conveys) to release the liability of a grantee who has assumed. Insofar as the grantor

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245. See authorities in *In re* Dan Hixson Chevrolet Co., 20 B.R. 108, 111 n.7 (Bankr. N.D. Tex. 1982). The parties may agree on the proportion of the mortgage the grantor and the grantee are to bear. *See* Wiggins v. Leinenweber, 404 So. 2d 778 (Fla. Dist. Ct. App. 1981).

246. Seasons, Inc. v. Atwell, 527 P.2d 792, 797–78 (N.M. 1974) ("one man's property should not be subjected to the payment of another man's debt"); Annot., 131 A.L.R. 4, 11 (1941).

247. Ruther v. Thomas, 604 P.2d 703 (Colo. Ct. App. 1979); Sanderson v. Turner, 174 P. 763 (Okla. 1918).

248. Howard v. Robbins, 63 N.E. 530, 531 (N.Y. 1902) (and authorities discussed in this and following case); *see* Rochester Sav. Bank v. Stoeltzen & Tapper, Inc., 26 N.Y.S.2d 718, 721 (Sup. Ct. Monroe Cnty. 1941); Milton R. Friedman, *Discharge of Personal Liability on Mortgage Debts in New York*, 52 YALE L.J. 771, 773–74 (1943).

The minority rule is that acquisition subject to a mortgage and with credit therefor is an assumption of the mortgage, or if they rely on the presumed assumption arising out of the primary fund doctrine. The importance of this is that the primary fund doctrine operates between a mortgagor and successive owners, without affecting the right of the mortgagee to proceed in the first instance against one or more obligors or sureties. See the authorities in the preceding paragraph.

The primary fund doctrine does affect the mortgagee in another connection. If the mortgagee acquires title to the property, this constitutes a release of the mortgage debt, either in full or to the extent of the value of the mortgaged premises. *See* Friedman, *supra*, at 786–87.

thereby releases a right that is personal to him, there is no problem. The question is whether the rights of the mortgagee, a third-party beneficiary, may be so released. The cases are in conflict.[249] A grantee who assumed a mortgage by agreement with the mortgagor-grantor was held released from his assumption per se, when he succeeded in rescinding his purchase for fraud. The holder of the mortgage was held to have no rights that survived the termination of those of the mortgagor.[250] The liability of an assuming grantee is also unenforceable for lack of consideration if this grantee is evicted for failure of title.[251]

§ 3:3.4 Exoneration of Debt After Mortgagor's Death

The common law rule entitles the heir or devisee of real property that was mortgaged by the testator to call upon the representative of the decedent to pay off the mortgage debt, so that the real property may pass unencumbered. This is currently the law in many jurisdictions.[252] It is often referred to as "exoneration" of the debt. The rule is subject to some qualifications that should be considered.

The operation of the rule is barred by a contrary intention of the testator, but this intention must be clearly expressed. The traditional direction to "pay all my just debts,"[253] to give "all my right, title and

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249. Milton R. Friedman, *Creation and Effect of Personal Liability on Mortgage Debts in New York*, 50 YALE L.J. 224, 236–40 (1940).

250. Capac State Sav. Bank v. McKnight, 191 N.W.2d 55 (Mich. Ct. App. 1971); Meyer v. Ludvik, 680 P.2d 459 (Wyo. 1984).

251. *In re* Cunningham, 48 B.R. 509, 513 (Bankr. M.D. Tenn. 1985); Dunning v. Leavitt, 85 N.Y. 30 (1881).

252. *In re* Estate of Dolley, 71 Cal. Rptr. 56 (Ct. App. 1968) (dictum); Higginbotham v. Manchester, 154 A. 242 (Conn. 1931); Tunis v. Dole, 89 A.2d 760 (N.H. 1952); Bethel v. Magness, 296 P.2d 792 (Okla. 1956), *see also* Caruthers v. Buscher, 382 A.2d 608 (Md. Ct. Spec. App. 1978); Norris v. Pellinger, 31 A.2d 398 (N.J. Ch. 1943); Wright v. Holbrook, 32 N.Y. 587 (1865).

The rule is reviewed in 3 AMERICAN LAW OF PROPERTY § 14.25 (1952); UNIFORM PROB. CODE PRAC. MANUAL 38, 44 (1972); Paulus, *Exoneration of Specific Devises: Legislation vs. The Common Law*, 6 WILLAMETTE L.J. 53 (1970) (comprehensive); Ryan, *Exoneration of the Specific Devise at the Expense of the Residue*, 44 MARV. L. REV. 290 (1960–61) [hereinafter Ryan]; Milton R. Friedman, *The Enforcement of Personal Liability on Mortgage Debts in New York*, 51 YALE L.J. 382, 390–93 (1942); Johnson, *Executor or Heir Who Pays the Mortgage?*, 113 TR. & EST. 244 (1974), Notes, 40 CALIF. L. REV. 457 (1952); 40 HARV. L. REV. 630 (1927); 19 MD. L. REV. 247 (1959): Annot., *Right of Heir or Devisee to Have Realty Exonerated From Lien Thereon at Expense of Personal Estate*, 4 A.L.R.3d 1023 (1965).

253. Tunis v. Dole, 89 A.2d 760 (N.H. 1952), *see also* Ryan, *supra* note 252, at 295; Annot., *Right of Heir or Devisee to Have Realty Exonerated From Lien Thereon at Expense of Personal Estate*, 4 A.L.R.3d 1023, 1057 *et seq.* (1965).

interest,"[254] or to give "subject to a mortgage"[255] are not generally sufficient for this purpose, though on each of these are cases to the contrary.[256]

Several reasons have been advanced for the rule. One is that the testator's property was increased by his placing a mortgage on the property,[257] a reason that does not apply to a purchase money mortgage (or its equivalent for this purpose, a testator's assumption of a preexisting mortgage), an improvement loan, or security pledged for another's debt. Another is a presumption that it represents the testator's intent; that is, an intent to leave an asset, not debts, especially where there is a specific legacy or devise.[258] Exoneration is to be out of undisposed personalty or realty charged with payment of debts. This reason is doubtful, especially where intestacy is involved. A third reason is to deprive a third person, the mortgagee, of a right to choose, in the enforcement of the debt, between foreclosing the mortgage, or maintaining an action at law for the debt.[259] Foreclosure would deprive the heir or devisee of the realty, in favor of the residuary estate. It is noteworthy that the common law presumption of testator's desire to have the mortgage paid out of other assets is reversed by the statutes, hereafter mentioned, that presume the opposite.

Some cases limit exoneration as to mortgages to those made by the testator and where the debt is his.[260] Some apply exoneration to mortgages assumed by the testator and others do not.[261] Exoneration

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254. Tobiason v. Machen, 142 A.2d 145, 146–47 (Md. 1958), noted in 19 MD. L. REV. 247; Kent v. McCaslin, 117 So. 2d 804 (Miss. 1960); 3 AMERICAN LAW OF PROPERTY § 14.25, at 669 (1952). *Contra* Taylor's Ex'r v. Broadway Methodist Church, 106 S.W.2d 69 (Ky. 1937) (alternate holding); Sav. Trust Co. v. Beck, 73 S.W.2d 282 (Mo. Ct. App. 1934).

255. Caruthers v. Buscher, 382 A.2d 608 (Md. Ct. Spec. App. 1978); 4 A.L.R.3d 1023, 1037–39 (1965). *Tobiason*, 142 A.2d 145, regarded these items as merely descriptive of the property demised.

256. Bridgeport Trust Co. v. Fowler, 128 A. 719 (Conn. 1925); 1 CLEAVELAND, HEWITT & CLARK, PROBATE LAW & PRACTICE IN CONNECTICUT § 460, at 676 (1915) [hereinafter CLEAVELAND]; *see also* 4 A.L.R.3d at 1057 *et seq.*

257. *In re* Estate of Dolley, 71 Cal. Rptr. 56, 61 (Ct. App. 1968); CLEAVELAND, *supra* note 256, at 677–78; Ryan, *supra* note 252.

258. *See* Ryan, *supra* note 252, at 304–05, 4 A.L.R.3d at 1034–36.

259. Ryan, *supra* note 252, at nn.290–91; Note, 40 HARV. L. REV. 630, 631 (1927). The New York statute effects this result.

260. *In re* Estate of Dolley, 71 Cal. Rptr. 56 (Ct. App. 1968); Higginbotham v. Manchester, 154 A. 242 (Conn. 1931); 3 AMERICAN LAW OF PROPERTY § 14.25, at 669 (1952); CLEAVELAND, *supra* note 256, at 677; Ryan, *supra* note 252, at 292; 4 A.L.R.3d at 1039–43 (1965).

261. Applying exoneration. Tracy v. Atwell, 32 F.2d 392 (D.C. Cir. 1929); *In re* Lienhart's Estate, 21 N.W.2d 749 (Neb. 1946); Owen v. Lee, 37 S.E.2d 848 (Va. 1946). *Contra In re* Hunt, 32 A. 204 (R.I. 1895).

Cases giving exoneration to purchase money mortgages, and denying it to others but not purchase money mortgages, and those drawing no

is applicable to the extent of the residuary estate, including undisposed realty.[262] The common law rule has been applied to encumbrances other than mortgages.[263]

Failure of a mortgagee to file a claim against the estate of a testator has been held to have no effect on the operation of the common law rule,[264] but here too there are cases contra.[265] The contra cases are not in accord with one of the reasons advanced for the common law rule; that is, that a third-party mortgagee should not affect the distribution of a decedent's estate.

Several cases involve the effects of conflicts of laws on the common law rule, as where a decedent was domiciled in a state following one rule and owned mortgaged real estate in a state following another rule. In a Connecticut case the testator was domiciled in Connecticut and the real estate was in Massachusetts. Connecticut follows the common law rule, which was abrogated by statute in Massachusetts. The Connecticut court presumed an intention by the testator that Connecticut's common law rule should govern.[266] On the other hand, New Hampshire and New York have applied the rule in effect at the location of the real estate. The New Hampshire court applied its common law rule to property located in New Hampshire and the contra statutory rule to Massachusetts property.[267]

The common law rule is limited to acquisition of real estate by will or intestacy. Accordingly, it does not apply to a joint tenant or tenant by the entirety who acquired realty by survivorship. These people take title by their deed, not as heir or devisee.[268] Because a surviving joint

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distinction are listed in Paulus, *Exoneration of Specific Devises: Legislation vs. the Common Law*, 6 WILLAMETTE L.J. 53, 61 (1970).

In denying exoneration of a purchase money mortgage, one court explained that purchasers buy property on small down payments, in mushrooming credit, with little intention of paying off the mortgage, and that it is ridiculous to believe the testator intended his executors to make payment for the benefit of a third person. *In re* Estate of Brown, 50 Cal. Rptr. 78 (Ct. App. 1966).

262. Tunis v. Dole, 89 A.2d 760 (N.H. 1952); Note, 40 HARV. L. REV. 630, 631–32 (1927).

263. Bethel v. Magness, 296 P.2d 792 (Okla. 1956); *In re* Riegelman's Estate, 34 A. 120 (Pa. 1896); *Ryan, supra* note 252, at 304–05; 40 HARV. L. REV. 630–31; Note, 19 MD. L. REV. 247, 248–49 (1959).

264. *In re* Estate of Dolley, 71 Cal. Rptr. 56 (Ct. App. 1968).

265. *See generally* 4 A.L.R.3d 1023, 1045–49 (1965).

266. Higginbotham v. Manchester, 154 A. 242 (Conn. 1931).

267. Tunis v. Dole, 89 A.2d 760 (N.H. 1952); *In re* Blackinton's Estate, 275 N.Y.S. 544 (Sur. Ct. N.Y. Cnty. 1934).

268. *In re* Estate of Dolley, 71 Cal. Rptr. 56 (Ct. App. 1968); *In re* Estate of Keil, 145 A.2d 563 (Del. 1958), noted in 73 HARV. L. REV. 425; 8 KAN. L. REV. 143; 42 MARQ. L. REV. 555; 58 MICH. L. REV. 137; 11 STAN. L. REV. 778; Lopez v. Lopez, 90 So. 2d 456 (Fla. 1956), noted in 11 MIAMI L.Q. 526

tenant does not have a common law right of exoneration, a modern statute that eliminates or restricts exoneration does not improve the joint tenant's position.[269] Denial of exoneration in this situation is distinguishable from contribution between joint debtors, as tenants-by-the-entirety are apt to be when both execute a mortgage and the mortgage obligation. Some cases that deny exoneration have given the survivor pro rata contribution.[270]

Colorado is apparently the only state that has rejected the common law rule by judicial decision.[271]

It is doubtful that application of the rule of exoneration carried out the testator's intent most of the time.[272] It was abrogated by statute in England.[273] It has been nullified by statutes in California, Maryland, Massachusetts, New Jersey, New York, Oklahoma, Pennsylvania, South Dakota, and Washington.[274] Furthermore, the Uniform Probate Code section 2-609 provides that a specific devise passes subject to any

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(1957); Cunningham v. Cunningham, 148 A. 444 (Md. 1930); *In re* Staiger's Estate, 144 A. 619 (N.J. Ch. 1929).

Staiger noted that exoneration would not benefit the estate of the deceased husband.

269. *In re* Estate of Zahn, 702 A.2d 482 (N.J. Super. Ct. App. Div. 1997) (rejecting argument of joint tenant, testator's girlfriend, that because New Jersey statute, N.J. REV. STAT. § 3B:25-1, only refers to heirs and devisees, she is entitled to exoneration on testator's purchase-money mortgage on house). The *Zahn* court also cast aside two other arguments raised by the joint tenant: that language in the will directing the executors "to pay all of my just debts" applied to the mortgage; and that the testator's alleged oral statements that she would get the house "free and clear" entitled her to exoneration.

270. *Keil*, 145 A.2d 563; *Cunningham*, 148 A. 444. *See also* 32 B.U. L. REV. 253 (1952). Contribution was denied in *Lopez*, 90 So. 2d 456; Magenheimer v. Councilman, 125 N.E. 77 (Ind. Ct. App. 1919); Ratte v. Ratte, 156 N.E. 870 (Mass. 1927). *Ratte* stated by way of dictum that the result might be different in case of tenants in common.

271. Ambrose v. Singleton, 356 P.2d 253 (Colo. 1960).

272. An extreme but hypothetical example would be: Testator leaves a house to his daughter, worth $100,000, but subject to a mortgage of $50,000; *i.e.*, the daughter receives an equity of $50,000. The residuary estate, amounting to $50,000 is left to the son. Testator believes he has treated his children equally. But when the daughter has the residuary estate applied to pay the mortgage, she ends with a $100,000 house free and clear and the son has nothing. For purposes of simplicity, this example disregards death taxes.

273. Locke King's Act, 17 & 18 Vict., § 113 (1854), amended by 30 & 31 Vict., ch. 69 (1867): Admin. Estate Act of 1925, 15 Geo. 5 ch. 23, § 35. These are discussed in 1 COOTE, MORTGAGES 792–800 (8th ed. 1912).

274. CAL. PROB. CODE § 21131 ("A specific gift passes the property transferred subject to any mortgage, deed of trust, or other lien existing at the date of death, without right of exoneration, regardless of a general directive to pay debts contained in the instrument"); MD. CODE, EST. & TRUSTS § 4-406;

security interest existing at the date of death, without right of exoneration, regardless of a general directive in the will to pay debts.

The New York statute has a long background and is the only one that has been thoroughly litigated. "As originally enacted, it included no charges other than mortgages, and the general estate, therefore, remained liable for all other debts affecting the mortgaged premises."[275] By a 1937 amendment it referred to real property "subject to a mortgage executed by any ancestor, or subject to any other charge." It provided that when such property passes, the distributee must satisfy the mortgage out of his own property.[276] The Massachusetts, New Jersey, and South Dakota statutes are substantially the same as this.[277] The New York statute was construed to have a substantial effect on the remedies of the mortgagee.

Section 250 was limited in its terms to the relations between heir or devisee and the general estate, but it was nevertheless extended by construction to the mortgagee. Though not intended to deprive the mortgagee of any part of his debt, it was held to make the mortgaged premises primarily liable for the mortgage debt and to limit the liability of the representative and distributees of the estate to a deficiency judgment. By judicial legislation, therefore, the mortgagee was required first to foreclose and then to claim against the general estate only for the deficiency. The mortgagee could not waive his lien on the property and claim for the full amount of the debt against the representative; section 250, on the other hand, created no personal liability in the heir or devisee for the debt. Thus, the mortgagee could recover a judgment against neither for principal or interest. For interest accruing before the obligor's death, the mortgagee could recover directly against the representative, but for interest accruing subsequently it was necessary first to resort to foreclosure and only charge the representative with any resulting deficiency. Enacted for the purpose of preventing an heir or devisee from taking property, as against the representative, free and clear of the mortgage, section 250 thus construed had the further effect of marshalling the assets by postponing and qualifying the mortgagee's rights on the bond. The mortgagee, however, was afforded some protection against the

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MASS. GEN. LAWS ch. 191, § 23; N.J. REV. STAT. § 3B:25-1; N.Y. EST. POWERS & TRUSTS LAW § 3-3.6; OKLA. STAT. ANN. tit. 46, § 5; 20 PA. CONS. STAT. ANN. § 2514(12.1); S.D. CODIFIED LAWS § 29A-2-607; WASH. REV. CODE § 11.12.070.

275. Milton R. Friedman, *The Enforcement of Personal Liability on Mortgage Debts in New York*, 51 YALE L.J. 382, 391 n.59 (1942) (discussing cases).

276. Former N.Y. REAL PROP. LAW § 250 (Laws 1937, ch. 75), now N.Y. EST. POWERS & TRUSTS LAW § 3-3.6.

277. MASS. GEN. LAWS ch. 191, § 23; N.J. REV. STAT. § 3B:25-1; S.D. CODIFIED LAWS § 29A-2-607.

dissemination of assets properly applicable to payment of his deficiency by a statute empowering the surrogate, on the mortgagee's application as a contingent creditor, to direct reservation of assets deemed sufficient to pay a deficiency judgment when finally determined.[278]

The current version of the New York statute is broader and refers to "any property, subject, at the time of the decedent's death, to any lien, security interest or other charge, including a lien for unpaid purchase price."[279]

The Maryland statute makes a legacy of specific property pass subject to a security interest, existing at the time of execution of the will, or a renewal, extension, or refinancing, all unless otherwise indicated in the will. Any such interest created or attaching after the will is subject to exoneration.[280]

The Pennsylvania statute bars exoneration with respect to any mortgage affecting the property and notwithstanding any general direction by the testator to pay debts.[281]

An Illinois court reached a decision comparable to a denial of exoneration, but on other grounds. In essence, a husband, who had mortgaged realty to his wife, left the realty to her by will. When she left the properties to charities her executors claimed the property was still subject to the mortgage. The court held the wife's equity in the property merged and cancelled the mortgage.[282]

Where a demand mortgage is used—and it is or has been usual in some places—many special clauses hereinafter mentioned are unnecessary for the mortgagee's security. It is unimportant, for instance, whether a demand mortgage expressly requires a mortgagor to maintain fire insurance for the benefit of the mortgagee if the latter may demand such insurance and call the mortgagor if he does not get it. But where the mortgage principal is payable otherwise, some special clauses are essential and these will be discussed. Whether an instrument is a demand instrument or one payable in installments may be doubtful. This is true when an instrument is payable "on demand" and also provides for payment of interest and installments of principal periodically. A New Hampshire court had no difficulty in holding a mortgage in this form callable on the mortgagee's demand.[283]

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278. Milton R. Friedman, *The Enforcement of Personal Liability on Mortgage Debts in New York*, 51 YALE L.J. 382, 391–93 (1942) (footnotes omitted). *See also* Jemzura v. Jemzura, 330 N.E.2d 414, 418 (N.Y. 1975).
279. N.Y. EST. POWERS & TRUSTS LAW § 3-3.6.
280. MD. CODE, EST. & TRUSTS § 4-406.
281. 20 PA. CONS. STAT. ANN. § 2514(12.1).
282. *In re* Estate of Grozier, 587 N.E.2d 77 (Ill. App. Ct. 1992).
283. Simon v. N.H. Sav. Bank, 296 A.2d 913 (N.H. 1972). At a time when demand mortgages were customary, they were rarely called. "It is a matter

A dissenting judge cited four cases involving promissory notes in this form that were held installment obligations.[284] If the instrument is held an installment obligation and includes no right to accelerate, the holder may recover only for past due installments.[285] Furthermore, the statute of limitations, which runs on a demand obligation from its inception, runs on an installment obligation only from maturity of the installments.[286]

If the mortgage and its accompanying note, bond, or otherwise does not specify the payment date, then it is payable instantly and the statute of limitations begins to accrue instantly, unless there is some event that tolls the statute.[287]

§ 3:4 Seller's Purchase Money Mortgage

The contract may flounder if it fails adequately to describe the terms of the seller's mortgage. In preparing a purchase money mortgage, its amount, interest rate, and terms of payment should be free from dispute. These will be set forth in the contract or memorandum of sale, if the contract or memorandum complies with the statute of frauds.

There is more, however, to a well-drawn mortgage than terms of payment. If the seller is financing the purchase, the contract should indicate the form of purchase money mortgage the seller will hold; that is, the specific covenants to be included, the intention that the purchaser also execute a note or bond to evidence his personal liability and his liability for the expense of the mortgage, or if the mortgage debt (that is, the mortgage and its mortgage note or bond) be non-recourse. If a purchase money mortgage is contemplated, it is

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of common knowledge that a savings bank rarely, if ever, collects a loan when secured and the interest is paid." Shelly v. Bristol Sav. Bank, 26 A. 474, 475 (Conn. 1893).

A note payable "on demand and if no demand be made . . . in monthly installments of ____" was held an installment note, but the court cited cases showing the law is split. Reese v. First Mo. Bank & Trust Co., 664 S.W.2d 530 (Mo. Ct. App. 1983). In *Reese*, the accompanying mortgage referred to installments.

284. Trigg v. Arnott, 71 P.2d 330 (Cal. Dist. Ct. App. 1937); Barron v. Boynton, 15 A.2d 191 (Me. 1940); Collateral Liquidation, Inc. v. Renshaw, 3 N.W.2d 834 (Mich. 1942); Maffett v. Emmons, 192 P.2d 557 (N.M. 1948). *Accord* Bank of Nova Scotia v. St. Croix Drive-In Theatre, Inc., 552 F. Supp. 1244 (D. St. Croix 1982).

285. Maffett v. Emmons, 192 P.2d 557 (N.M. 1948).

286. Trigg v. Arnott, 71 P.2d 330 (Cal. Dist. Ct. App. 1937); Barron v. Boynton, 15 A.2d 191 (Me. 1940); Collateral Liquidation, Inc. v. Renshaw, 3 N.W.2d 834 (Mich. 1942).

287. Vanica v. Oehm, 526 N.W.2d 648 (Neb. 1995).

advisable, for reasons hereinafter mentioned, that the deed to be delivered by the seller makes express reference to the purchase money mortgage and that the contract of sale permits the seller, rather than the purchaser, to arrange for recordation of the deed.

There are many provisions that mortgagees deem essential for their protection, some of which a well-advised mortgagor will regard as objectionable. How will the dispute be resolved? There will be no dispute if the contract of sale is sufficiently explicit, by identifying the form of mortgage to be used or annexing it as an exhibit. There will also be little ground for dispute if the contract provides for a purchase money mortgage with "such covenants for the seller's protection as the seller's attorneys may specify," but the results then may not be happy for the mortgagor. Absent a clear directive, there will be plenty of ground for dispute.

In the first place, a provision in the contract of sale for a purchase money mortgage, specifying only the mortgage principal and terms of payment, will probably not entitle the mortgagee to a mortgage bond, note, or covenant for payment of the principal and interest.[288] Personal liability is not a prerequisite of a mortgage, although consideration is necessary.[289]

The fact that the contract does not provide for the usual terms of a mortgage in local use—such as a covenant to pay taxes or to supply

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288. Cochran v. Taylor, 7 N.E.2d 89, 93 (N.Y. 1937). *But see* Weidenbaum v. Raphael, 90 A. 683, 684 (N.J. Ch. 1914).

In this event the mortgage will be a valid lien on the property entitling the mortgage to foreclose for its breach but without right to a money judgment. N.Y. REAL PROP. LAW § 249; WIS. STAT. § 706.10(6); Vreeland v. Dawson, 151 A.2d 62 (N.J. Super. Ct. 1959).

The execution of a mortgage does not imply a personal obligation to pay the debt. Flover v. Lavington, 1 P. Wms. (1714); IND. CODE § 3-1813 (1968); Alexander v. Hergenroeder, 138 A.2d 366 (Md. 1958); Matthews v. Sheehan, 69 N.Y 585 (1877). The rule that no covenants are implied in conveyances, 7 S. WILLISTON, CONTRACTS § 926 (3d ed. 1963); N.Y. REAL PROP. LAW § 251; OR. REV. STAT. § 93.140; WIS. STAT. ANN. § 706.10(6), has been applied to mortgages. Stoddard v. Weston, 53 Hun. 634, 6 N.Y.S. 34 (Sup. Ct. 1889).

See generally Milton R. Friedman, *Creation and Effect of Personal Liability on Mortgage Debts in New York*, 50 YALE L.J. 224 (1940).

An agreement to enter into a mortgage extension agreement does not entitle the mortgagee to the owner's covenant to pay where this was not one of the terms agreed on. *In re* Home Title Ins. Co., 32 N.E.2d 548 (N.Y. 1940).

289. *See* cases collected in Kawauchi v. Tabata, 413 P.2d 221, 229–30 (Haw. 1966); M. De Matteo Constr. Co. v. Daggett, 168 N.E.2d 276 (Mass. 1960); Derry v. Babcock, 438 P.2d 1008 (Or. 1968); Seattle-First Nat'l Bank v. Hart, 573 P.2d 827 (Wash. Ct. App. 1978).

insurance—is insufficient to make it unenforceable.[290] A contract to give a mortgage in "usual" form, with "statutory . . . covenants, conditions and powers of sale" was held sufficiently definite for enforcement.[291] Under the majority rule, a memorandum of sale that provides for a purchase money mortgage, without specification of its maturity or rate of interest, is unenforceable.[292] The same would, of course, apply where the principal of the mortgage has been left indefinite.[293] If the purchase money mortgage is prepayable, the purchaser may treat the transaction as a cash sale by offering full payment and avoiding the problems of uncertainty.[294] New York and New Jersey are in the minority in holding that if no reference is

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290. Baker v. Dawson, 141 A.2d 157, 165 (Md. 1958).

291. M. De Matteo Constr. Co. v. Daggett, 168 N.E.2d 276 (Mass. 1960).

292. Kearns v. Andree, 131 A. 695 (Conn. 1928); Bambico v. Perez, 631 P.2d 592 (Haw. Ct. App. 1981); Sweeting v. Campbell, 132 N.E.2d 523 (Ill. 1956); Balboa Constr. Co. v. Golden, 639 P.2d 586 (N.M. 1981); Pollak v. Dapper, 220 N.Y.S. 104 (App. Div. 1st Dep't), *aff'd per curiam*, 157 N.E. 886 (N.Y. 1927); RESTATEMENT (SECOND) OF CONTRACTS § 33 illustration 2 (1981).

A contract for a "$48,500 second mortgage" was held too ambiguous for enforcement. Ide Farm & Stable, Inc. v. Cardi, 297 A.2d 643 (R.I. 1972).

A contract specifying that purchaser is to secure a first loan on the property for at least $12,500, no other details being specified, is void. *See* Kenimer v. Thompson, 196 S.E.2d 363 (Ga. Ct. App. 1973).

A broker's claim for commission, based on the theory that a sale had been consummated, was dismissed where the amount, interest and amortization rate, and term of purchase money mortgage, had been left for future determination at the time of defendant's repudiation. Oliver Williams, Inc. v. Nielsen, 131 N.Y.S.2d 773 (Sup. Ct. App. Term 1st Dep't 1954).

The Georgia cases are collected in Hicks v. Stucki, 137 S.E.2d 399 (Ga. Ct. App. 1964); the Maryland cases in Gilbert v. Banis, 257 A.2d 206 (Md. 1969); *see also* Cook v. Barfield, 162 S.E.2d 417 (Ga. 1968).

An agreement that contemplates further negotiations respecting the terms of a purchase money mortgage is unenforceable. Read v. Henzel, 415 N.Y.S.2d 520 (App. Div. 4th Dep't 1979). Same as to terms of a wrap-around mortgage. Fromberg, Fromberg & Roth Props., Inc. v. Springtree I, Ltd., 408 So. 2d 1070 (Fla. Dist. Ct. App. 1982).

293. Annot., 60 A.L.R.2d 251, 276–78 (1958). Specifying a mortgage of a minimum amount without indicating the maximum is insufficient. Grooms v. Williams, 175 A.2d 575 (Md. 1961).

294. A mortgage payable in specified installments "or more" permits prepayment and permits the purchaser to treat the matter as a cash transaction. Darneille v. Geraci, 205 A.2d 55 (Md. 1964) (and authorities collected); Haire v. Patterson, 386 P.2d 953 (Wash. 1963).

A contract providing for payment of specific installments, with the balance payable when specified "if not sooner paid," does not permit prepayment. Kruse v. Planer, 288 N.W.2d 12 (Minn. 1979).

made to maturity or rate of interest then the mortgage is impliedly payable on demand and at the legal rate of interest.[295] But even in these states this presumption is not applied where the papers negate any intention of creating a demand obligation.[296] There is some authority to the effect that a failure to specify interest and maturity is immaterial where a mortgage loan from a third person is contemplated.[297] Other cases refuse to recognize a contract as complete where details of third-party financing remained open.[298] A contract to sell for $9,500, payable $3,000 in cash with the balance payable in annual installments of $1,500, with interest at 5%, was held to infer an intention to follow "ordinary practice" by securing the deferred payments by a mortgage with terms in accordance with those specified in the contract.[299] Other contracts that provided for deferred payments without security have caused difficulty.[300]

It may well be that a provision for a purchase money mortgage will entitle the seller to a mortgage in the form of and containing

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295. Ansorge v. Kane, 155 N.E. 683, 685 (N.Y. 1927) (dictum); Berlinger v. Moffitt, 82 N.Y.S.2d 833 (N.Y. Sup. Ct. Queens Cnty. 1948); *see* Cauco v. Galante, 77 A.2d 793 (N.J. 1951).

A failure to designate a time for payment has been held to imply an obligation to pay within a reasonable time in the circumstances. Ferris v. Jennings, 595 P.2d 857 (Utah 1979).

296. Heim v. Shore, 151 A.2d 556 (N.J. Super. Ct. 1959); Monaco v. Levy, 209 N.Y.S.2d 555 (App. Div. 2d Dep't 1961) (mortgage payable in installments, with no indication of their amount and duration); Israelson v. Bradley, 139 N.Y.S.2d 107 (Sup. Ct. Rockland Cnty. 1954), *aff'd*, 139 N.Y.S.2d 913 (App. Div. 2d Dep't 1955) (provision for release of individual lots from lien of mortgage on specified payments).

297. Chambers v. Jordan, 262 A.2d 505 (Md. 1970); *see* Johnson v. Watson, 272 P.2d 580 (Nev. 1954); Heim v. Shore, 151 A.2d 556, 562 (N.J. Super. Ct. 1959); Kenner v. Edwards Realty & Fin. Co., 236 N.W. 597 (Wis. 1931).

298. Cole v. Cutler, 102 S.E.2d 82 (Ga. Ct. App. 1958); Smith v. Biddle, 52 A.2d 473 (Md. 1947); *see* Harris v. Kirshner, 70 A.2d 47 (Md. 1949); Annot., 23 A.L.R.2d 164, 213 *et seq.* (1952).

A contract fixing a purchase price of $14,000 payable by the buyer's obtaining a $10,000 mortgage, with the balance payable in cash, was held too indefinite to be enforceable. Williams v. Gottlieb, 83 S.E.2d 245 (Ga. Ct. App. 1954).

Failure to specify the interest rate on a mortgage to be obtained by plaintiff or his assigns made the agreement incomplete. If the assignee were a corporation, there would be no legal limit on the interest rate in New York. The case involved a contract to lease under which the prospective lessor agreed to "subordinate the fee" to a mortgage to be made by the lessee. Kusky v. Berger, 225 N.Y.S.2d 797 (Sup. Ct. Nassau Cnty. 1962), *aff'd*, 249 N.Y.S.2d 858 (App. Div. 2d Dep't 1964).

299. Durepo v. May, 54 A.2d 15 (R.I. 1947).

300. Rhyne v. Garfield, 225 S.E.2d 43 (Ga. 1976), states that a purchase money note need not be secured or include an acceleration clause. But it held that a provision for release of the land "at rate of 120% per acre" implied an

conditions usually found in mortgages affecting similar properties in the community. It has been so held with respect to a farm mortgage.[301] But, generally speaking, it is not clear what provisions may properly be included in "a mortgage."

When the seller has agreed to subordinate the seller's purchase-money mortgage to a new mortgage to be obtained by the buyer, the contract should describe the buyer's new mortgage in detail. Some courts, but not all, are quite forgiving when the provision is sketchy. An Alabama court enforced a contract in which the provision did not specify the amount of the buyer's new mortgage.[302] However, a contract requiring subordination of a purchase money mortgage to a future mortgage was held too uncertain for enforcement where the amount of the future mortgage was to be not over 60% of the cost of a prospective building to cost between $75,000 and $300,000. The decision was based on a failure to state the amount of interest and the terms and conditions of the obligation to be secured by the future mortgage.[303] This would appear to be the better rule.

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intention for security. Other cases hold that omission of security makes the contract fatal. Bonk v. Boyajian, 274 P.2d 948 (Ct. App. 1954); Reynolds v. Sullivan, 383 A.2d 609 (Vt. 1978). *Contra* Wilson v. Holyfield, 313 S.E.2d 396 (Va. 1984).

301. Gibson v. Brown, 73 N.E. 578 (Ill. 1905). Provision for a "usual deed of trust lien" was held not so ambiguous as to vitiate a contract of sale. Phillips v. Campbell, 480 S.W.2d 250 (Tex. Civ. App. 1972).

302. McCarty v. Harris, 216 Ala. 265, 113 So. 233 (1927) (clause authorized purchaser to place first mortgage on property with $2,900 cash due at closing "to be paid out of the proceeds of the first mortgage"); *accord* Atwood v. Cobb, 33 Mass. 227 (1834); Milner Hotels v. Ehrman, 11 N.W.2d 914 (Mich. 1943); Ray v. Wooster, 270 S.W.2d 743 (Mo. 1954).

Uncertain provision for subordination of a purchase money mortgage to a construction loan may entitle purchaser to damages or specific performance, without the subordination but subject to equities. Stenehjem v. Kyn Jin Cho, 631 P.2d 482 (Alaska 1981).

303. Gould v. Callan, 273 P.2d 93 (Cal. Dist. Ct. App. 1954); *accord* Kusky v. Berger, 225 N.Y.S.2d 797 (Sup. Ct. Nassau Cnty. 1962), *aff'd*, 249 N.Y.S.2d 858 (App. Div. 2d Dep't 1964); *see generally* Comment, *Subordination of Purchase-Money Security*, 52 CALIF. L. REV. 157 (1964).

Contracts were held too uncertain for enforcement where the purchase money mortgage was to be subordinate to a building construction mortgage in an amount to be computed at a maximum rate per square foot of new construction, but where the interest rate, monthly payments, and period of the debt were left to future agreement, Kessler v. Sapp, 338 P.2d 34 (Cal. Dist. Ct. App. 1959); and also where not even the amounts of the construction loan were specified, Lahaina-Maui Corp. v. Tau Tet Hew, 362 F.2d 419 (9th Cir. 1966) (distinguished in Malani v. Clapp, 542 P.2d 1265 (Haw. 1975)); Roven v. Miller, 335 P.2d 1035 (Cal. Dist. Ct. App. 1959); Magna Dev. Co. v. Reed, 39 Cal. Rptr. 284 (1st Dist. Ct. App. 1964). A similar contract was upheld where the construction loan was not to exceed

If the contract provides for a purchase money mortgage, and the purchaser or an assignee of the purchaser is a corporation or an entity other than one or more individuals, the seller should have satisfactory evidence that the purchase money mortgagor is a properly organized legal entity and authorized to execute the mortgage. A clause for this purpose appears below.

CLAUSE 3-9

Purchase Money Mortgagor as Legal Entity

If a purchase money mortgagor shall be a party other than one or more individuals, Seller shall be entitled to proof reasonably satisfactory to Seller's attorney, that such mortgagor is a properly organized legal entity and authorized to execute such mortgage.

§ 3:5 Junior Mortgages

§ 3:5.1 Generally

The foregoing discussion is as applicable to a second or junior mortgage as to a first mortgage. But it is customary to include in junior mortgages a provision to the effect that (1) any default in the first mortgage shall, ipso facto, constitute a default in the junior mortgage and permit its foreclosure,[304] and (2) the mortgagee may cure any default in the first mortgage and add the cost thereof, with interest, to the junior indebtedness. This clause is virtually standard and unobjectionable, provided its phraseology permits foreclosure only after expiration of any grace period in the first mortgage.

$80,000 with interest at no more than 7.5%, payable at such terms and upon such conditions as might be required by the lender. Stockwell v. Lindeman, 40 Cal. Rptr. 555 (2d Dist. Ct. App. 1964). This situation, involving perhaps a minimum of uncertainty respecting the terms of superior encumbrances, has been contrasted with an uncertainty of terms between purchaser and seller. *See* Handy v. Gordon, 52 Cal. Rptr. 385 (2d Dist. Ct. App. 1966), *aff'd*, 422 P.2d 329 (Cal. 1967).

A contract requiring seller to subordinate to a construction mortgage for a specified sum did not obligate the seller to subordinate to a larger mortgage, part of which was to be used to pay the purchase price. Pollock v. Tiano, 61 Cal. Rptr. 235 (2d Dist. Ct. App. 1967).

304. A mortgagor under a junior mortgage was relieved from acceleration, based on a clause of this nature, where the mortgagor paid interest on the senior mortgage after its due date but before expiration of the grace period permitted by the senior mortgage. Trowbridge v. Malex Realty Corp., 191 N.Y.S. 97 (App. Div. 1st Dep't 1921).

A clause making breach of a paramount mortgage automatically a default in a junior mortgage was enforced in Crescent Beach Co. v. Conzelman, 321 So. 2d 437 (Fla. Dist. Ct. App. 1975).

A junior mortgage occasionally provides that if the amount of any prior mortgage is increased, a sum equal to such increase will be paid in reduction of the junior mortgage. A provision of this type is apt to be a form of right to prepay the junior mortgage, depending on its language, and should be considered in this light. It has been held that the prior mortgagee is not obligated to see that this payment is made. The court found it unnecessary to determine the mortgagor's liability for this payment or whether the failure to make this payment made the lien of the junior mortgage paramount to the extent of the increase in the senior mortgage.[305] The clause entitling a junior mortgagee to a payment in reduction of his mortgage, equal to any increase in the prior mortgage, was held inapplicable to a situation in which the senior mortgagee elected to apply the proceeds of fire insurance in reduction of his mortgage and then reloaned a similar sum to the mortgagor at an increased rate of interest.[306] In a Kentucky case a first mortgage was subordinated to a bank mortgage that was not to exceed $125,000. Subsequently, the bank mortgage was increased to $200,000 without consulting the subordinated mortgagee. In a foreclosure action the bank applied the proceeds of sale first to its debt above $125,000. This was held improper for lack of fair dealing. The result could have been explained on the ground of marshalling assets.[307]

A provision in a mortgage forbade the making of junior mortgages. It was held that a junior mortgage made despite the provision was not void but merely permitted acceleration of the prior mortgage, treating the provision as a due-on-sale clause. The matter arose in the bankruptcy of the mortgagor who made the junior mortgage, but nevertheless claimed it was void. If true this would have made the junior debt an unsecured claim.[308] Another mortgage permitted acceleration if the property was sold or transferred. The clause did not refer to encumbrances. A divided court held that making a junior mortgage was permissible, but its enforcement by foreclosure permitted acceleration of the senior mortgage.[309]

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305. Zelnick v. Kings Cnty. Sav. Bank, 218 N.Y.S.2d 876 (Sup. Ct. N.Y. Cnty. 1961), *aff'd*, 224 N.Y.S.2d 270 (App. Div. 1st Dep't 1962).
306. Zelnick v. Kings Cnty. Sav. Bank, 232 N.Y.S.2d 541 (Sup. Ct. N.Y. Cnty. 1962).
307. Ranier v. Mount Sterling Nat'l Bank, 812 S.W.2d 154 (Ky. 1991). The subordination agreement did not require reduction of the subordinated mortgage by any increase in the paramount mortgage.
308. *In re* Henson, 103 F.3d 470 (5th Cir. 1997).
309. Unifirst Fed. Sav. & Loan Ass'n v. Tower Loan, Inc., 524 So. 2d 290 (Miss. 1986). One reason for barring a junior mortgage is similar to that involving a due-on-sale clause. Other reasons are that payments on a junior lien may exhaust funds necessary to pay the senior mortgage, particularly where the first mortgage is nonrecourse.

A mortgagee's covenant to subordinate to another mortgage, and any renewals or consolidations thereof, on payment of $31,500, was held to require more than one subordination and payment, on the ground that "consolidation" contemplates additional funding and, therefore, more than one mortgage.[310]

Occasionally, where the senior mortgage requires periodic amortizations, an additional clause is included in a junior mortgage. Inasmuch as every payment in reduction of the first mortgage increases the security of the junior mortgagee, the latter is interested in seeing such amortizations made. The clause requires additional payments on the junior mortgage in a sum equal to any amortizations unpaid on the senior mortgage, regardless of any waiver thereof by the senior mortgagee and, further, that these additional payments shall not affect the regular payments, if any, required under the junior mortgage. In the absence of such a clause, a waiver of amortization by the senior mortgagee would prevent a junior mortgagee from invoking a clause under which a default in a senior mortgage becomes, ipso facto, a default in the junior mortgage.[311]

A sample subordination clause for inclusion in a junior mortgage is provided below.

CLAUSE 3-10

Subordination Clause in Junior Mortgage

This mortgage is subject and subordinate to a certain mortgage covering said premises, dated _____, made by _____ to _____, and recorded on _____, in the Office of _____ in Book __ at page ___, which mortgage was given to secure the sum of $_____ and interest at the rate of _____%, on which mortgage there is now owing the sum of $_____, with interest from _____.

If said prior mortgage shall be in default for any reason, and should said default continue for ten (10) days or more, or should any suit be commenced to foreclose said prior mortgage, then the amount secured by this mortgage and the accompanying note shall be due

310. Statland Holliday, Inc. v. Stendig Dev. Corp., 362 N.Y.S.2d 2 (App. Div. 1st Dep't 1974).

311. Bohland v. Horn, 153 A. 588 (N.J. Ch. 1931); *accord* 100 Eighth Ave. Corp. v. Morgenstern, 150 N.Y.S.2d 471 (Sup. Ct. Kings Cnty. 1956), *modified*, 164 N.Y.S.2d 812 (App. Div. 2d Dep't 1957) (agreement reducing amortizations under senior mortgage); Guleserian v. Fields, 351 Mass. 238, 218 N.E.2d 397 (1966) (same).

> and payable at the option of the owner or holder of this mortgage. If said prior mortgage shall be in default by reason of nonpayment of the principal or interest, or any part thereof, or otherwise, the owner or holder of this mortgage may cure such default and the cost of curing such default, with interest at the rate of _____% per annum from the time of the advance or advances therefore, shall be added to the indebtedness secured by this mortgage and the accompanying note, and may be collected thereunder at any time after the time of such advance or advances therefore.
>
> If payment of the principal or interest or any part of principal or interest, secured by said prior mortgage shall not be made at the time in said prior mortgage specified, then regardless of any postponement, extension, indulgence, or forgiveness thereof which may be agreed to or acquiesced in by the holder of said prior mortgage, a sum equal to the amount of such principal or part thereof shall immediately become due and payable in reduction of this mortgage, provided, however, that nothing herein contained shall be deemed or construed to entitle the owner or holder of this mortgage to any payment in excess of the sum hereby secured and accrued interest.

This clause does not contemplate an increase in the prior mortgage, with a compensatory reduction of the junior mortgage, as described above.

A paramount mortgage may be modified or extended by agreement between the mortgagee and the owner, without the consent of a junior mortgagee and without affecting the priority of the respective liens.[312] The agreement may include a waiver of amortizations,[313] as well as an

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312. Resolution Trust Corp. v. BVS Dev., Inc., 42 F.3d 1206 (9th Cir. 1994) (term of construction mortgage extended five months); Barbano v. Cent.-Hudson Steamboat Co., 47 F.2d 160 (2d Cir. 1931); Eurovest Ltd. v. 13290 Biscayne Island Terrace Corp., 559 So. 2d 1198 (Fla. Dist. Ct. App. 1990); Aetna Cas. & Sur. Co. v. Valdosta Fed. Sav. & Loan Ass'n, 333 S.E.2d 849 (Ga. Ct. App. 1985) (modification of mortgage; release of mortgagor no novation); Guleserian v. Fields, 218 N.E.2d 397 (Mass. 1966) (and cases collected); Hyman v. Hauff, 21 N.Y.S. 984 (C.P.), *aff'd on other grounds*, 33 N.E. 735 (N.Y. 1893); Meislin, *Extension Agreements and the Rights of Junior Mortgagees*, 42 VA. L. REV. 939, 943 n.17 (1956). *But see* Citizens & S. Nat'l Bank v. Smith, 284 S.E.2d 770 (S.C. 1981) (priority lost). Execution of a renewal note is not, without more, a discharge of the original debt but only an extension of time for its payment. *In re* Lambert Enters., Inc., 21 B.R. 529 (Bankr. W.D. Va. 1982).

313. Guleserian v. Fields, 218 N.E.2d 397 (Mass. 1966); 100 Eighth Ave. Corp. v. Morgenstern, 150 N.Y.S.2d 471 (Sup. Ct. Kings Cnty. 1956), *modified*, 164 N.Y.S.2d 812 (App. Div. 2d Dep't 1957).

increase in interest rate,[314] without giving the junior mortgagee a right to foreclose. A paramount mortgage may be consolidated with another without consent of a junior mortgagee, or an agreement between the paramount mortgagee and the mortgagor may increase the interest rate of the paramount mortgage, also without consent of a junior mortgagee.

Such modifications, however, are ineffective as to a junior mortgagee to the extent that they increase the amount of the paramount mortgage unless the junior mortgagee has subordinated its lien or consented to them.[315] The agreement is nonbinding on the junior mortgagee in an action to foreclose the paramount mortgage and cut off the junior lien if it is prejudicial to the junior lienor.[316] Moreover, in an extreme case, where the change in the paramount mortgage has substantially impaired the security interest of the junior mortgage, the lien of the latter has been elevated above the paramount mortgage.[317] In this situation some authorities subordinate only that part of the modification that is prejudicial to the junior mortgage.[318]

A similar result follows under the discharge rules applicable to mortgage notes governed by Article 3 of the Uniform Commercial Code. An agreement that impairs recourse or collateral discharges a

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314. Barbano v. Cent.-Hudson Steamboat Co., 47 F.2d 160 (2d Cir. 1931); 100 Eighth Ave. Corp. v. Morgenstern, 150 N.Y.S.2d 471 (Sup. Ct. Kings Cnty. 1956), *modified*, 164 N.Y.S.2d 812 (App. Div. 2d Dep't 1957).

315. Shane v. Winter Hill Fed. Sav. & Loan Ass'n, 492 N.E.2d 92 (Mass. 1986); Société Générale v. Charles & Co., 597 N.Y.S.2d 1004, 1008 (Sup. Ct. N.Y. Cnty. 1993) (consolidation of two mortgages on condominium does not deprive condominium association of its statutory priority over all mortgages except first mortgage).

316. Remodeling & Constr. Corp. v. Melker, 65 N.Y.S.2d 738 (Sup. Ct. Kings Cnty.), *aff'd*, 64 N.Y.S.2d 175 (App. Div. 2d Dep't 1946); *see* Barbano v. Cent.-Hudson Steamboat Co., 47 F.2d 160, 162–63 (2d Cir. 1931); Empire Trust Co. v. Park-Lexington Corp., 276 N.Y.S. 586, 592 (App. Div. 1st Dep't 1934); Diamond v. Tau Holding Corp., 226 N.Y.S. 129, 132 (Sup. Ct. N.Y. Cnty. 1927).

In an action by a second mortgagee to foreclose, and to redeem from a prior mortgage, an extension of the prior mortgage was held no reason for denial of relief when the plaintiff had neither actual nor constructive notice of the extension of the first mortgage when he acquired the second. Wheeler v. Menold, 47 N.W. 871 (Iowa 1891).

317. Gluskin v. Atl. Sav. & Loan Ass'n, 108 Cal. Rptr. 318 (Ct. App. 1973) (term of construction mortgage shortened from thirty years to ten months; interest rate increased).

318. Lennar Ne. Partners v. Buice, 57 Cal. Rptr. 2d 435 (Ct. App. 1996); Shultis v. Woodstock Land Dev. Assocs., 594 N.Y.S.2d 890 (App. Div. 3d Dep't 1993).

secondary obligor, except where liability is preserved by a prior consent provision incorporated in the note or otherwise given.[319]

A similar analysis applies to priority disputes between tenants and mortgagees when mortgages are modified or consolidated. The extension and consolidation of mortgages does not affect the priority of an earlier mortgage over a subordinate lease or other interest.[320]

The holder of a first mortgage has been held entitled to subordinate its mortgage to a lease, in exercising its business judgment that its interest would be served by foreclosing subject to the continuation of this lease. Junior lienors had sought to set aside the subordination, presumably in the belief that the property would be more valuable if free of the lease.[321]

Recordation of a first mortgage gave a junior mortgagee continuous notice of a superior lien, although an assignment of the first mortgage was not recorded until after recordation of the junior mortgage.[322]

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319. U.C.C. § 3-605. *See* Crown Life Ins. Co. v. Haag, Ltd. P'ship, 929 P.2d 42 (Colo. 1996) (interpreting former U.C.C. § 3-606(1)(b).

320. UMB Bank & Trust Co. v. S.H.M. W. Parking Corp., 581 N.Y.S.2d 324 (App. Div. 1st Dep't 1992); Dominion Fin. Corp. v. 275 Wash. St. Corp., 316 N.Y.S.2d 803, 806 (Sup. Ct. Westchester Cnty. 1970).

321. Landau v. W. Pa. Nat'l Bank, 282 A.2d 335 (Pa. 1971). An alternative reason was that the parties seeking to rescind the subordination, which would lead to termination of the lease, had "either negotiated or ratified the lease," to which they were legally bound as lessors.

Substantially contra to *Landau* is G.B. Seeley's Son, Inc. v. Fulton-Edison, Inc., 382 N.Y.S.2d 516 (App. Div. 2d Dep't 1976). It holds that, at the insistence of the mortgagor, the holder of a mortgage (1) must join and cut off a subordinate tenant in foreclosure, and (2) could not subordinate the mortgage to the lease without the mortgagor's consent. The court cited N.Y. REAL PROP. ACTS. LAW § 1311, which requires a foreclosing mortgagee to join a tenant he claims to be subordinate. However, there is no requirement that the mortgagee make this claim. The case is inconsistent with Metropolitan Life Ins. Co. v. Childs Co., 130 N.E. 295 (N.Y. 1921), despite a statutory change since *Metropolitan Life*. The latter case holds a foreclosing paramount mortgagee has the option of cutting off or confirming a subordinate lease. In *Seeley*, the court may have been influenced by the fact that the plaintiff in foreclosure, an assignee of the mortgage, was an alter ego of the tenant.

Accord with *Metropolitan Life*, 130 N.E. 295, and stating the majority rule requires joinder of a subordinate tenant to cut off his lease is Citizens Bank & Trust Co. v. Bros. Constr. & Mfg., Inc., 859 P.2d 394 (Kan. Ct. App. 1993) (citing contra cases). A lease paramount to a mortgage is unaffected by foreclosure of a subordinate mortgage.

322. Bank W. v. Henderson, 874 P.2d 632 (Kan. 1994).

Holders of various liens may alter the order of priority by agreement between themselves, without consent of the mortgagor-owner.[323] A subordination agreement is subject to the statute of frauds,[324] but the statute may be inapplicable where there is an equitable estoppel after an advance made in reliance on a subordination.[325]

In a Virginia case, a purchaser under a sale-leaseback arrangement fraudulenty induced the seller to sign a subordination agreement.[326] The purpose of the subordination was to obtain a new mortgage that would prime the seller's purchase money mortgage. The court held that the subordination agreement was voidable and that under the Virginia third-party beneficiary statute[327] the seller has a rescission right that she could assert against the new mortgagee, even though that lender lacked notice of the fraud. Query whether this result could have been obtained in the absence of the statute on the ground of an agency relation? If so, it might be applicable to fraudulent delivery of other instruments, for example, delivery of a deed, etc.

Priority questions may arise if a mortgagee takes a new promissory note from the borrower after recordation of a second lien. The new note retains first priority if it constitutes a renewal of the original note. The new note may represent a renewal even if there is a change in the interest rate.[328]

Mortgages usually include warranties of title, and a mortgagee can benefit from the doctrine of after-acquired title. In an Alabama case, a second mortgagee gained priority over the first mortgagee when the first mortgagee foreclosed and then conveyed title back to the mortgagor.[329]

A second mortgage will not be extinguished by foreclosure of a prior mortgage, or its assignee, if the junior mortgage can show a collusive

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323. Graydon v. Colonial Bank-Gulf Coast Region, 597 So. 2d 1345 (Ala. 1992); Oakes v. Mich. Oil Co., 476 So. 2d 618 (Ala. 1985); Morgan v. Kline, 42 N.W. 558 (Iowa 1889); Putnam v. Broten, 232 N.W. 749 (N.D. 1930).

324. L&R Realty v. Conn. Nat'l Bank, 732 A.2d 181 (Conn. App. Ct. 1999) (statute of frauds bars enforcement of bank's oral agreement to subordinate mortgage to future construction mortgage); Metrobank for Sav. v. Nat'l Cmty. Bank, 620 A.2d 433 (N.J. Super. Ct. 1993). *Contra* N. Ga. Sav. & Loan Ass'n v. Corbeil, 339 S.E.2d 779 (Ga. Ct. App. 1986).

325. *See* Metrobank for Sav. v. Nat'l Cmty. Bank, 620 A.2d 433, 439 (N.J. Super. Ct. 1993).

326. Ashmore v. Herbie Morewitz, Inc., 475 S.E.2d 271 (Va. 1996).

327. VA. CODE § 55-22.

328. Rebel v. Nat'l City Bank, 598 N.E.2d 1108 (Ind. Ct. App. 1992); First Fid. Bank v. Bock, 652 A.2d 262 (N.J. Super. Ct. 1994) (relying on N.J. REV. STAT. § 46:9-8.2).

329. Ala. Home Mortg. Co. v. Harris, 582 So. 2d 1080 (Ala. 1991). *Cf.* Libby v. Brooks, 653 A.2d 422 (Me. 1995).

or fraudulent scheme between the holder of the prior interest and the mortgagor to eliminate the junior lien.[330]

If the holder of two mortgages on the same property forecloses the junior mortgage and purchases at the foreclosure sale, his bid is presumably reduced by the amount of the senior mortgage; and if the value of the property exceeds the amount of the senior mortgage, and there is no agreement to the contra, the senior mortgage is extinguished.[331] "The primary issue in each case is whether the lender in fact would be enriched unjustly if he were permitted to enforce the debt."[332] When the holder of two mortgages forecloses the junior mortgage, bids a fair price at the foreclosure sale, and is not unjustly enriched, he may enforce the debt of the senior mortgage.[333]

Future advances made under a prior mortgage, when required by its terms, take priority over junior liens. If the advances are not so required they nevertheless take precedence generally if the prior mortgagee has no notice of the junior liens.[334] Recordation of the junior interest is not, as a rule, notice to the prior interest.[335]

If a mortgagee retains the proceeds of the mortgage loan to advance them during construction for the cost thereof, the mortgagee is deemed an agent of the mortgagor, with liability for improper advances.[336]

A junior mortgagee who perfects his right to the rents, as against a paramount mortgagee, is entitled to keep the rents collected on his

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330. *See* Aubrey Equities, Inc. v. SMZH 73d Assocs., 622 N.Y.S. 276 (App. Div. 1st Dep't 1995).

331. Mid Kan. Sav. & Loan Ass'n v. Dynamic Dev. Corp., 804 P.2d 1310 (Ariz. 1991); Centennial Square Ltd. v. Resolution Trust Co., 815 P.2d 1002 (Colo. Ct. App. 1991); Tri-Cnty. Bank & Trust Co. v. Watts, 449 N.W.2d 537 (Neb. 1989); Licursi v. Sweeney, 594 A.2d 396 (Vt. 1991).

332. Burkhart, *Freeing Mortgages of Merger*, 40 VAND. L. REV. 283, 382 (1987).

333. *In re* Richardson, 48 B.R. 141 (Bankr. E.D. Tenn. 1985).

334. *In re* Johnson, 124 B.R. 648 (Bankr. E.D. Pa. 1991).

335. *Id.*

336. Garbish v. Malvern Fed. Sav. & Loan Ass'n, 517 A.2d 547 (Pa. Super. Ct. 1986) (and cases discussed); First Nat'l Bank v. Wernhart, 555 N.W.2d 819 (Wis. 1996); Note, *Construction Lending: The Mortgagee's Right to Inspect the Construction Project and Duty to Ensure Proper Disbursement of Constructive Loan Proceeds*, 81 KY. L.J. 511 (1992–93) (cites many cases and concludes that cases putting mortgagee under implied obligation to inspect premises are in minority).

A lender who was required to limit advances to work done, and therefore advanced less than requested sums, was not liable for cost overruns when both borrower's architect and builder underpriced cost of construction. The construction loan agreement expressly provided against any trust relations between the parties. Nichols v. Chi. Title Ins. Co., 669 N.E.2d 323 (Ohio Ct. App. 1995).

behalf, but if a paramount mortgagee thereafter perfects his right to the rent, he is entitled to the rents then uncollected and the rents thereafter payable, both to the exclusion of the junior mortgagee.[337] In this situation the senior mortgagee's right to rents depends on his obtaining a receiver or an extension of an existing receivership.[338]

On foreclosure of a junior mortgage any surplus goes to the mortgagor rather than to the holder of a prior mortgage.[339]

Several cases involve agreements of cross-collateralization of several mortgages and the effect of this on junior liens. In one case, Parsons was the owner of two first mortgages, one on Parcel *A* and the other on Parcel *B*. A bank held a blanket second mortgage covering both parcels. Parsons, the bank, and the mortgagors joined in execution of an agreement that made a default in one first mortgage a default in the other. The court held that the combined debt of both first mortgages was prior in lien to that of the junior mortgage.[340] This will be satisfactory to the owner of the first mortgages if the relation between these mortgages and junior liens is clarified. But if a sale of one of the mortgaged properties is contemplated, how will its prospective purchaser react to the possibility that the mortgage on this property may go into default by the acts and omissions of a stranger who owns other mortgaged property? The situation is comparable to cross defaults under leases. One may question the effect on all this of the bankruptcy of one owner.[341]

§ 3:5.2 *Equitable Subrogation Doctrine*

A mortgage whose proceeds were used to satisfy a prior mortgage may generally be subrogated to the lien of the prior mortgage as against

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337. Vecchiarelli v. Garsal Realty, Inc., 443 N.Y.S.2d 622 (Sup. Ct. 1980).
338. Depan, Eichenberger & Knowles, Inc. v. Greenbriar Props. I, 607 N.Y.S.2d. 177 (3d Dep't 1994). For discussion of receivership, see *infra* section 3A:1.5.
339. Bohra v. Montgomery, 792 S.W.2d 360 (Ark. Ct. App. 1990).
340. Parsons v. Biscayne Valley, Inc., 935 P.2d 218 (Kan. Ct. App. 1997). Parsons argued successfully that the bank's execution of the agreement was consent to this effect and that otherwise its signature would have been unnecessary. The bank argued that its signature was made for the sole purpose of and in consideration for Parsons' agreement to make no further advances on the first mortgage, and that a deficit on the first mortgage would be a third lien on the other property. In First State Bank v. Hoenke Nursery Co., 667 P.2d 1022 (Or. Ct. App. 1983), the facts were somewhat complicated, but the result was comparable to *Parsons*. This litigation would have been unnecessary if the cross-collateralization agreement had recited that the junior mortgage would have been subordinate, or otherwise, to its full effect.
341. *See* 1 MILTON R. FRIEDMAN, FRIEDMAN ON LEASES § 9:1.4 (Patrick A. Randolph, Jr., ed., 5th ed. PLI 2011); 2 *id.* § 16:1.

intervening liens,[342] except where the intervening liens may be adversely affected.[343] This may be more easily accomplished when the original mortgage instrument specifies that the mortgage secures the borrower's promissory note "together with all renewals thereof."[344]

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342. S. Colonial Mortg. Co. v. Medeiros, 347 So. 2d 736 (Fla. Dist. Ct. App. 1977); Davis v. Johnson, 246 S.E.2d 297 (Ga. 1978); Gutermuth v. Ropiecki, 387 A.2d 385 (N.J. Super. Ct. Ch. Div. 1977) (subrogation to prior judgments as well as mortgages); Resolution Trust Corp. v. Barnhart, 862 P.2d 1243 (N.M. 1993); King v. Pelkofski, 229 N.E.2d 435 (N.Y. 1967); Wagner v. Maenza, 636 N.Y.S.2d 857 (App. Div. 2d Dep't 1996); Dedes v. Strictland, 414 S.E.2d 134 (S.C. 1992); Auto Acceptance & Loan Corp. v. Taus, 137 N.W.2d 452 (Wis. 1965). *Cf.* Betts v. Brown, 136 S.E.2d 365 (Ga. 1964). Full subrogation to the lien of a first mortgage was enforced, despite an underpayment, where this was due to an error by the original first mortgagee. Mut. Life Ins. Co. v. Grissett, 500 F. Supp. 159 (M.D. Ala. 1980).

A variance of this is the rule that a new mortgage that secures the old debt does not extinguish the original lien. Marine Bank v. Hietpas, Inc., 439 N.W.2d 604 (Wis. Ct. App. 1989).

This principle was applied where the proceeds of a mortgage, nullified by defective execution, were mostly applied to satisfy an existing mortgage. The mortgagee was given a lien to the extent of the earlier mortgage. Assocs. Fin. Serv. Co. v. Bennett, 611 So. 2d 973 (Miss. 1992).

In La. Nat'l Bank v. Belello, 577 So. 2d 1099 (La. Ct. App. 1991), the proceeds of a third mortgage were used to pay off a first mortgage. This was held not to advance the third mortgage above the second. The court noted the alleged existence of a verbal subordination, which it found did not exist and it cast doubt on the effect of a verbal subordination if it did exist. The court denied that this was an unjust enrichment of the second mortgagee. Subrogation was not discussed.

343. Gen. Builders Supply Co. v. Arlington Coop. Bank, 271 N.E.2d 342 (Mass. 1971).

A lender who advances money and takes a mortgage as security may be subrogated to the priority rights of an old mortgage by assignment or subordination, but does not take priority if he knows of the existence of a junior mortgage. Metrobank for Sav. v. Nat'l Cmty. Bank, 620 A.2d 433 (N.J. Super. Ct. 1993).

An unrecorded mortgage, whose proceeds were used to discharge another mortgage, was held subordinate to the rights of the mortgagor's trustee in bankruptcy. *In re* Bridge, 18 F.3d 195 (3d Cir. 1994) (New Jersey law). *Contra*, as to mechanic's lien. First Nat'l Bank v. Cardinal Roofing & Siding, Inc., 630 So. 2d 1101 (Fla. Dist. Ct. App. 1949).

A Federal tax lien filed after erroneous discharge of a mortgage (for mistaken belief of its payment) was held prior to a subsequent reinstatement of the mortgage on the ground that the government was a hypothetical judgment creditor. *In re* Haas, 31 F.3d 1081 (11th Cir. 1994).

344. That was the situation in Hummel v. Hummel, 896 P.2d 1203 (Okla. Ct. App. 1995). There, husband and wife were liable on the original mortgage. Upon their divorce, the property was awarded to the ex-wife, and the ex-husband was given a junior mortgage. After this the first mortgage was renewed. Because the ex-husband was a co-signer, the rule that one cannot prefer a mortgage he owns to one he owes might appear to be applicable.

In the ordinary case, the lender who refinances the prior mortgage is ignorant of the intervening lien due to a faulty title search. *Eastern Savings Bank v. Pappas*[345] is illustrative. In *Eastern Savings Bank*, a landowner executed a deed of trust to secure a loan for $159,000 in 1990. In 1998, the owner refinanced the debt with a new $168,000 loan from a different lender; several years later judgment creditors filed judgment liens against the owner. The owner defaulted, and the refinancing lender commenced foreclosure. Its title search failed to disclose the liens; it thus had constructive, but not actual, notice of the intervening liens. The trial court held that the judgment creditors had the prior lien under the "first in time, first in right" principle, but the appellate court reversed. Under equitable subrogation, the refinancing lender had priority to the extent (and only to the extent) of the debt it refinanced.

Often the refinancing lender's ignorance of the intervening lien is due to negligence, either on its part or on the part of its agent. Courts commonly hold that proof of negligence makes no difference in the outcome—the negligent lender is still subrogated to the senior lien.[346]

If, however, the refinancing lender has actual knowledge of the intervening lien but made the loan anyway, equitable subrogation might not be available. Although the Restatement sanctions equitable

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345. E. Sav. Bank v. Pappas, 829 A.2d 953 (D.C. 2003) (following RESTATEMENT (THIRD) OF PROPERTY (Mortgages) § 7.6 (1997)).

346. In Houston v. Bank of Am. Fed. Sav. Bank, 78 P.3d 71 (Nev. 2003), a bank agreed to refinance a mortgage loan, ordering a title report, which disclosed no defects. Twenty-seven days later, the bank funded the loan. Earlier on the day the bank filed its mortgage for recordation, plaintiffs, who were suing the owner, filed a prejudgment writ of attachment, which supplemented a lis pendens filed three days after completion of the title report. After obtaining judgment, plaintiffs sought a writ of execution in order to force a sale of the property. The court granted the bank priority over the plaintiffs' lien by applying the doctrine of equitable subrogation. This allows the refinancing lender to retain the priority of the retired mortgage debt, up to the amount of that debt paid off by the new lender. In some states, the bank would not be entitled to equitable subrogation if it had actual notice of the intervening lien, had constructive notice, or had committed negligence. The court adopted the rule of RESTATEMENT (THIRD) OF PROPERTY (Mortgages) § 7.6 (1997), which disregards notice and negligence, provided the junior lienholder is not prejudiced. Thus, under the *Restatement* approach, plaintiffs' claim that the bank was negligent in failing to update the title report prior to closing the loan was not relevant. *Accord* Lamb Excavation, Inc. v. Chase Manhattan Mortg. Corp., 95 P.3d 542 (Ariz. Ct. App. 2004) (applying equitable subrogation to grant priority to permanent lender over mechanics' liens; court observed it did not matter whether permanent lender was negligent in failing to discover liens).

subrogation even in the face of actual knowledge,[347] the Washington State Supreme Court has disagreed.[348]

Alabama applies equitable subrograton to protect a refinancing lender, but only if the new lender's failure to discover the intervening liens is not due to "culpable negligence."[349]

This equitable subrogation doctrine inures to the benefit of an assignee of the superseding mortgage,[350] but not to the benefit of one who assumes or is liable for the payment of the intervening lien.[351] A mortgagor cannot prefer a mortgage he owns to a mortgage he owes but does not own.[352] The doctrine may be illustrated by the following:

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347. RESTATEMENT (THIRD) OF PROPERTY (Mortgages) § 7.6, comment e (1997):

> Most of the cases disqualify the payor who has actual knowledge of the intervening interest, although they do not consider constructive notice from the public records to impair the payor's right of subrogation. Under this Restatement, however, subrogation can be granted even if the payor had actual knowledge of the intervening interest; the payor's notice, actual or constructive, is not necessarily relevant. The question in such cases is whether the payor reasonably expected to get security with a priority equal to the mortgage being paid.

A number of states follow the minority position, espoused by the *Restatement*, that the refinancing lender's actual knowledge of an intervening lien is irrelevant. *E.g.*, LaSalle Bank, N.I. v. First Am. Bank, 736 N.E.2d 619 (Ill. App. Ct. 2000) (construction lender's knowledge of buyer's contract of purchase with developer does not disqualify lender from invoking equitable subrogation when its proceeds paid off a prior mortgage).

348. Kim v. Lee, 31 P.3d 665 (Wash. 2001) (title insurance company, which obtained actual knowledge of judgment lien between the time it issued commitment and the policy, is subordinate to lien).

349. Foster v. Porter Bridge Loan Co., 27 So. 3d 481 (Ala. 2009) (title search conducted by title company missed recorded judgment lien; court did not decide whether title company was lender's agent for purpose of imputing culpable negligence because lienor but had introduced no evidence that searcher's mistake represented "something more than simple negligence").

350. Provident Coop. Bank v. James Talcott, Inc., 260 N.E.2d 903 (Mass. 1970).

351. J. POMEROY, EQUITY JURISPRUDENCE § 1213 (5th ed. 1941); *see* Milton R. Friedman, *Creation and Effect of Personal Liability on Mortgage Debts in New York*, 50 YALE L.J. 224, 242 *et seq.* (1940); Note, *Subrogation of Purchaser to Rights of Mortgagee*, 48 YALE L.J. 683, 687 (1939).

352. Examples of this doctrine include Peat Marwick, Mitchell & Co. v. Bates, 839 P.2d 208 (Okla. Ct. App. 1992); Quackenbush v. Quackenbush, 225 N.Y. Supp. 152 (Sup. Ct. Cattaraugus Cnty. 1927); Milbrandt v. Huber, 440 N.W.2d 807 (Wis. 1989).

In Old Republic Ins. Co. v. Currie, 665 A.2d 1153 (N.J. Super. Ct. 1995), a mortgagor lost title by foreclosure of a first mortgage and subsequently went bankrupt. Thereafter, the former mortgagor repurchased the property, which was thereby held to reinstate a former junior mortgage by reason of a warranty of title in the junior mortgage. The warranty, made by the same former mortgagor, was not discharged in bankruptcy.

(1) *X* buys Blackacre subject to a mortgage he does not assume; (2) *X* gives mortgage *B*, a second mortgage, which may or not be a purchase money mortgage, on which *X* is liable; (3) thereafter whether or not he still owns Blackacre, *X* becomes owner of mortgage *A*. As between *X* and the second mortgagee, mortgage *B* becomes a first mortgage and mortgage *A* a second mortgage. *X*'s liability on the second mortgage precludes any priority of mortgage *A* that *X* owns.[353] A mortgagee cannot avoid this result by "filter through," that is by acquiring the mortgage from a bona fide purchaser.[354] The rule that one cannot prefer a mortgage he owns over one he owes has been applied where the mortgagor is liable on the junior mortgage. It has been logically suggested that the rule should also apply when he is not so liable, on the ground that his payment of the senior mortgage is merely paying the consideration for the property.[355] This would not apply after he sells the property. In fact, a borrower who sells the property subject to the mortgage and thereby allows its amount in reduction of the purchase price and thereafter pays off the mortgage would apparently be entitled to be subrogated to the lender's rights. Any other result would be an unjust enrichment of the then-owner of the property.[356]

The priority of the superseding mortgage is to the extent of the earlier mortgage, as of the time of its cancellation, less any sums applicable in reduction of the superseding mortgage.[357] Under the same reasoning the discharge of a mortgage and its simultaneous

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353. *See* Transamerica Fin. Serv., Inc. v. Lafferty, 856 P.2d 1188, 1193 (Ariz. 1993). *But see* Ray v. Atkins, 421 S.E.2d 317 (Ga. Ct. App. 1992).

354. Chergosky v. Crosstown Bell, Inc., 463 N.W.2d 522 (Minn. 1990).

355. Burkhart, *Freeing Mortgages of Merger*, 40 VAND. L. REV. 283, 362 (1987).

356. *See also In re* Estate of Grozier, 587 N.E.2d 77 (Ill. App. Ct. 1992).

357. Provident Coop. Bank v. James Talcott, Inc., 260 N.E.2d 903 (Mass. 1970). Assocs. Fin. Serv. Co. v. Bennett, 611 So. 2d 973 (Miss. 1992); Resolution Trust Corp. v. Barnhart, 862 P.2d 1243 (N.M. 1993).

An example of this is ITT Diversified Credit Corp. v. First City Capital Corp., 737 S.W.2d 803 (Tex. 1987). There, a third lien was foreclosed. The first and third lienors had made an agreement exchanging their priorities. The former third lien was held prior to the second, but only to the amount of the former first lien.

Another example is Fid. Union Title & Mortg. Guar. Co. v. Magnifico, 151 A. 499 (N.J. Ch. 1930). There, a mortgage was given to secure a payment price, plus an additional cash advance; *i.e.*, it was a purchase money mortgage to the extent it secured payment of the purchase price. This mortgage was paramount to another purchase money mortgage, but only to the extent that it was a purchase money mortgage. A judgment lienor against the mortgagor was held subordinate to both mortgages, but subordinate to the first only to the extent it was a purchase money mortgage.

See also the discussion and cases in *In re* Cliff's Ridge Skiing Corp., 123 B.R. 753, 767 (Bankr. W.D. Mich. 1991).

replacement by another, as by the substitution of a construction mortgage by a permanent mortgage, does not subordinate the new mortgage to interim liens, in the absence of paramount equities.[358] Where the superseding mortgage is foreclosed with joinder of a junior mortgage,[359] joinder of a part owner of the property who had not executed the superseding mortgage, or where the party executing the superseding mortgage had a defective title,[360] the situation is complicated.

The rule of subrogation has been applied to a co-owner of the property who paid the mortgage. Payment gives the payor the right to foreclose against the non-paying co-owner.[361]

Several cases, however, have upheld the priority of the superseding mortgage to its full extent, although larger than its predecessor. Young v. Shaver, 35 N.W. 625 (Iowa 1887) (old mortgage $400, new mortgage $600); Commercial Fed. Sav. & Loan Ass'n v. Grabenstein, 437 N.W.2d 775 (Neb. 1989) (old mortgage $84,000, new mortgage $98,000).

358. *See* Houston Lumber Co. v. Skaggs, 613 P.2d 416 (N.M. 1980).

The release of a mortgage, followed by a new mortgage, continues the original lien when done in good faith and in ignorance of intervening liens without intention of releasing the lien of the original mortgage. This was true even for a mortgage for a larger amount. Commercial Fed. Sav. & Loan Ass'n v. Grabenstein, 437 N.W.2d 775 (Neb. 1989); 59 C.J.S. *Mortgages* § 281 (1949).

A "replacement mortgage" was given priority over a mechanic's lien that was filed in the interim between recording the original and the replacement mortgages, although the original mortgage had not been released. This was based on intent. Stephens Wholesale Bldg. Supply, Inc. v. Birmingham Fed. Sav. & Loan Ass'n, 585 So. 2d 870 (Ala. 1991).

359. In Levenson v. G.E. Capital Mortg. Serv., Inc., 643 A.2d 505 (Md. Ct. Spec. App. 1994), the superseding mortgage was larger than the mortgage it liquidated. Accordingly, its priority was retained over the subordinate interest because the subordinate interest was unknown to the superseding mortgagee, but the priority was limited to the superseded mortgage. However, the court noted that equitable subrogation is inchoate and does not exist until judicially noted—something that had not occurred at the judicial sale. It also noted that a purchaser at a foreclosure sale obtains no more than the mortgagee's interest. The mortgagee bid $45,000 at the sale—less than the mortgage debt. Held: the foreclosure was subject to the mortgagee's equitable subrogation to the superseded mortgage and to the junior liens. The subrogated lien was held not to merge with the interest that mortgagee purchased at the foreclosure sale. Its $45,000 bid was to be applied to the mortgagee's remaining lien. The opinion is an excellent discussion of the entire subject and cites virtually all the authorities and many cases.

360. A superseding mortgage executed by part of the owners, the proceeds of which were used to discharge a prior mortgage executed by part of the owners, bound all the owners, even to the extent of that part of the proceeds that were used to improve the property. United Carolina Bank v. Beesley, 663 A.2d 574 (Me. 1995).

361. Richards v. Suckle, 871 S.W.2d 239 (Tex. Civ. App. 1994).

§ 3:5.3 Subordination Agreements

The owner of undeveloped or underdeveloped property may be required by a purchaser to (1) accept a purchase money mortgage in part payment, and (2) subordinate this mortgage to a prospective construction mortgage to be made by a lending institution. If the seller's hopes are fulfilled, his property will be sold and the subordination will result in the security of an improvement on the land. But a very real risk exists that the proceeds of the construction loan will be diverted from their intended purposes, leaving the subordinator with a relatively large mortgage and without the security of the intended improvement. Foreclosure of the construction mortgage and destruction of the subordinated mortgage are certain to follow. The law is clear: absent collusion between construction mortgagee and mortgagor, or an express stipulation between lender and subordinator, the lender's priority may generally not be dislodged by reason of diversion.[362] The result is contra in case of express conditions imposed on

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362. Grenada Ready-Mix Concrete, Inc. v. Watkins, 453 F. Supp. 1298 (N.D. Miss. 1978); Drobnick v. W. Fed. Sav. & Loan Ass'n, 479 P.2d 393 (Colo. Ct. App. 1970); Baldwin v. Bright Mortg. Co., 791 P.2d 1182 (Colo. Ct. App. 1989); Conn. Bank & Trust Co. v. Carriage Lane Assocs., 595 A.2d 334 (Conn. 1991); First Conn. Small Bus. Inv. Co. v. Arba, Inc., 365 A.2d 100 (Conn. 1976); Inversiones Inmobiliarias Internacionales de Orlando Sociedad Anomina v. Barnett Bank, 584 So. 2d 110 (Fla. Dist. Ct. App. 1991); Rockhill v. United States, 418 A.2d 197 (Md. 1980); Hyatt v. Md. Fed. Sav. & Loan Ass'n, 402 A.2d 118 (Md. Ct. Spec. App. 1979); First Nat'l State Bank v. Carlyle House, Inc., 246 A.2d 22 (N.J. Super. Ct. 1968); Brooklyn Trust Co. v. Fairfield Gardens, Inc., 182 N.E. 231 (N.Y. 1932), and note thereon in 42 YALE L.J. 981 (1931); Tuscarora, Inc. v. B.V.A. Credit Corp., 241 S.E.2d 778 (Va. 1978); *see* Iowa Loan & Trust Co. v. Plewe, 209 N.W. 399 (Iowa 1926), and note thereon in 12 IOWA L. REV. 201 (1927); and cases in Cambridge Acceptance Corp. v. Hockstein, 246 A.2d 138, 140 (N.J. Super. Ct. App. Div. 1968); Daniels v. Big Horn Fed. Sav. & Loan Ass'n, 604 P.2d 1046 (Wyo. 1980). *Cf.* Fikes v. First Fed. Sav. & Loan Ass'n, 533 P.2d 251 (Alaska 1975); McWaters v. Frederick W. Berens, Inc., 238 S.E.2d 717 (Ga. Ct. App. 1977) (lender not liable to owner for paying contactor without inspecting work).

In *Inversiones Inmobiliarias*, 584 So. 2d 110, a seller took back a purchase money mortgage for the full purchase price and was fully wiped out by the mortgage to which it had subordinated. The fact that the now paramount mortgagee released parts of the property without payment as part of a revolving credit arrangement with the builder was not deemed of importance.

A lender is under no duty to supervise construction of projects it has financed. Resolution Trust Corp. v. BVS Dev., Inc., 42 F.3d 1206 (9th Cir. 1994) (California law; loan of excess funds spent carelessly); Armetta v. Clevetrust Realty Investors, 359 So. 2d 540 (Fla. 4th Dist. Ct. App. 1978), distinguishing Connor v. Great W. Sav. & Loan Ass'n, 447 P.2d 609 (Cal. 1968). It is not material that the lender charged a 1% inspection fee. Rice v.

the subordination.[363] It has also been held that a lender's failure to

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First Fed. Sav. & Loan Ass'n, 207 So. 2d 22 (Fla. Dist. Ct. App. 1968) (lender not liable for defect in construction).

California has applied a rule of implied conditional subordination, making diversion of advances a lender's risk. *See* Middlebrook-Anderson Co. v. Sw. Sav. & Loan Ass'n, 96 Cal. Rptr. 338 (4th Dist. Ct. App. 1971).

New Jersey differentiates between a commercial and consumer-type transaction. If there is no express provision therein for use of the loan money, the clause may be found ineffective to elevate a lender, whose advances were not used to benefit the property, to priority unless the clause was bargained for and understood. B.J.I. Corp. v. Larry W. Corp., 443 A.2d 1096 (N.J. Super. Ct. Ch. Div. 1982).

A buyer regularly bought undeveloped property with a small down payment and a purchase money mortgage for the balance. The mortgage permitted subordination to a new mortgage without specifying that the new mortgage be a construction loan. The buyer used the proceeds of the new mortgage for the down payment, kept the rest, and then abandoned the property. The court construed the instruments by "surrounding circumstances" to indicate a construction loan was intended and held the escrow agent liable in damages. Burkons v. Ticor Title Ins. Co., 813 P.2d 710 (Ariz. 1991).

363. Colo. Nat'l Bank v. F.E. Biegert Co., 438 P.2d 506 (Colo. 1968).

Provision for use of proceeds of a loan for construction was the issue in Mercantil Intercontinental, Inc. v. Generalbank, 601 So. 2d 293 (Fla. Dist. Ct. App. 1992) (and authorities cited), and the court authorized their use for incidental preliminary expenses of construction. G. Credit Co. v. Mid-West Land Dev., Inc., 485 P.2d 205 (Kan. 1971) (landlord's "subordination of fee").

Where a construction mortgagee agrees with a subordinator to see that the proceeds of the loan are applied to construction, he will be held to his agreement and lose priority as to any advance not going into construction. Cambridge Acceptance Corp. v. Hockstein, 246 A.2d 138, 140 (N.J. Super. Ct. App. Div. 1968).

Where a lienholder subordinated on a mortgagee's promise to procure a similar subordination by another judgment creditor, eighteen months' delay in obtaining the other subordination agreement was held unreasonable. Keystone Bank v. Nuclear Magnetic Resonance Specialties, Inc., 366 A.2d 251 (Pa. Super. Ct. 1976).

Construction lender was liable to mortgagor for continuing to disburse funds after mortgagor's notification of a construction defect and request to stop. Davis v. Nev. Nat'l Bank, 737 P.2d 503 (Nev. 1987). Lender did not inspect. The court indicated lender might not be liable after an erroneous inspection. *Cf.*, as to this, Rice v. First Fed. Sav. & Loan Ass'n, 207 So. 2d 22 (Fla. Dist. Ct. App. 1968).

An unconditional subordination placed no restrictions on the mortgage now paramount. The subordinated mortgage provided that the proceeds of the former would be used for improvements on the property. The now paramount mortgagee was not a party and was held not bound thereby. Roberts v. Harkins, 292 So. 2d 603 (Fla. Dist. Ct. App. 1974), *cert. denied*, 302 So. 2d 417 (Fla. 1974).

A first mortgagee was held liable to a second mortgagee for distributing the proceeds of its loan to the borrower after assuring the second mortgagee that its position would be unchanged after completion of an improvement. Pastor v. Lafayette Bldg. Ass'n, 567 So. 2d 793 (La. Ct. App. 1990).

administer the loan in the conventional manner of construction loans and masking a loan on the general credit of the borrower with the form of a construction loan, estopped the lender from asserting the subordination.[364] A mortgagee must advance the consideration for the mortgage to the mortgagor, absent an agreement otherwise. If the mortgagee has agreed to apply the consideration to payment of encumbrances, the mortgagee is liable for failure to obtain releases of these encumbrances or otherwise make distribution in accordance with his agreement.[365]

The subordination stipulation may well specify two other matters: (1) Are the proceeds of the construction mortgage to be applied to improve the mortgaged premises alone or to other property as well? (2) How many subordinations are to be executed—one for a construction mortgage, another for the permanent mortgage, or more? Use of the term "subordination instruments" may leave the matter in doubt.

A subordination is valid if made by the mortgagor and the subordinator. It is unnecessary for the party whose lien is thereby elevated to be a party.[366]

§ 3:5.4 Wraparound Mortgages

A wraparound mortgage is a junior mortgage in which the junior debt includes or "wraps" the prior mortgage debt. Both of the debts are installment obligations, and the borrower under the wraparound mortgage pays the holder of the junior debt and mortgage, who in turn pays the holder of the senior debt. Typically, a wraparound is a form of seller financing to enable a buyer to purchase a property (a purchase money mortgage) or is a technique for refinancing a property. When parties use a wraparound rather than ordinary junior financing, the most common reason is to preserve the economic value of an interest rate on the senior loan that is below the prevailing market rate at the time the wrap transaction is consummated, or to handle an existing mortgage that is not prepayable, or is prepayable only at a substantial premium.

The interest rates on the wraparound mortgage loan and the wrapped loan do not need to be the same. Usually the parties agree to a higher interest rate on the wraparound than on the paramount mortgage; thus the wraparound mortgagee who pays the lower interest

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364. Cambridge Acceptance Corp. v. Hockstein, 246 A.2d 138 (N.J. Super. Ct. App. Div. 1968) (landlord's "subordination of fee").

365. *See* Prudential Ins. Co. v. Exec. Estates, Inc., 369 N.E.2d 1117 (Ind. Ct. App. 1977).

366. S. Floridabanc Fed. Sav. & Loan Ass'n v. Buscemi, 529 So. 2d 303 (Fla. 4th Dist. Ct. App. 1988); Rose v. Provident Sav., Loan & Inv. Ass'n, 62 N.E. 293 (Ind. Ct. App. 1901); Londner v. Perlman, 113 N.Y.S 420 (App. Div. 1st Dep't 1908), *aff'd mem.*, 92 N.E. 1090 (N.Y. 1910); Cummings v. Consol. Mineral Water Co., 61 A. 353 (R.I. 1905).

on the paramount mortgage receives a premium on the interest. Questions of usury have arisen in this connection.[367]

Tax planning is another reason why parties sometimes employ wraparound mortgages for seller-financed deals. Wraparound transactions often have different tax consequences for the parties than normal seller-financed sales. Under the installment method of reporting gain, a seller may pay income tax from the sale of property over time, rather than all at once in the year of sale. More favorable tax treatment is available to the seller if the deal is properly structured as a wraparound rather than a straight sale in which the buyer assumes or takes subject to the seller's existing mortgage debt. The total amount of gain is the same either way, but there is more deferral of payment until later years. Differences may also result from other types of taxes. For example, there may be a dispute as to calculation of state or local recordation or transfer taxes for wrap sales.[368]

Wraparound transactions are complicated compared to ordinary mortgage loans, and this complexity adds risk not only for the holder of the wraparound mortgage, but also for the wraparound mortgagor. Unless the senior debt was nonrecourse in nature, the wraparound mortgagee has continuing personal liability on the senior debt. The wraparound mortgagee could have eliminated this risk by selling the property on terms that included retirement of the senior debt or its refinancing by the buyer. The position, however, is no more risky than a regular loan assumption, in which the buyer agrees to assume the mortgage loan and the seller is not released from liability. With an assumption, the seller becomes liable as a surety. In fact, the seller who takes a wraparound mortgage is in a slightly better position in terms of risk than a seller whose buyer assumes an existing debt. With a loan assumption, the buyer may default on the assumed debt and it may take a long period of time, perhaps many months, before the seller is notified of the problem. With a wrap transaction, no default on the existing debt can occur without the wraparound lender's knowledge because she pays that debt directly. Because the wraparound lender pays that debt, in effect using the funds of the wraparound mortgagor (buyer), she will know instantly if and when the buyer fails to pay her the installment required in order to pay the wrapped debt.

Conversely, the wraparound mortgagor (buyer) is in a much riskier position with a wraparound loan than she would be with a loan

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367. *See* Mitchell v. Trs. of U.S. Inv. Trust, 375 N.W.2d 424 (Mich. Ct. App. 1985) (no federal preemption of state usury law because wraparound mortgage does not create first lien).

368. Prince George's Cnty. v. McMahon, 477 A.2d 1218 (Md. Ct. Spec. App. 1984) (state recordation tax is based on difference between wraparound debt and wrapped debt; local transfer tax is based on cash paid by seller, ignoring both debts).

assumption. With a loan assumption, it is up to the buyer to pay the holder of the senior debt, and if the buyer fails to pay, she will of course be the first to know. If, however, the wraparound mortgagee collects the mortgage payments but fails to pay the paramount mortgagee, then the buyer is in substantial trouble.[369] The buyer undertakes the risk that the wraparound mortgagee will default in the payment obligation on the wrapped senior debt. In effect, the buyer has selected the wraparound mortgagee as an agent or intermediary who is to be responsible for remitting the buyer's payment to the holder of the senior debt. There is the risk that even though the buyer pays every installment punctually, the wraparound mortgagee might fail to send one or more payments to the senior lender. If this happens, it might take a long time for the buyer to realize that the wraparound mortgagee has defaulted and broken her promise. Indeed, many wrap transactions envision secrecy, with both parties intentionally failing to tell the senior debt holder that its borrower has sold the property. Thus, as long as the plan for secrecy works, the senior mortgagee will not even consider telling the buyer that the loan is in default. Quite possibly the buyer will not learn of the problem until the eve of foreclosure, when the buyer may see a foreclosure notice posted at the property, a legal notice in the newspaper, or, if the deed of conveyance to the buyer is of record, a title search done as part of the foreclosure process reveals the buyer's interest.

There may be steps the wraparound mortgagor (buyer) can take to attempt to reduce the risk of nonpayment by the wraparound mortgagee, such as requesting from the wraparound mortgagee periodic proof of payment of the wrapped loan. Such monitoring, however, may be costly for the parties, time-consuming, and may not necessarily work perfectly in the sense that the risk cannot be eliminated completely, only reduced. One way for the wraparound mortgagor (buyer) to try to reduce this risk is not to follow the usual format where he makes payments to the wraparound mortgagee. Parties that wrap financings sometimes engage an independent third party to receive and disburse the buyer's payments pursuant to a collection agreement. This technique reduces the risk of transactional misbehavior by the seller who owns the wrap obligation. However, if the seller was seeking to increase tax deferral under the installment method, then the use of a collection agent seriously jeopardizes the seller's hoped-for favorable tax treatment.

One additional reason wrap transactions are generally riskier than standard financing techniques is legal uncertainty. Although parties

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369. *See, e.g.*, Holland v. McCullen, 764 So. 2d 810 (Fla. Dist. Ct. App. 2000) (holder of wrapped loan refused to accept payments from wraparound mortgagee because hazard insurance lapsed).

have used wrap loans in the United States since at least the 1920s, they have not generated a large body of case law, and in most states there are no statutes that provide guidance on the parties' rights and obligations.

In particular, matters such as the proper way to accelerate and foreclose a wrap obligation are often unsettled. Usually at foreclosure the wrap lender will behave as a normal junior mortgagee and sell the property subject to the prior mortgage or mortgages. This should mean the foreclosure purchaser is bidding on an asset whose value is far less than the face amount of the wrap debt. The asset's value is equal to the present full market value of the property, less the amount of the senior wrapped debts. When the mortgage lender bids at her own foreclosure, she is not required to pay cash but can make a credit bid, using all or part of her debt as a means of paying the foreclosure purchase price. A wrap lender can do the same thing, but when the issue arises, how much of a credit bid can she make? May she bid up to the entire face amount of the wrap debt, or is she limited to her "equity" in the wrap debt, which is the difference between the amount owed to her and the amount she owes on the wrapped debt? Courts have split on this thorny issue. The Texas Supreme Court has endorsed the former approach, which is called the "outstanding balance" method.[370] Under this method, a surplus results if the bid exceeds the entire outstanding debt (the wraparound debt); if less, then there is a deficiency. The latter approach, known as the "true debt" method, results in a surplus if the bid exceeds the outstanding balance of the wrapped obligation.[371]

Prepayment of a wraparound mortgage did not imply an obligation by the wraparound mortgagee to pay off the underlying mortgage.[372]

A provision in a wraparound mortgage, required by a state attorney general in the conversion to cooperative apartments, that made nonpayment of the underlying mortgage a satisfaction of the wraparound prevailed over another provision in the wraparound that permitted redemption.[373]

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370. Summers v. Consol. Capital Special Trust, 783 S.W.2d 580 (Tex. 1989).

371. For problems of foreclosure and bidding in foreclosure of wraparound mortgage, see Armsey v. Channel Assocs., 299 Cal. Rptr. 509 (2d Dist. Ct. App. 1986). For computing deficiency judgments, see Lee v. O'Leary, 742 S.W.2d 28 (Tex. Civ. App. 1987). *See also* Caraway, *Unwrapping the Wraparound Mortgage Foreclosure Process*, 47 WASH. & LEE L. REV. 1025 (1990) (drafting and bidding suggestions).

372. Carroll v. Miller, 561 N.Y.S.2d 478 (App. Div. 2d Dep't 1990), later opinion, 624 N.Y.S.2d 627 (App. Div. 2d Dep't 1995).

373. 405 W. 57th St. Owners v. Coronet Props. Co., 616 N.Y.S.2d 585 (App. Div. 1st Dep't 1994); Gregory House Owners Corp. v. Coronet Props. Co., 616 N.Y.S.2d 586 (App. Div. 1st Dep't 1994).

§ 3:6 Discharge of Mortgage

§ 3:6.1 Discharge by Mistake or Fraud

Mortgages have been cancelled and discharged by mistake or otherwise without payment. As between a mortgagee and a mortgagor, with no intervening rights, the mortgage is still valid and enforceable.[374] Where the rights of third persons have intervened, the results differ. If the discharge is by forgery of a third person, the mortgagee prevails over an innocent party despite the latter's reliance on the record, but if the discharge is due to the negligence of the mortgagee or his reliance on some person with whom he is affiliated, the innocent party prevails.[375] A mortgage that is mistakenly discharged may be re-recorded and its position is restored as of the time of the rerecording.[376]

§ 3:6.2 Merger

A conveyance to the mortgagee or a transfer of the mortgage to the fee owner unites both interests in a single hand and generally discharges the mortgage by merger.[377] But to have this result, the transfer must be to the same person in the same capacity.[378] A mortgage executed by a husband on his property to his wife was

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374. Long Island Sav. Bank v. FSB, 596 N.Y.S.2d 808 (App. Div. 2d Dep't 1993). This is no preference in bankruptcy. *In re* Billingsly, 175 B.R. 286 (Bankr. E.D. Ark. 1994).

375. See the extended discussion of cases in *In re* O'Reilly, 30 B.R. 562 (Bankr. N.D. Ohio 1983), and the summary of cases in Sunrise Sav. & Loan Ass'n v. Giannetti, 524 So. 2d 697 (Fla. Dist. Ct. App. 1988); *see also In re* Cameron, 151 B.R. 303 (Bankr. D. Conn. 1993).

376. *In re* Cameron, 151 B.R. 303 (Bankr. D. Conn. 1993); *In re* O'Reilly, 30 B.R. 562 (Bankr. N.D. Ohio 1983). But re-recording when the mortgagor is insolvent within ninety days of its bankruptcy is a preferential transfer.

377. Lyman v. Gedney, 29 N.E. 282 (Ill. 1885); Close v. Martin, 94 N.E. 388 (Mass. 1911); McLaughlin v. Nelson, 202 N.W. 871 (Neb. 1925); Tennenberger v. Sozio, 136 A. 806 (N.J. Ch. 1927); Krekeler v. Aulbach, 64 N.Y.S. 908 (App. Div. 1st Dep't 1900), *aff'd*, 62 N.E. 416 (N.Y. 1902); Greenfield v. Mills, 107 N.Y.S. 705 (App. Div. 2d Dep't 1907); Summy v. Ramsey, 101 P. 506 (Wash. 1909).

378. Sturtevant v. Jaques, 96 Mass. 523 (1867); *see* Clark v. Rowell, 298 N.Y.S. 232 (Cnty. Ct. Delaware Cnty. 1937). *But see* Larson v. Thomas, 215 N.W. 927 (S.D. 1927) (no merger by purchase at foreclosure sale by holder of coordinate mortgage); Sautter v. Frick, 242 N.Y.S. 369 (App. Div. 4th Dep't 1930), *aff'd*, 177 N.E. 129 (N.Y. 1931) (holder of fourth, fifth, and seventh mortgages purchased on foreclosure of fifth; seventh not merged); *In re* Nochomov's Estate, 132 N.Y.S.2d 720 (Sur. Ct. Kings Cnty. 1954). Equitable Sav. & Loan Ass'n v. Lenz, 436 N.W.2d 902 (Wis. Ct. App. 1989).

held merged and cancelled when the wife received the property under her husband's will.[379]

A mortgagee who received a conveyance of the mortgaged property was held to have an enforceable right in a policy of fire insurance that had theretofore insured it "as to the interest of the mortgagee only."[380] Although the existence of merger is largely one of intent,[381] the union of mortgage and realty in one who is primarily liable for the mortgage debt is virtually certain to result in merger,[382] except possibly, as against intervening encumbrances.

A conveyance by a mortgagor to a mortgagee does not as a rule merge the mortgage against junior liens.[383] A conveyance to a mortgagee does not, by weight of authority, merge the mortgage as against the intervening encumbrances.[384] An intention to keep the mortgage alive is presumed where this is to one's interest.[385] A few cases come out the other way, applying merger to the mortgagee's disadvantage.[386]

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379. *In re* Estate of Grozier, 587 N.E.2d 77 (Ill. App. Ct. 1992).

380. Fort Scott Bldg. & Loan Ass'n v. Palatine Ins. Co., 86 P. 142 (Kan. 1906).

381. First Nat'l Bank v. Gilbert Imported Hardwoods, 398 So. 2d 258 (Ala. 1981).

382. Waff Bros. v. Bank of N.C., 221 S.E.2d 273 (N.C. 1976), following Hussey v. Hill, 26 S.E. 919 (N.C. 1897).

383. Bank of Powell v. Peoples Bank, 503 So. 2d 845 (Ala. 1987); Tom Riley Law Firm v. Padzensky, 430 N.W.2d 416 (Iowa 1988); London Bank & Trust Co. v. Am. Fid. Bank & Trust Co., 697 S.W.2d 956 (Ky. Ct. App. 1985); Riggs v. Kellner, 716 S.W.2d 3 (Mo. Ct. App. 1986); Wietzki v. Wietzki, 437 N.W.2d 449 (Neb. 1989) (conveyance by contract purchaser); Branch Banking & Trust Co. v. Home Fed. Sav. & Loan Ass'n, 354 S.E.2d 541 (N.C. Ct. App. 1987); Westgard v. Farstad Oil, Inc., 437 N.W.2d 522 (N.D. 1989); Citizens Sec. Bank v. Courtney, 572 P.2d 1302 (Okla. Ct. App. 1977).

The same was applied to a first mortgage without notifying the Internal Revenue Service, holder of a junior tax lien. *See* First Am. Title Ins. Co. v. United States, 848 F.2d 963 (9th Cir. 1988), and cases discussed. *Accord*, as to judgment creditor, Fed. Land Bank v. Colo. Nat'l Bank, 786 P.2d 514 (Colo. Ct. App. 1989).

384. Brightwell v. United States, 805 F. Supp. 1464 (S.D. Ind. 1992) (but indicates, at 1474, that if mortgagee sells the property he has no interest to protect and mortgage will merge against grantee); 6424 Corp. v. Commercial Exch. Prop., 217 Cal. Rptr. 803 (Ct. App. 1985); Barton v. Cannon, 489 P.2d 1021 (Idaho 1971); Fort Scott Bldg. & Loan Ass'n v. Palatine Ins. Co., 86 P. 142 (Kan. 1906); Fowler v. Carter, 425 P.2d 737 (N.M. 1967); Small v. Cunningham, 120 N.W.2d 13 (N.D. 1963); Altabet v. Monroe Methodist Church, 777 P.2d 544 (Wash. Ct. App. 1989).

385. *In re* B.F. Dewees, Inc., 404 F.2d 519 (3d Cir. 1968); Fed. Land Bank v. Colo. Nat'l Bank, 786 P.2d 514 (Colo. Ct. App. 1989); Overland-Wolf, Inc. v. Koory, 162 N.W.2d 889 (Neb. 1968).

386. *E.g.*, Janus Props., Inc. v. First Fla. Bank, 546 So. 2d 785 (Fla. Dist. Ct. App. 1989) (first mortgagee's acceptance of warranty deed from mortgagor-owner elevated former second mortgage to first).

On a conveyance by a mortgagor to a mortgagee, merger of the mortgage is a matter of intent, a strong presumption being against merger. This permits the mortgagee-grantee to protect himself against junior liens. But a mortgagee's sale of the property thereafter was held a merger, which protected a junior lien.[387]

The fact that the same party is the record owner of both mortgage and fee is no assurance of merger due to the possibility of an unrecorded deed or an unrecorded assignment of the mortgage. In a New York case, a mortgagee assigned his mortgage by an instrument that was never recorded and thereafter acquired the fee.[388] The court held that a purchaser of the real estate from the mortgagee took subject to the mortgage and that no merger had occurred. This was on the ground that although recordation of the assignment was necessary under the recording acts to protect as against a subsequent purchaser of the mortgage, recordation was unnecessary as against a subsequent purchaser of the fee.[389] Not all states would go so far.[390]

A recital in such conveyance that the mortgage is not to merge will generally be given effect.[391] But an intention to this effect will not be enforced where the result would be inequitable.[392] Merger is generally disfavored where its result will be inequitable.[393]

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387. Constr. Mach. v. Roberts, 819 S.W.2d 268 (Ark. 1991).
New York cases holding that a mortgagor's conveyance to a mortgagee may either constitute a satisfaction of a mortgage or merely release mortgagor of liability, depending on intent, a question of fact, are collected in Egrini v. Cnty. of Suffolk, 599 N.Y.S.2d 457, 459 (Sup. Ct. Suffolk Cnty. 1993).

388. Curtis v. Moore, 46 N.E. 168 (N.Y. 1897).

389. *Accord* Thauer v. Smith, 250 N.W. 842 (Wis. 1933), noted in 29 ILL. L. REV. 121 (1934). The possibility of the occurrence of this situation was discounted in Summy v. Ramsey, 101 P. 506 (Wash. 1909).
Cf. Lloyd v. Chi. Title Ins. Co., 576 So. 2d 310 (Fla. Dist. Ct. App. 1990), where a mortgage was assigned by unrecorded instrument and thereafter fraudulently released.

390. Annot., 89 A.L.R. 171, 180 (1934); 7 U. FLA. L. REV. 93, 95 (1954).

391. United States v. Joe Murray's Point Lookout, 342 F. Supp. 92 (S.D.N.Y. 1972); Abbott v. Curran, 98 N.Y. 665 (1885); Egan v. Engeman, 110 N.Y.S. 366 (App. Div. 1st Dep't 1908).

392. In Cambridge Factors, Inc. v. Thompson, 626 N.Y.S.2d 259 (App. Div. 2d Dep't 1995), where a first mortgage owned by the mortgagor in a sham corporation, was held merged as against a second mortgage. *See* Citizens Sec. Bank v. Courtney, 572 P.2d 1302 (Okla. Ct. App. 1977); Widett & Widett v. Snyder, 467 N.E.2d 1312 (Mass. 1984).

393. *See* Clark v. Rowell, 298 N.Y.S. 232 (Cnty. Ct. Delaware Cnty. 1937). For an extended discussion of the historical background in England and in the United States of merger and a criticism of merger as anachronism, see Burkhart, *Freeing Mortgages of Merger*, 40 VAND. L. REV. 283 (1987).

§ 3:6.3 Deed in Lieu of Foreclosure

At the time the parties enter into a mortgage, the mortgagor is not allowed to waive his equity of redemption.[394] After default, the situation is different. The parties may agree to a deed in lieu of foreclosure. This relieves the mortgagor from the burden of foreclosure, and perhaps releases the mortgagor from personal liability on the mortgage debt. But any such conveyance is subject to strict scrutiny for its fairness and is subject to being overturned.[395] A Florida case upheld a conveyance to the mortgagee pursuant to the settlement of foreclosure litigation.[396] Title examiners must satisfy themselves of

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An owner of realty who takes by assignment a mortgage affecting the premises may elect against a merger. *See In re* Nochomov's Estate, 132 N.Y.S.2d 720 (Sur. Ct. Kings Cnty. 1954). *Cf.* Flanagan v. Babineau, 125 N.E.2d 231 (Mass. 1955).

394. *See supra* section 3:1.2.

395. Humble Oil & Ref. Co. v. Doerr, 303 A.2d 898, 908 (N.J. Super. Ct. 1973).

For fairness of the transaction and adequacy of consideration, see Villa v. Rodriguez, 79 U.S. 323, 339 (1870); Galvin v. Johnson, 41 A.2d 113, 116–17 (Conn. 1945); J&J Wall Sys., Inc. v. Shawmut First Bank & Trust Co., 594 N.E.2d 859 (Mass. 1992) (incomplete building worth less than mortgage). Releasing the mortgagor from liability may not be sufficient when the value of the property substantially exceeds the amount of the mortgage. For a good extended discussion, see Caron, *Connecticut Deeds in Lieu of Foreclosure: Under Concerns and Title Issue*, 64 CONN. B.J. 433 (1990). A more extended discussion appears in Murray, *Deeds in Leiu of Foreclosure: Practical and Legal Considerations*, 26 REAL PROP., PROB. & TR. J. 459–534 (1991) [hereinafter Murray, *Deeds*], including the danger of receiving the property with hazardous waste, transfer taxes, and compliance with the Foreign Investment in Real Property Tax Act, where these are applicable, and some state statutes. A detailed study of the problems in actual and potential bankruptcy of the mortgagor in this situation appears in Roberts, *Deeds in Lieu of Foreclosure*, 2 MOD. REAL EST. TRANSACTIONS 1251 (ALI-ABA 4th ed. 1983). Murray & Jacobson, *Due Diligence and Deeds in Lieu of Foreclosure,* REAL PROP., PROB. & TR. J. at 32 (May/June 1993) stress the importance of voiding the mortgage as against subordinate lienor, construction liens, etc. For this purpose, Murray advocates no release of the mortgage debt by a covenant not to sue, in lieu thereof, while both advocate a separate properly organized entity to take title. Jacobson suggests checking leases, security deposits thereunder, cash flow, insurance, labor contracts, and permits (for food and liquor, etc.), and their transferability, personal property, business records—which is perhaps as if corporate stock rather than realty were being purchased.

396. Rothschild Reserve Int'l, Inc. v. Silver, 830 So. 2d 224 (Fla. Dist. Ct. App. 2002). In *Rothschild*, after a homeowner defaulted on a mortgage loan, the lender obtained a summary judgment for foreclosure. The parties then signed a settlement agreement, pursuant to which the borrower delivered a deed in escrow to the lender's counsel. If the borrower paid the debt in full within two months, counsel would return the deed to him. Otherwise, the

the fairness of a conveyance of a deed in lieu of foreclosure and its freedom from being a preferential payment or a fraudulent conveyance.[397] On the other hand, a mortgagee need not accept a deed at any time tendered by the mortgagor.[398] The effect of the conveyance as a merger of the mortgage is considered above.[399]

A mortgagee acquiring title by foreclosure or deed in lieu of foreclosure to non-residential property should consider the liability it might acquire under environmental laws and under other statutes, such as the Americans with Disabilities Act.[400] A feasibility study of the property by an expert would help the mortgagee determine its course of action.

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deed was to be effective and the borrower agreed to surrender possession. After failing to pay, the borrower claimed that the deed constituted a disguised mortgage, and thus he still had the right to redeem. The court rejected this argument, stating that agreements settling foreclosure actions should be valid and that the borrower had benefited from the agreement. The court interpreted a Florida statute providing all "conveyances . . . for the purpose or with the intention of securing the payment of money . . . shall be deemed and held mortgages." FLA. STAT. ANN. § 697.01. The decision is of general applicability, however, because the statute merely codifies the generally accepted principle of equitable or disguised mortgages.

397. Bankruptcy Code § 547; *In re* Carr, 34 B.R. 653 (Bankr. D. Conn. 1983), *aff'd*, 40 B.R. 1067 (D. Conn. 1984); Caron, *Connecticut Deeds in Lieu of Foreclosure*, 64 CONN. B.J. 443–46 (1990); *see generally* Murray, *Deeds, supra* note 395.

For this reason the American Land Title Association title policy, as of May 4, 1990, excludes from its coverage the effect on title of federal and state bankruptcy and insolvency laws. Although the mortgagee's title insurance policy continues in effect after a foreclosure or a conveyance in lieu thereof, it is effective only as of its date of issuance; Murray, *supra*, suggests that because of the problems involved, the mortgagee procure a new policy as of the date of conveyance.

398. *In re* Koeller, 170 B.R. 1019 (W.D. Mo. 1994); Bank of Boston Conn. v. Platz, 596 A.2d 31 (Conn. Super. Ct. 1991); Albany Sav. Bank v. Novak, 574 N.Y.S.2d 140 (Sup. Ct. Orange Cnty. 1991); CUNA Mortg. v. Aafedt, 459 N.W.2d 801 (N.D. 1990).

The reasons for this include the possibility of the conveyance being set aside in bankruptcy of the mortgagor, attack by creditors, and, principally, the fact that a creditor need not accept anything but cash. *Bank of Boston Connecticut*, 596 A.2d 31.

This was applied in a case where the mortgage excused the mortgagor from liability on the mortgage debt. Brown v. Fin. Sav., 828 P.2d 412 (N.M. 1992) (applying Texas law).

In *Koeller*, 170 B.R. 1019, the holder of a deed of trust refused to accept property the owner sought to abandon because of fire damage. The holder would not assume liability for taxes, personal injury, and housing violations. The court noted the holder of a deed of trust merely has a lien to satisfy the debt, and the owner remains the owner until acceptance.

399. *See supra* section 3:6.2.

400. Americans with Disabilities Act, codified at 42 U.S.C. §§ 12101 to 12213.

The issue of merger of the mortgage and the fee often comes up in the context of a deed in lieu of foreclosure. Ordinarily the question is the status of junior liens created by the mortgagor. Junor leases are similarly situated.[401] Courts often protect the mortgagee from such liens by refusing to find merger. This is especially likely when the deed in lieu has an anti-merger clause, expressing the parties' intent that the mortgage shall continue in existence and merger shall not occur. In an unusual case, a mortgagee sought to protect itself from its own debt by denying merger. The court held for the mortgagee's creditor, finding merger notwithstanding the presence of an anti-merger clause in the deed in lieu of foreclosure.[402]

§ 3:7 Mortgage Bond or Note

Mortgage debt is evidenced in the great majority of states by a note. In New York and a few other states the mortgage bond had been traditional. It had been compulsory for trustees and lending institutions because statutes authorizing their investments have referred only to bonds and mortgages. This had been a disadvantage in the case of corporate mortgages because a corporate bond was subject to federal stamp tax upon its issue, its transfer, and again upon its renewal.[403] In 1948, statutory changes in New York authorized mortgage notes as an alternative to bonds.[404] A transition to the general use of notes with corporate mortgages was delayed by *General Motors Acceptance Corp. v. Higgins*,[405] which left some doubt between nontaxable corporate notes and taxable corporate obligations. Since 1966,

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401. A deed in lieu of foreclosure did not merge the mortgagee's rights against a subordinate tenant. GBJ, II v. First Ave. Inv. Corp., 520 N.W.2d 508 (Minn. 1994).

402. U.S. Leather, Inc. v. Mitchell Mfg. Grp., Inc., 276 F.3d 782 (6th Cir. 2002) ($1.5 million judgment lien for unpaid purchase price of goods sold to mortgagee). In *U.S. Leather*, the mortgagee granted a security interest in the note and the mortgage to its parent corporation, to secure debt owed to that corporation. The mortgagee's creditor then brought an action to collect its debt. While the action was pending, mortgagor and mortgagee entered into their deed-in-lieu transaction. Next, the creditor obtained judgment and a judgment lien. The parent corporation claimed its security interest in the mortgage was superior to the judgment lien. The court disagreed, using merger to extinguish the mortgage. In effect, the court "pierced the corporate veil," believing the parent and the subsidiary had colluded to forestall collection of a just debt.

403. Former I.R.C. §§ 4311, 4312, 4331 (1954), repealed by Act of June 21, 1965, Pub. L. No. 89-44 § 401(a), 79 Stat. 136, 148.

404. N.Y. BANKING LAW § 235(6).

405. Gen. Motors Acceptance Corp. v. Higgins, 161 F.2d 593 (2d Cir.), *cert. denied*, 332 U.S. 810 (1947).

federal stamps have not been required on corporate bonds or assignments or renewals thereof.

The mortgage and an accompanying note or bond, as well as other collateral instruments that are executed at the same time, are deemed part of one transaction and are construed together.[406] In case of inconsistency between the mortgage and the note or bond, the note or bond prevails.[407]

Acceptance of a new note, without increasing its amount, is no discharge of a mortgage unless intended and the mortgage continues as security for the obligation as so modified or extended.[408]

§ 3:8 Expenses of Mortgage

The expense of a purchase money mortgage is the cost of giving credit to the buyer. Accordingly, the cost of a loan is generally borne by the borrower.[409] It is fairly customary to apply this to purchase money mortgages by providing in the contract of sale that the buyer will pay seller's attorney for preparing the mortgage papers. This is contemplated by the Customs in New York County.[410] Recording a short mortgage may cost from $10 to $25. In New York and a handful of states, a state mortgage recording tax involves a more substantial payment.[411] A requirement that the mortgagor pay the mortgage

406. Morgan Guar. Trust Co. v. Mowl, 705 A.2d 923 (Pa. Super. Ct. 1998) (mortgagee may not recover on bond after mortgagors satisfied judgment in foreclosure action by paying sheriff full amount on writ of execution; satisfaction of mortgage also represents satisfaction of bond when both instruments are executed on same day as part of same transaction). Metro. Life Ins. Co. v. Monroe Park, 442 A.2d 503, 509 (Del. Super. Ct. 1982).

407. Moss v. McDonald, 772 P.2d 626 (Colo. Ct. App. 1988); Adler v. Berkowitz, 175 N.E. 323 (N.Y. 1930), noted in 31 COLUM. L. REV. 328 (1931).

408. *In re* Bogosian, 114 B.R. 7 (Bankr. D.R.I. 1990); United Bank v. Jefferson Indus. Bank, 791 P.2d 1250 (Colo. Ct. App. 1990); Nw. Bank Neb. Nat'l Ass'n v. Kizzier, 446 N.W.2d 204 (Neb. 1989).

409. Smallwood v. Overseas Storage Co., 33 N.Y.S.2d 876, 881 (App. Div. 2d Dep't 1942), *aff'd*, 47 N.E.2d 435 (N.Y. 1943).

410. *See* X and XI of Customs in Respect to Title Closings, Recommended by the Real Estate Board of New York, Inc., set forth in Appendix A of that document. The custom is not peculiar to New York. Miller, *Hacking a Path Through the New York State Mortgage Tax Jungle*, 43 ALB. L. REV. 37 (1978).

411. In New York there are state and New York City recording taxes that vary with the amount of the mortgage and the nature of the property. N.Y. TAX LAW §§ 253, 253-a; N.Y.C. ADMIN. CODE §§ 11-2601 to 11-2604.

recording tax does not make the mortgage usurious,[412] even when the statute imposes the tax on the mortgagee.[413]

§ 3:9 Release of Part of Mortgaged Premises

A purchaser will find it virtually impossible to resell a part of his property if it is subject to a blanket mortgage covering the entire premises.[414] The mortgagee cannot be compelled to accept part of the mortgage debt and release a corresponding part of the mortgaged property.[415] If the mortgagor intends to sell any one or more parts, it will be necessary to provide in advance for the release of each parcel, at the time of its sale, from the lien of the mortgage. Appropriate provisions for this should be included in the purchase money mortgage.[416] The provisions should entitle the mortgagor to an absolute right to releases, subject to payment or other specified conditions. Subjecting the releases to a mortgagee's consent "not unreasonably to be withheld" is unworkable.[417]

Each released parcel should be adequately described or identified, to enable preparation of a legally sufficient release and to avoid dispute about the property to be released.[418] A metes and bounds description of each released parcel may be included in the mortgage. This is unnecessary if the released parcels are shown on a map. A subdivision, for instance, will be plotted on a map showing the dimensions of the various lots and identifying them by numbers or letters. In this case, a

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412. Lassman v. Jacobson, 146 N.W. 350 (Minn. 1914); Seamen's Bank v. McCollough, 151 N.Y.S. 600 (App. Div. 1st Dep't 1915), *aff'd*, 117 N.E. 1083 (N.Y. 1917); 1918F L.R.A. 383.

413. Robertson Banking Co. v. Chamberlain, 228 F. 500 (5th Cir. 1916). *Contra In re* Elmore Cotton Mills, 217 F. 810 (S.D. Ala. 1914). For cases pro and con, see Annots., 21 A.L.R. 797, 883 (1922); 63 A.L.R. 823, 837 (1929); 105 A.L.R. 795 (1936).

414. For the problems that can arise from an assumption of the entire mortgage by a grantee of part of the mortgaged premises, see *supra* section 3:3.3.

415. Miller v. Fed. Land Bank, 587 F.2d 415 (9th Cir. 1978); R.I. Hosp. Trust Nat'l Bank v. Post, 544 N.E.2d 592 (Mass. App. Ct. 1989); Jones Land & Livestock Co. v. Fed. Land Bank, 733 P.2d 258 (Wyo. 1987). *See infra* section 3A:9 (no general right to repay mortgage debt).

416. For forms of release clauses, see *infra* section 3:9.1.

417. *See, e.g.*, Sun First Nat'l Bank v. Grinnell, 416 So. 2d 829 (Fla. Dist. Ct. App. 1982).

418. An exhaustive annotation on release clauses appears in 41 A.L.R.3d 7 (1971). For a comprehensive general discussion, see Eldridge v. Burns, 142 Cal. Rptr. 845 (1st Dist. Ct. App. 1978).

release may cover "Lot 1, as shown on a certain map. . . ." The mortgagor may select the premises to be released unless the mortgage provides otherwise.[419]

The mortgagor is generally required to make a payment in reduction of the mortgage principal in order to obtain a partial release. The amount of this payment may occasionally be the same for each parcel, but where the parcels vary in size, location, and value, the consideration for the releases will vary, and a release schedule is attached to the mortgage showing the release price for each parcel. Inasmuch as each release reduces the plottage or assemblage value of the unreleased property and its security to the mortgage, the consideration for each release is usually greater than the pro rata value of the particular release parcel and may be 125% of such value. The release clause usually provides for payment of a specified sum as this consideration, plus interest thereon accrued to date of payment. Some clauses have not been this clear.[420] The clause generally contemplates that a release will be obtained on a sale of the parcel released, but a sale is not invariable in this situation. A mortgagor entitled by the terms of his mortgage to releases on paying a specified sum for each lot sold or encumbered was held entitled to releases on tender of this price even though no sale or encumbrance was contemplated.[421]

A mortgagee's right to payment for releases entitles him to payments made in the usual course, in accordance with the terms of the mortgage. Payment of part of the mortgage debt, under compulsion of foreclosure, is no such payment and creates no right to a release.[422] The same is presumably true of payments made from proceeds of insurance or from an award for a partial taking in eminent domain.

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419. Burroughs v. Garner, 405 A.2d 301 (Md. Ct. Spec. App. 1979).

420. A clause authorizing release of lands worth $4,000 on payment of every $1,000 against principal and interest was held to entitle the mortgagor to release of lands worth four times the sum of principal and interest. *See* Chesapeake Isle, Inc. v. Rolling Hills Dev., Inc., 237 A.2d 1 (Md. 1968).

Under a clause that seemed inconsistent, in providing for releases on payment of $1,152 per acre, and also providing for releases on payment "on the debt secured hereby," mortgagor unsuccessfully claimed a right to release based on making the down payment. The court saw no reason for these provisions if mortgagor were entitled to an immediate release. Henderson Mill Ltd. v. McConnell, 229 S.E.2d 660 (Ga. 1976). *Accord* Agric. Alumni Seed Improvement Ass'n v. Diaz, 432 So. 2d 788 (Fla. Dist. Ct. App. 1983); Baldwin v. Benedict, 82 N.W. 956 (Iowa 1900).

421. Geary v. Dade Dev. Corp., 280 N.E.2d 359 (N.Y. 1972). The mortgagee could not have been prejudiced by acceptance of the tender. He had sought a literal construction of the release clause in an effort to obtain a higher payment.

422. Widmann v. Hammack, 187 P. 1091 (Wash. 1920). *See also* Tel. Sav. & Loan Ass'n v. Guar. Bank & Trust Co., 385 N.E.2d 97 (Ill. App. Ct. 1978).

These are, in effect, payments out of the mortgaged property, the making of which dilutes the mortgagee's security pro tanto.[423]

It is generally held that a mortgagor's right under a release clause to obtain partial releases is not affected by a default in the mortgage.[424] Cases inconsistent with this have been explained on the ground that the mortgagor is entitled to a partial release, although in default under the mortgage, if payment for the release would give the mortgagee all he would be entitled to, absent a default, but not where the mortgagee would not, such as interest, tax payments, or, in some cases, where the mortgage debt has been accelerated.[425] A New Jersey court, departing from its precedents, denied a partial release where the mortgagor was in default on the ground that one in substantial breach under an executory contract may not enforce performance against a party not in

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Provision for release of security on payment of a specified sum means payment in ordinary course of business prior to default, excluding insurance proceeds, condemnation awards, etc. *See* Myers v. Lewis State Bank, 462 So. 2d 530, 533 (Fla. Dist. Ct. App. 1985).

423. Fid. Trust Co. v. Brooklyn Props. Corp., 242 N.Y.S. 111, 114 (App. Div. 2d Dep't 1930), indicates that a guaranty of part of a mortgage debt is not to be credited with the proceeds of insurance or a condemnation award nor with the amount of consideration paid for release of property from the mortgage lien. Smith v. Ferris, 39 N.E. 3 (N.Y. 1894), holds that remission of insurance proceeds to a mortgagee was not a payment "according to its terms" to be credited against a guaranty of part of a mortgage debt. The same is true of the proceeds of a foreclosure sale. Tel. Sav. & Loan Ass'n v. Guar. Bank & Trust Co., 385 N.E.2d 97 (Ill. App. Ct. 1978).

424. Harada v. Burns, 445 P.2d 376 (Haw. 1968), *cert. denied*, 393 U.S. 1106 (1969); Eichorn v. Lunn, 816 P.2d 1226 (Wash. Ct. App. 1991). For minority cases, see Ryan v. Rizzo, 159 A. 272 (Conn. 1932); Dozier v. Shirley, 239 S.E.2d 343 (Ga. 1977) (minority rule); Burroughs v. Garner, 405 A.2d 301 (Md. Ct. Spec. App. 1979); Moriello v. Matrix Prod. & Realty, Ltd., 385 N.Y.S.2d 391 (App. Div. 3d Dep't 1976); City Bank Farmers Trust Co. v. Heckmann, 297 N.Y.S. 592 (Sup. Ct. Westchester Cnty. 1937); Horner v. Payne, 586 S.W.2d 101 (Tenn. 1979); Saunders v. Sharp, 840 P.2d 796, 803, 805 (Utah 1992) (despite pending foreclosure; citing cases); *see also* Eldridge v. Burns, 142 Cal. Rptr. 845, 856 (1st Dist. Ct. App. 1978). *Contra* R.I. Hosp. Trust Nat'l Bank v. Post, 544 N.E.2d 592 (Mass. App. Ct. 1989); Eisenhart v. Schreimann, 889 S.W.2d 887, 894 (Mo. Ct. App. 1994).

Mortgagee's claim of mortgagor's anticipatory breach, for nonpayment of installments, was no justification for mortgagee's refusal to deliver partial releases. This, on the ground that the doctrine of anticipatory breach has no application to contracts for the payment of money only. Crouse v. Nantucket Vill. Dev. Co., 460 N.E.2d 1389 (Ohio Ct. App. 1983).

The same rule has been applied to entitle a purchaser to a release of a parcel from an installment contract, although in default under his contract. Columbia Dev., Inc. v. Watchie, 448 P.2d 360 (Or. 1968).

425. See the discussion in Rolfes v. O'Connor, 844 P.2d 1230 (Colo. Ct. App. 1992).

breach.[426] It is desirable, therefore, from the mortgagee's point of view, to provide expressly that any right to partial releases shall lapse during any such time as the mortgagee shall be in default. Under a provision of this kind, a mortgagor is entitled to a release if he qualifies when he requests it, despite a subsequent default.[427] He is also entitled to a release when the concomitant payment cures a default.[428]

If the mortgage requires periodic amortizations, should these be excused to the extent of payments made for partial releases? This is a question of business judgment rather than of law, but the answer should not be left in doubt.[429] The mortgagee may well take the position that inasmuch as the mortgage entitles him to payment in full, by way of required amortizations over the term of the mortgage, without releasing any security before such payment, an amortization received for surrender of security should be in addition to periodic amortizations. If the purchase money mortgage in question was given as part of an installment sale, the mortgagee may be expected to refuse to prejudice his tax position by accepting the entire purchase price in the taxable year of the sale. This will impel him to refuse to give a complete release of the mortgage during this period.[430]

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426. Goldman S. Brunswick Partners v. Stern, 627 A.2d 1160 (N.J. Super. Ct. 1993), relying on RESTATEMENT (SECOND) OF CONTRACTS § 237 (1981). *Cf.* R.I. Hosp. Trust Nat'l Bank v. Post, 544 N.E.2d 592 (Mass. 1989) (citing Massachusetts cases in accord).

In *Goldman*, the mortgage was nonrecourse and a release would reduce the mortgagee's security because no payment was specified for the release.

427. Eldridge v. Burns, 142 Cal. Rptr. 845 (1st Dist. Ct. App. 1978); Saunders v. Sharp, 840 P.2d 796 (Utah 1992). Same, in the absence of such provision. Cassville-White Assocs., Ltd. v. Bartow Assocs., Inc., 258 S.E.2d 175 (Ga. Ct. App. 1979); Adair v. Kona Corp., 452 P.2d 449 (Haw. 1969).

A provision entitling mortgagor to release of forty-two acres without payment was held to prevail over another provision that forbade any release while the mortgage should be in default. Willow Mountain Corp. v. Parker, 247 S.E.2d 11 (N.C. Ct. App. 1978). *Accord* Horner v. Payne, 586 S.W.2d 101 (Tenn. 1979).

428. Pioneer Nat'l Trust Co. v. Pioneer Nat'l Trust Co., 566 P.2d 312 (Ariz. Ct. App. 1977).

429. The mortgage in White v. Spencer, 594 P.2d 609 (Colo. Ct. App. 1979), required annual amortizations of $9,000, and required payments of $12,857 for each 160 acres released. This was constructed to entitle the mortgagor with credit of the fixed amortizations against payments for the releases.

430. I.R.C. § 453(b)(1) (1986) defines an installment sale as a disposition of property where at least one payment is to be received after the close of the taxable year in which the disposition occurs. This supersedes the former rule that limited an installment sale to one in which no more than 30% of the purchase price was paid during the taxable year in which the transaction occurred.

The owner's usual remedy for the mortgagee's failure to deliver partial releases is specific performance. A judgment for damages is also possible.[431] This raises the possibility of damages for loss of profits and, in some situations, of punitive damages.

The order of releases is of importance to the mortgagee, who may become revested with title to the unreleased premises if the purchaser's venture fails and a foreclosure follows. Releases in haphazard order may make the released and unreleased parcels resemble a checkerboard and leave the unreleased property useless for any purpose other than that in which the mortgagor failed. Release of the front parcels may make the rear parcels of doubtful use or value. If a tract is to be subdivided, the seller-mortgagee may require the releases to be begun at one end of the property and continue in order, so that at any one time all the released parcels will be contiguous, or substantially so. The developer may have reason to vary this pattern. If, for instance, he begins building low-priced houses at one end and wants to shift to expensive houses, he will probably want to do this at the other end. To cover this situation, the mortgage may permit releases at both ends, but require that subsequent releases at each end be contiguous. "Contiguity" should not be carried to the extreme of preventing releases of lots on opposite sides of the same street. The term "contiguous" may lack a requisite definiteness.[432]

A clause may provide for release of acres, on payment of a specified sum, without expressing what parcels and in what order the releases may be had. In this situation there is some authority to the effect that the owner-mortgagor has the right of initial selection, with a burden on the mortgagor to show that the requested release would prejudice the mortgagee's security; and in this event the process is to be repeated; that is, the mortgagor is to make the initial selection, etc.[433]

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431. Cassville-White Assocs., Ltd. v. Bartow Assocs., Inc., 258 S.E.2d 175 (Ga. Ct. App. 1979).

432. A provision for release of plots with a minimum acreage but contiguous to a parcel previously released was held too indefinite for enforcement, although the basic contract of sale and conveyance was not invalidated. The reference to acres, which denotes areas but no particular shape, would, the court apparently concluded, have permitted the mortgagor to free from the mortgage all the property suitable for development and leave the rest, with no real security to the mortgagee. This, by selecting a parcel that merely touched a previously released parcel and wound around it in any fashion. Lawrence v. Shutt, 75 Cal. Rptr. 533 (4th Dist. Ct. App. 1969).

In another connection "contiguous" was held applicable to land beyond a road. Grand Union Co. v. Laurel Plaza, Inc., 256 F. Supp. 78 (D. Md.), *aff'd*, 369 F.2d 697 (4th Cir. 1966).

433. White v. Spencer, 594 P.2d 609 (Colo. Ct. App. 1979). The explanation is that the release clause is for the mortgagor's benefit, but that the primary purpose of the mortgage is for the mortgagee's security. *Id.*

Some cases hold a release of part of the mortgaged premises to be severance of wholly owned property, which may create easements by implication.[434] It may be good practice, in some cases, to negate the possibility of such easements by providing for the inclusion of a clause, such as the one below, in each release.

CLAUSE 3-11

Clause to Avoid the Creation of Easement By Implication

> This instrument is given and accepted with the understanding that its execution and delivery shall create no rights, for the benefit of the premises hereby released in the premises which remain under the lien of said mortgage, by way of necessity or in the nature of an easement expressed or implied, or otherwise.

This is not practical in the case of a subdivision where the mortgagor-developer sells lots by reference to a map showing the lots, as well as proposed streets, parks, and possibly other common areas. The purchasers of lots expect easements in these common areas and any effort to prevent their creation would probably also prevent sales. The possibility of limiting street easements to abutting streets, and to such other streets as are essential for reaching the nearest public highway, is considered elsewhere.[435]

If the mortgagee expects the mortgagor to pay the legal expenses of preparing the releases, this, as well as the amount of such expense, should be specified.

In case of a subdivision, the mortgagor may contemplate eventual dedication of the streets and other common areas to the municipality.[436] It may be desirable to donate part of the property for a school or other public purposes. All this requires consent of the mortgagee, and provision therefore should appear in the mortgage. If releases for these purposes are to be without payment to the mortgagee, the mortgagee will undoubtedly require that by the time he is called on to give any such release, the mortgage principal will be reduced to such sum as will assure its ultimate payment in full.

A provision giving the mortgagor an unfettered right of selection has been held not unenforceable for uncertainty. Lambert v. Jones, 540 S.W.2d 256 (Tenn. Ct. App. 1976).

First Equity Inv. Corp. v. United Serv. Corp., 386 S.E.2d 245 (S.C. 1989), holds flatly that if the release is silent, the choice is with the mortgagor.

434. *See infra* section 5:3.1.

435. *See infra* section 10:7.2[B].

436. *See* the third Form of Release, subdivisions (viii) and (ix).

§ 3:9.1 Sample Forms of Release

FORM 3-1[437]

So long as this mortgage shall not be in default, any owner of the mortgaged premises shall be entitled on or after January 1, 20___,[438] upon ten days' prior written notice to the holder of this mortgage, to a release from the lien of this mortgage of any of the parcels hereinbelow set forth, on payment, respectively, to the holder of this mortgage, in reduction of the principal sum hereby secured, of the sum set opposite such parcel below, together with interest accrued upon such payment to the date of such release, as such release parcels are shown on the attached map, marked "Schedule A":

Release Parcels	Considerations for Release
A	$_____
B	$_____
etc.	$_____

Upon receipt of such payment, the holder of this mortgage shall deliver a proper partial release of mortgaged premises in the form set forth in Schedule B attached hereto.

[Schedule A, as mentioned in foreword to the foregoing form, to be attached.]

[Schedule B, consisting of form of release, to be attached. Consideration should be given to adding the clause quoted in Schedule A in following Form 13-2 below.]

FORM 3-2[439]

If the Mortgagor or any successor of the Mortgagor shall file a subdivision map of the mortgaged premises, with all necessary approvals

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437. This form should be considered in light of the discussion in *supra* section 3:9, and should be compared with the comparable forms Forms 3-2 and 3-3. Form 13-1, unlike Forms 3-2 and 3-3, does not require contiguity between the parcels released.

438. If the mortgage is a purchase money mortgage, which is likely in this situation, a release or releases during the calendar year in which the sale was made, accompanied by full payment on the balance of the mortgage debt, deprives the mortgagee of the income tax advantages of an installment sale.

439. Form 13-2 should be considered in light of discussion in *supra* section 3:9, and should be compared with Forms 3-1 and 3-3.

thereof, showing lots (with the areas thereof specified) and roads thereon, the Mortgagee shall release parts of the premises from the lien of this mortgage, subject, however, to the following provisions:

(i) There shall be no right to releases until January 1, 20___.

(ii) A right to releases shall exist only while there is no default under this mortgage.

(iii) No released parcel shall be less than ___ acres.

(iv) The Mortgagee shall be entitled to at least ten (10) days' prior written notice before executing and delivering a release.

(v) There shall be no release of any parcel fronting on the _____ Highway to a depth of _____ feet, until the full satisfaction of the mortgage debt.

(vi) After the first release each subsequently released parcel shall be contiguous to the extent of at least 80% of its common lot line, to a parcel previously released.

(vii) All releases shall be in the form set forth in Schedule A, annexed hereto.

(viii) Simultaneously with the delivery of any such release, and as a condition precedent to the Mortgagee's obligation to deliver the same, the Mortgagor or any subsequent owner of the mortgaged premises will pay the Mortgagee in reduction of the mortgage debt a sum computed at $____ per acre of the premises released, plus attorney's fees of $_____ for each such release. No payment made under this subdivision shall have the effect of postponing payment of amortizations required by paragraph _____ of this mortgage.[440] For the purpose of this paragraph, acreage shall be taken as the aggregate area of the lots to be released, excluding therefrom the area of any road abutting such lots to the center of such road.

Schedule A, consisting of form of release, to be attached. This form may include the following:

Schedule A

This instrument is given and accepted with the understanding that its execution and delivery shall create no rights for the benefit of the

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440. The reference is to the provision requiring amortization payments regardless of partial releases. The provision is contrary to the clause in Pioneer Nat'l Trust Co. v. Pioneer Nat'l Trust Co., 566 P.2d 312, 313 (Ariz. Ct. App. 1977), where the contract stated: "Payments for releases shall apply toward the next principal payment or payments due."

premises hereby released, in the premises that remain under the lien of said mortgage, by way of necessity or in the nature of an easement expressed or implied, or otherwise, except that any owner of a lot or lots hereby released shall have an easement of ingress and egress, along any road abutting such lot or lots, to and from the released premises and the nearest public highway, as measured along such road, which easement shall terminate upon a completed dedication of such road.

FORM 3-3

Any owner of the mortgaged premises shall be entitled to releases of parts of the mortgaged premises from the lien hereof, on or after January 1, 20___, subject, however, to the further provisions of this paragraph:

(i) The Mortgagee shall have received in duplicate a subdivision map of the mortgaged premises, together with evidence of all necessary approvals thereof by governmental subdivisions and the due filing in the office of the Clerk of _____ County and the filing of any bond or bonds or deposit of any other security required by such governmental subdivisions.

(ii) Said map shall provide for [two] roads affording direct ingress and egress between the entire mortgaged premises and a public road. Said roads may be joined at the _____ part of said premises.

(iii) At the time of any such release the Mortgagor shall pay the Mortgagee a sum computed by dividing $_____[441] by the number of acres to be released and multiplying the result by 125%. Such sum shall be applied in reduction of the principal sum hereby secured, and shall be accompanied by a payment of the interest on such sum accrued to the date of payment. The release price for the last lots covered by this mortgage shall not exceed the balance of the principal and interest hereby secured at the time of such release. No payment made under this subdivision shall have the effect of postponing payment of amortizations required by paragraph _____ of this mortgage.[442] For the purpose of this article, acreage shall be taken as the aggregate of the acres of the lots to be released, excluding therefrom the area of any road abutting such lots to the center of such road.

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441. This sum is the original amount of the mortgage debt.

442. The reference is to the provision requiring amortization payments regardless of partial releases. *But see* Pioneer Nat'l Trust Co. v. Pioneer Nat'l Trust Co., 566 P.2d 312 (Ariz. 1977).

(iv) The Mortgagee shall not be obligated to deliver any release of less than _____ acres.

(v) The Mortgagee shall not be obligated to deliver any release at a time when there shall be a default hereunder. The Mortgagor will give the Mortgagee at least ten (10) days' prior written notice of a request for a release.

(vi) Any property released after the first release shall be contiguous to property theretofore released; and for this purpose a lot shall be deemed contiguous to a lot on the opposite side of a road as well as an adjoining lot. Notwithstanding the preceding sentence, the Mortgagor shall be entitled to a release of property fronting on the [northerly] part of the property and also at the most [southerly] part of the property, but in such event any subsequent released lot shall be contiguous to property theretofore released at either end of the mortgaged premises. Notwithstanding anything in this subdivision (vi), the Mortgagor shall be entitled to no release that shall make the aggregate highway frontage released a greater part of the original highway frontage, included in the lien hereof, than the aggregate area released shall bear to the area originally included in the lien hereof. For this purpose the original highway frontage shall be taken as _____ feet and the original area included in this mortgage shall be taken as _____ acres.

(vii) Any such release shall be in the form set forth in Schedule A annexed hereto, and shall be prepared by the attorneys of the Mortgagee at a cost to the Mortgagor of $____ per release, regardless of the number of lots included in such release.

(viii) If the Mortgagor shall have installed roads and drainage facilities or sewer lines on or under the mortgaged premises, all in conformity with said map, and with any and all relevant legal requirements, the Mortgagee will on request of the Mortgagor join, without charge by the Mortgagee, in a dedication of such roads, drainage facilities and sewers. Any instrument for this purpose shall be prepared by the Mortgagor at the Mortgagor's expense and shall be reasonably satisfactory in form to the Mortgagee.

(ix) The Mortgagee will upon request of the Mortgagor consent, without charge to the Mortgagor, to the creation of such easements in the mortgaged property as may be reasonably necessary and appropriate for drainage purposes or for any utilities to be supplied to any building that may be hereafter erected upon any part of the mortgaged property; and will subordinate the lien of this mortgage to any such easements, provided, however, that no lien or charge shall be created thereby prior to the lien of this mortgage. Any instrument for the purpose mentioned in this

subdivision (ix) will be prepared by the Mortgagor at the expense of the Mortgagor and shall be reasonably satisfactory in form to the Mortgagee. The Mortgagee shall execute the same without charge to the Mortgagor.

Schedule A, consisting of a form of release to be attached, as per Schedule A attached to Form 13-2.