Chapter 3

Mortgage Financing

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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.

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 reverts 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 areas 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 Similar rules are applied to both mortgages and deeds of trust.³ 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,⁴ with the result that a wrongful sale may make the deed-of-trust beneficiary liable for damages.⁵

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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.


While enforcement of a mortgage requires a civil action, a deed of trust may be enforced by a sale out of court. Patton v. First Fed. Sav. & Loan Ass’n, 578 P.2d 152 (Ariz. 1978).

4. Patton v. First Fed. Sav. & Loan Ass’n, 578 P.2d 152 (Ariz. 1978) [enforcement of a mortgage requires a civil action, a deed of trust may be enforced by a sale out of court].

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.\(^6\)

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 mortgage and may not be foreclosed.\(^7\) 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.\(^8\) It creates no lien and is not paramount to subsequent liens.\(^9\) 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,\(^10\) but in others the option is valid because the court infers that the option must be exercised within a reasonable time.\(^11\) If the documents are ambiguous, the court may conclude that the option must be exercised within the lifetime of the optionee,\(^12\) which is consistent with the general exclusion of the rule against perpetuities from commercial transactions,\(^13\) and is also consistent with cases involving a lease for a term to commence after completion of a structure housing the

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8. 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].
leased premises. In many states, the “wait-and-see” rule protects an option from violating the rule against perpetuities. The repurchase price must also be reasonable. 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.

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, although there are occasional decisions that seem to go the other way.

16. 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).
18. 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. E.g., John Hancock Mut. Life Ins. Co. v. Breuning Farms Corp., 537 F. Supp. 936 [N.D. Iowa 1982].
20. 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.
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 paragraph. One such example is *Humble Oil & Refining Co. v. Doerr.* 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 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. 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

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22. *Id.*

In Cunningham v. Esso Standard Oil Co., 118 A.2d 611 (Del. 1955), aff’d 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
the creation of the mortgage. Some American statutes validate secured parties’ options to purchase, provided their exercise is not conditioned on a default in the security instrument.

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

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.

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 option and deed were canceled. The mortgagor was held entitled to return of his property in the form in which he mortgaged it.

The cases cited in this note, and other English and American cases are analyzed and discussed extensively in Kane, The Mortgagee’s Option to Purchase Mortgaged Property, in FINANCING REAL ESTATE DURING THE INFLATIONARY 80s, at 123 (Strum ed. ABA 1981) [hereinafter Kane], and also in Licht, The Clog on the Equity of Redemption and Its Effect on Modern Real Estate Finance, 60 ST. JOHN’S L. REV. 452 (1986) [hereinafter Licht].

23. In MacArthur v. N. Palm Beach Utils., Inc., 202 So. 2d 181 (Fla. 1967), 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. Cf. Smith v. Smith, 135 A. 25 (N.H. 1926).

See generally, Kane, note 22 supra, at 128 et seq.

24. CAL. CIV. CODE § 2906 [inapplicable to residential property with four or less units]; N.Y. GEN. OBLIG. LAW § 5-334 [applicable to loans of $2.5 million or more]; UNIFORM LAND SECURITY INTEREST ACT § 211, 7A U.L.A. (1986). These are discussed in Licht, note 22 supra, at 492–97.

25. CAL. CIV. CODE § 2889; 18 GUAM CODE § 35302 [borrowed verbatim from California Code].

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.

mortgage. The intention of the parties is determinative of this rather than the form or name of the instrument.\(^\text{27}\) 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.\(^\text{28}\)

\(\text{Humble Oil \& Refining Co. v. Doerr}\)\(^\text{29}\) was distinguished in a case with complicated facts where although a mortgage was involved, there was no loan.\(^\text{30}\)

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


\(^{30}\) 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 2 MILTON R. FRIEDMAN, FRIEDMAN ON LEASES § 15:6 [Patrick A. Randolph, Jr., ed., 5th ed. PLI 2006]. Subtenant paid the head landlord $175 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 \(\text{Humble}\).
unenforceable.  

The nature of duress has changed over the years from the threat of an unlawful act, for example, a tort or a crime, to include business compulsion that leaves the victim no reasonable alternative. 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.

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.

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.

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, 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


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 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.


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. Trans Ohio Sav. Bank v. Patterson, 590 N.E.2d 1338 (Ohio Ct. App. 1990).

35. 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.

(Friedman on Contracts, Rel. #7, 5/09) 3–9
tenant in common of the non-signing spouse, with no right of survivorship. 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.

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.

§ 3:2 New Mortgage from Third Party

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’s 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 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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38. 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].
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 parties made a mathematical mistake with respect to payments required to amortize a purchase-money mortgage loan.39

39. 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).
§ 3:2.1 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.\(^{40}\) 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.\(^{41}\) 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.\(^{42}\) 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

\(^{40}\) 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).


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].

\(^{42}\) 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).
an affirmative covenant on the purchaser’s part to obtain the specified approval, for failure of which he is liable in damages. 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.

[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. A mortgage condition that fails to specify the principal amount of the buyer’s loan is badly flawed. A Louisiana court had held that a condition calling for the amount “to be determined” does not allow a buyer to terminate the contract.


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).


45. 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).

46. 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, App. 623, 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].

47. 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 the buyers
A contract to close when the purchaser has arranged financing agreeable to him has been held conditional. 48 It has been suggested that a reference to uncertain purchase money financing must necessarily be intended to create a condition. 49 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. 50

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.” 51 But when a seller agreed, after execution of a contract of sale, to pay a mortgage company discount, to enable the purchaser to obtain the specified mortgage and convert

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.


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; collects Georgia cases].


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.

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. 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. The purchaser’s personal contacts with several financial institutions were deemed “reasonable efforts”, although no formal loan application was made. 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. Absent specifics, a mortgage contingency clause requires only good faith. “Best efforts” require more than good-faith efforts.

“Best efforts” have been defined in various ways, as more demanding than due diligence, as an “unprovable standard,” and as “clutter-some shambles,” depending on its mechanism.

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 a due-on-sale clause?, etc., or some requirement, such as that the purchaser sell

52. 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.
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.\textsuperscript{59} The result was otherwise when a purchaser lost his eligibility for a mortgage when his employer relocated him to another state.\textsuperscript{60} 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.\textsuperscript{61}

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 contingent clause is no commitment.\textsuperscript{62} A commitment conditioned on a purchaser’s selling his

\begin{itemize}
\item Maynard v. Bazazzdegan, 732 S.W.2d 950 (Mo. Ct. App. 1987).
\item 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).
\item 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 County 1958).
\item 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].
\end{itemize}


property is not a firm commitment. A long-term loan is implied. A buyer is not required to accept two mortgages; or to accept a single mortgage for a lesser amount and obtain the balance elsewhere; or to guaranty a corporate mortgage; or to agree to a due-on-sale clause. He need not accept terms more onerous than those specified in the contract; or use a corporate applicant, instead of himself, to avoid usury laws. Neither does the purchaser need to mortgage any property other than that involved in the sale. 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. 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. A buyer’s failure to make

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].

written application for a mortgage, as required by his contract, was
demed 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.\footnote{74}

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.\footnote{75}

lending institution, was held 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 suffi-
ciently 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’
1965], aff’d, 219 N.E.2d 291 [N.Y. 1966].

A purchaser who agreed to apply to an institution was held under no
duty to accept a mortgage from seller on conditions customarily different
App. 1975].

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.

\footnote{75. 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
that purchaser give written notice was waived by acceptance of parol
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
[App. Div. 3d Dep’t 1991].}
A purchaser’s notice within the required time ends the contract.\(^76\) A purchaser’s suggested changes in the contract thereafter is a counter-offer without effect by itself.\(^77\) The cases do not agree if time is of the essence in giving notice in this situation.\(^78\) Recent cases have required purchasers to comply with some reasonable requirements not mentioned in the contract of sale.\(^79\) A purchaser’s arbitrary failure to apply for a mortgage\(^80\) or an application on terms different from those specified in the contract\(^81\) makes the contract unconditional.

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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 County 1958).


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.


77. Id.


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.
A purchaser is not to be penalized for making a truthful application, although his candor makes rejection virtually certain, and where rejection is certain, a purchaser was not required to await formal rejection. 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.

[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.

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. Generally, whether the purchaser acted in good faith is a jury question.

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]; Mortgage 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.

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].

86. 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.


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.\footnote{Merrill Lynch Realty/Carll Burr, Inc. v. Skinner, 63 N.Y.S.2d 590 (1984); Schwartz v. Donnenberg, 168 N.Y.S.2d 31 (Sup. Ct. Nassau County 1957) [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).} A contract conditional on a purchaser’s receiving an FHA mortgage within fifteen days was held to permit the purchaser to rescind after fifteen days, despite subsequent FHA approval.\footnote{Soudelier v. Whitney, 141 So. 2d 91 (La. Ct. App. 1962). Accord Gardner v. Padro, 517 N.E.2d 1131 (Ill. App. Ct. 1987).} 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.\footnote{Patterson v. Marchese, 173 N.Y.S.2d 759 (Sup. Ct. Westchester County 1958), aff’d, 196 N.Y.S.2d 903 (App. Div. 2d Dep’t 1960).} 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.\footnote{Sainato v. Hormozdzi, 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 County 1959).} In this situation, a seller has also been held authorized to cancel despite the purchaser’s suit for specific performance.\footnote{McDonald v. Cullen, 559 P.2d 506 (Or. 1977).} 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.\footnote{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).} But where a purchaser accepted a later commitment, and scheduled a closing, he could no longer withdraw without being in breach of contract.\footnote{Loper v. O’Rourke, 382 N.Y.S.2d 663 (Dist. Ct. Suffolk County 1976) [purchaser sought withdrawal by reason of matrimonial problem]. Accord Keliher v. Cure, 534 N.E.2d 1133 (Ind. Ct. App. 1989).} A purchaser


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


entitled to a refund of his down payment in this situation was held entitled to interest thereon.96

[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.97 It has also been held to permit the purchaser alone to determine what is “necessary” for him, subject to good faith on his part.98 The same is


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 Dept. 1986].

A contract subject to “favorable financing” was held enforceable. Hunt v. Shamblin, 371 S.E.2d 591 [W. Va. 1988].


“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).


Any indefiniteness in this situation is cured, sufficiently for purchaser to have specific performance against seller, when purchaser obtains
true of “suitable financing.” 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. 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. A contract subject to obtaining financing “reasonable” to the borrower is construed objectively and governed by what others similarly situated would consider reasonable. But a contract subject to a


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.

99. Gildea v. Kapenis, 402 N.W.2d 457 [Iowa Ct. App. 1987] [and cases discussed].
100. Kovarik v. Vesely, 89 N.W.2d 279 [Wis. 1958].
102. 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 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,
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. 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. Parol evidence was also held competent to determine the intention of the parties in inserting into a contract the phrase “obtain maximum loan.”

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. 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. A contract “subject to bank financing” was held in the circumstances to mean for 65% of the purchase price. A condition for a mortgage at a fixed rate of interest is not fulfilled by one with an adjustable rate.

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 in 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).

105. 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.
108. 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.”
109. 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”].
[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.\(^{110}\)

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 damage provision is enforceable if reasonable in amount, because of the difficulty of fixing precise damages—.5% to 3% is in this category.\(^{111}\)

In one case there was no operational language indicating the nature of 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.\(^{112}\)

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.\(^{113}\) A lending institution has been held not liable to a purchaser-mortgagor

\(^{110}\) Khabbaz v. Swartz, 319 N.W.2d 279 (Iowa 1982).

\(^{111}\) 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).

\(^{112}\) Woodbridge Place Apartments, 965 F.2d 1429.

\(^{113}\) Miles v. Perpetual Sav. & Loan Co., 388 N.E.2d 1364 (Ohio 1979) (collecting authorities on agency and fiduciary relations).
for allegedly negligent review of commercial leases. The review was
deemed for the institution’s benefit not the purchaser’s.\textsuperscript{114}

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 Settle-
ment 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.\textsuperscript{115}

\textbf{§ 3:2.2 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 3-2 below can be
substituted.

\textbf{CLAUSE 3-2}

\textit{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

\textsuperscript{115} In Schuetz v. Banc One Mortgage 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
(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.
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.\textsuperscript{116}

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 often required more than one application.\textsuperscript{117} 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.\textsuperscript{118}

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.\textsuperscript{119} Particular language of the financing condition may support this conclusion. For example, a

\begin{quotation}

\textsuperscript{116} 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); Mortgage 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.

\textsuperscript{117} 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”].

\textsuperscript{118} 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].

\textsuperscript{119} 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];

\end{quotation}
sloppily drafted contract mixed the plural and singular, requiring the buyer to make “truthful and proper applications to a lending institution designated by the Seller.”

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. Only rarely have courts discussed which party has the burden of proving that the buyer could or could not obtain the requisite mortgage loan, and the courts have split. 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*, 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.

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120. *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].

121. *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].


§ 3:2.3 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. 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. Likewise, if he applies for a larger mortgage than specified in the contract of sale. A buyer may be estopped to set up the condition, as by accepting a mortgage of $16,000 where the contract is conditioned upon his obtaining a larger mortgage. If the condition is the obtaining of a mortgage from a third person, the buyer may waive the condition by offering cash.

126. 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 443 [Sup. Ct. 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 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 County Dist. 1975].


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
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. In one case the contract was conditioned 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.

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129. 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 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).

130. 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 County 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 to permit him to accept a better offer from a third person.
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 as the purchaser’s. This may, among other matters, bar purchaser’s right to waive provisions in a proposed paramount mortgage.131 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.132 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.133

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 purchaser, the seller should include in the contract a provision forbidding waiver of the condition without consent of both.

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).


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 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).

133. See id. at 584 et seq.
§ 3:2.4 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. 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 3-3

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 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. But this is not invariably true. A purchaser may prefer to borrow from a bank or other lending institution, with its established practices, than


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).
from a private lender. The latter, a court might note, may be a rougher creditor. ¹³⁶

§ 3:2.5 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. ¹³⁷

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 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].


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

¹³⁷. 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, that is, term, market rent, and financial status of tenant, to avoid giving the lender unlimited discretion.
amount of the damages or the enforceability of a liquidated damage clause. If the clause states that it is consideration 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.”\textsuperscript{138} 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.\textsuperscript{139}

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 \textit{Woodridge Place Apartments},\textsuperscript{140} 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.\textsuperscript{141} 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.

\textbf{CLAUSE 3-4}

\textbf{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

\begin{itemize}
\item \textsuperscript{138} Wolf, \textit{The Refundable Commitment Fee}, 23 \textit{Bus. Law.} 1065, 1069 [1968].
\item \textsuperscript{139} Id.
\item \textsuperscript{140} \textit{Woodridge Place Apartments v. Wash. Square Capital}, 965 F.2d 1429, 1435 (7th Cir. 1992).
\item \textsuperscript{141} Id. at 1437.
\end{itemize}
lender’s obligation to loan the money in question, but this sum shall be returned if the loan is consummated in accordance with the terms of this commitment.\footnote{142.}{142. Wolf, The Refundable Commitment Fee, 23 BUS. LAW. 1065, 1074 (1968).}

The possibility of an applicant’s forfeiture of a commitment or standby fee in case of a substantial mortgage on commercial property is far more serious than in 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).\footnote{143.}{143. See infra section 3:7.4.}

The borrower will also want provisions dealing with fire and casualty insurance\footnote{144.}{144. See infra section 3:7.2[B].} and partial condemnation\footnote{145.}{145. See infra section 3:8.8.} 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.

\section*{§ 3:2.6 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,\textsuperscript{146} but there are contrary decisions.\textsuperscript{147} 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.\textsuperscript{148}

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 3-5**

**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.


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. It 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]; 2 MILTON R. FRIEDMAN, FRIEDMAN ON LEASES § 26:3 (Patrick A. Randolph, Jr., ed., 5th ed. PLI 2006).

\textsuperscript{147} 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].

§ 3:3 Continuation of Existing Mortgage

§ 3:3.1 Ambiguity

Great care must be taken 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. But another case concluded that the phrase might mean the contrary and, for this reason, held the contract too indefinite for specific performance.

This ambiguity may be avoided by reciting the purchase price substantially as follows:

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

• $20,000 on the signing of this contract, by check subject to collection.
• $150,000 by taking subject to an existing first mortgage in that amount.
• $50,000 by Purchaser’s purchase money note and mortgage.


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).

150. 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).

A contract was held unenforceable where the recited purchase price was subject to an “existing loan.” 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.

For a similar reason a contract requiring purchaser to “assume” existing assessments was held ambiguous. Wright v. Lowe, 296 P.2d 34 (Cal. Dist. Ct. App. 1956).
$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.

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

This recital 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, or if the purchaser is to be credited with insurance moneys paid to a seller for fire damage, 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. 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. The purchaser should see that this provision is limited to payments required under the mortgage and does not permit the seller to prepay otherwise.

151. 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.


153. 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.

154. 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).
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.

Sometimes a buyer finances the purchase in part by taking over the seller’s existing mortgage or mortgages. 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.

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.155

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.156 These terms must be examined. The mortgage may cover 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

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155. A form for this purpose reads:

> 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.


bizarre provision will be found in the mortgage, such as payment in gold.\textsuperscript{157}

In some states, a “dragnet” clause mortgage presents special problems. A Georgia open end or “dragnet” clause mortgage, which secures “any other present or future indebtedness,” may be increased, after purchaser’s acquisition of title, by loans made to the original mortgagor.\textsuperscript{158} By statute, tort claims are excluded from the dragnet.\textsuperscript{159} In many states, the application of a dragnet clause is limited to the same or a series of similar transactions unless otherwise specified.\textsuperscript{160}

The clause in a mortgage with several debtors does not apply a subsequent mortgage to all the previous debtors.\textsuperscript{161} Possible complications are raised with a mortgage by a husband and wife who thereafter split up.\textsuperscript{162} Dragnet clauses do not generally extend to unmentioned prior obligations.\textsuperscript{163} Dragnet clauses are construed against the mortgagee and have been denominated “anaconda mortgages” for their tendency to enwrap a mortgagor in debts he did not contemplate.\textsuperscript{164}

The clause is enforced in Arizona.\textsuperscript{165}

The dragnet mortgage is a relative minor example of the broader and much more used mortgage for future advances. If a mortgage provides for obligatory advances, they have priority over subsequent liens. But if the advances are optional, and the mortgagee had knowledge of subsequent liens at the time the advances are made, these lose priority over the subsequent liens. If, however, the mortgagee does not have such knowledge, the optional advances take priority whether made before or after the subsequent liens, and in

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\text{\textsuperscript{157.} Blanck v. Sadlier, 47 N.E. 920 [N.Y. 1897].} \\
\text{\textsuperscript{159.} GA. CODE § 44-14-1.} \\
\text{\textsuperscript{161.} \textit{In re Lemka}, 201 B.R. 765 [Bankr. E.D. Tenn. 1996].} \\
\text{\textsuperscript{162.} \textit{See} Schmidt v. Wantresh State Bank, 555 N.W.2d 655 [Wis. 1996].} \\
\text{\textsuperscript{164.} Berger v. Fuller, 21 S.W.2d 419, 421 [Ark. 1929].} \\
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this connection the mortgagee must have actual knowledge of the subsequent liens, not the constructive knowledge imparted by their recordation. In other words, the mortgagee need not check the records before making subsequent advances.

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. 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.

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, 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.

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. A material misdescription of the mortgage excuses the buyer from performance. It is, therefore, risky for a seller to attempt to

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167. See Dyches, Priority Disputes in Future Advance Mortgages: Picking the Winner in Arizona, 1985 ARIZ. ST. L.J. 537 [problems of notice, difference between optional and obligatory advances is not always clear; at times mortgagee makes advances that are legally optional but “economically obligatory,” as where more money is necessary to complete a building, pay taxes, insurance, etc.].
170. For a discussion of due-on-sale clauses, see infra section 3:3.1. See also Home Sav. & Loan Ass’n v. Schneider, 469 N.E.2d 585 [Ill. App. Ct. 1984].
171. For a discussion of prepayment, see infra section 3:8.4.
172. See Annot., 26 A.L.R. 528, 532 [1923].
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. County 1897).

But 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.

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

An incorrect reference in the contract to the subordination clause in a junior mortgage excuses the buyer. 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). 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.” Elterman v. Hyman, 84 N.E. 937 (N.Y. 1908).

And, a seller’s agreement to obtain an extension of an existing mortgage, effected by an agreement with similar provisions. Schiff v. Tamor, 93 N.Y.S. 853 (App. Div. 2d Dep’t 1905). A purchaser was also excused by the presence of a “Brundage clause” in a mortgage. Groden v. Jacobson, 114 N.Y.S. 183 (App. Div. 2d Dep’t 1908).

In view of the present form statutory mortgage in New York and some other states, most of these provisions would undoubtedly be held “usual” today. 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.

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. Baker v. Leight, 370 P.2d 268 (Ariz. 1962). The court wrote: ‘Had the agreement merely said, ‘The buyer buys subject to the mortgage,’ or ‘The buyer assumes and agrees to pay the
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. And an agreement to take subject to a past due mortgage does not require the buyer to take subject to a foreclosure action. A failure to mention the existence of an assignment of rents to the mortgagee was held to excuse performance by the buyer.

The buyer should have a copy of an existing mortgage for present examination and future reference. In 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 the note or bond. 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. It is, therefore, insufficient to rely on the mortgage alone.

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.” Baker, 370 P.2d at 270. 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. Lane v. Bisciglia, 488 P.2d 474 [Ariz. 1971].


176. Star Apartment, Inc. v. Martin, 204 F.2d 829 [5th Cir. 1953].

177. 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.

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. The same was held with respect to a requirement for a prepayment premium incorporated only in the note.

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. Nevertheless, a failure to incorporate expressly the provisions of one instrument in another has resulted in a provision that is enforceable, for example, acceleration, in one instrument and not in another.

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.

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183. “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].
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, 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. 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. Banks, insurance companies, and other institutional lenders will often refuse to give more than a letter to such effect. 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. An owner is not entitled to a statement of the sum owing on a mortgage either by implication 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

184. 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.


186. 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.

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].

187. For a mortgagee’s statement of amount due as an estoppel, see Annot., 90 A.L.R. 1432 [1934].

commitment, to a statement from the holder of a mortgage on the property of the amount of the mortgage debt. 189 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. 190 One that overstated the amount and refused a refund was held liable in damages. 191

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,192 or it may be assumed by the buyer.

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189. 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 mortgagor 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.

190. 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.


The majority rule, that a grantee “subject” to a mortgage is not impliedly liable thereon, was adopted by statute in New Jersey. N.J. STAT. ANN. § 46:9-7.1 [1990] [overruling Max v. Beckelman, 169 A. 640 [N.J. Ch. 1934]]. 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. Naffah v. City Deposit Bank, 23 A.2d 340 [Pa. 1941].

In Maryland an assumption is implied when a grantee is credited, against the purchase price, with the amount of the mortgage debt. This implication is negated in a wrap-around mortgage situation when the wrap-around mortgagee agrees to make payments on the preexisting mortgage. Daugharty v. Monritt Assocs., 444 A.2d 1030 [Md. 1982].
The contract of sale determines which is to occur.\textsuperscript{193} 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.\textsuperscript{194} Assumption of a mortgage creates an obligation to pay the interest as well as the principal, even without express reference to interest.\textsuperscript{195} 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.\textsuperscript{196}

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.\textsuperscript{197} In New York and some other states the mortgagee may enforce such assumption only if the grantor is liable on the mortgage, whereas many states enforce this assumption regardless of the grantor’s liability.\textsuperscript{198} A grantee’s assumption may be

“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].

193. A buyer’s agreement, included in the contract, to assume 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.

194. 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.


In Connecticut, by statute, an assuming grantee is liable irrespective of his grantor’s liability. \textsc{Conn. Gen. Stat. Ann.} § 52-75; Schneider v. Ferrigno, 147 A. 303 [Conn. 1929]. \textit{Accord} Bankers Mortgage Corp. v.

(Friedman on Contracts, Rel. #7, 5/09) 3–47
effected by the deed conveying the premises. In the absence of statute
the grantee’s mere acceptance of a deed with a clause reading, substan-

tially

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. 199
And for the same reason, a parol assumption of a mortgage is valid and
enforceable. 200 But in New York the assumption must, by statute, be
in writing. In Maryland a grantee who is credited against the purchase
price with the amount of an existing mortgage is held, as against his
grantor, to have assumed the mortgage by implication. 201

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

If the conveyance to an assuming grantee is not an absolute convey-
ance, 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 Friedman, supra, preceding paragraph.

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

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].

against grantee amount of mortgage installment payment made by
grantor].

3–48
Successive assuming grantees form a chain of liability, the last grantee being the principal debtor and the others assureties. 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. As heretofore mentioned, there is a split of authority with respect to a mortgagee’s right to enforce the mortgage debt


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


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 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 [1943]. Accord Langman v. Alumni Ass’n, 442 S.E.2d 669 [Va. 1994].
against an assuming 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. The assuming grantee is under a duty to protect the unsold premises and is liable for a breach. 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 and may recover judgment against the grantee for the money so paid. 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. 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. 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 the lien of the mortgage. A variation of this occurred when part of the mortgaged

204. Annot., 21 A.L.R. 504, 530 (1922); 59 C.J.S. Mortgages § 433 (1949).

The mortgagor or subsequent “surety” who is forced to pay the mortgage debt is subrogated to the rights of the mortgagee. Toler v. Baldwin County 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.

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.\textsuperscript{211} 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.\textsuperscript{212} This does not apply in the face of evidence of a contrary intention.\textsuperscript{213} Some jurisdictions follow a rule of apportionment, under which each parcel conveyed subsequent to the mortgage is prorated between the parcels

\textsuperscript{211} MGIC Fin. Corp. v. H.A. Briggs Co., 600 P.2d 573 (Wash. Ct. App. 1979). In \textit{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 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.


Inverse order of alienation is a form of marshalling assets. But \textit{Hill} rejected marshalling of assets in favor of sale in inverse alienation.

\textsuperscript{213} 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 \textit{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 \textit{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. \textit{In re Oxford Dev. Ltd.}, 67 F.3d 683 (8th Cir. 1995); 4 J. POMEROY, EQUITY JURISPRUDENCE §§ 1224–25 (4th ed. 1941).
according to their respective values.\textsuperscript{214} 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.\textsuperscript{215}

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.\textsuperscript{216} 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.\textsuperscript{217}

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

\begin{itemize}
\item \textsuperscript{215} \textit{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).
\item \textsuperscript{216} \textit{Ruther v. Thomas}, 604 P.2d 703 (Colo. Ct. App. 1979); \textit{Sanderson v. Turner}, 174 P. 763 (Okla. 1918).
\end{itemize}
be enforced by the mortgagee, and the grantee may obtain reformation in a foreclosure or separate action. 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. 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 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.

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. The liability of an assuming grantee is also unenforceable for lack of consideration if this grantee is evicted for failure of title.

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.


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 Muhlilg v. Fiske, 131 Mass. 110 [1881].

219. 59 C.J.S. Mortgages § 403 [1949].


by having the grantee, as well as the grantor, execute and acknowledge a deed that includes this recital.

A mortgage clause that requires any transferee to assume the mortgage does not make a grantee of the premises liable per se.\textsuperscript{224}

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,\textsuperscript{225} although there is dictum to the effect that they may be subject to some equitable limitations.\textsuperscript{226}

A provision for increase in the interest rate has been held to permit multiple increases.\textsuperscript{227} It implies no right to increase the amount of the periodic payments or to extend the maturity of the mortgage.\textsuperscript{228}

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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.


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. Weaver v. King County, 437 P.2d 698 (Wash. 1968).


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.


\textsuperscript{227} Sec. Sav. & Loan Ass'n v. Wauwatosa Colony, Inc., 237 N.W.2d 729 (Wis. 1976).

\textsuperscript{228} 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.
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.229

The right of a mortgagee to make a transfer charge on a conveyance of the property has been upheld.230 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.231

§ 3:3.2 Due-on-Sale Clauses

Prior to the 1970s, the sale of mortgaged property subject to the continuance of the mortgage required a consideration of little more than whether the purchaser is to take the property subject to the mortgage or subject to the mortgage plus an assumption by the purchaser of the mortgagor’s obligations under the mortgage. Since the 1960s, due-on-sale clauses have come into widespread use, injecting considerable complications. The clause purports to authorize the mortgagee to accelerate the mortgage debt if the mortgagor sells or encumbers the property. The language of the clause may vary and its scope may be broader than mentioned above.232 The due-on-sale clause set forth in
the forms jointly promulgated by two federal entities, the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Association (Freddie Mac) have been used in millions of home mortgage loans.

The most recent version of the Fannie Mae/Freddie Mac clause provides as below.

**CLAUSE 3-6**

**Due-on-Sale Clause**

*(From Fannie Mae/Freddie Mac)*

If all or any part of the Property or any Interest in the Property is sold or transferred (or if Borrower is not a natural person and a beneficial interest in Borrower is sold or transferred) without Lender's prior written consent, Lender may require immediate payment in full of all sums secured by this Security Instrument. However, this option shall not be exercised by Lender if such exercise is prohibited by Applicable Law.

If Lender exercises this option, Lender shall give Borrower notice of acceleration. The notice shall provide a period of not less than 30 days from the date the notice is given in accordance with section 15 within which Borrower must pay all sums secured by this Security Instrument. If Borrower fails to pay these sums prior to the expiration of this period, Lender may invoke any remedies permitted by this Security Instrument without further notice or demand on Borrower.²³³

A strict due-on-sale clause used by a financial institution for business property, after substantial changes made by the author [Milton Friedman] is shown below.

Due-on-Sale Clause

Financial Institutions for Business Property

The Mortgagee may declare the sum secured by this mortgage immediately due and payable in case of

(a) any transfer of title to the mortgaged property or any part thereof;

(b) any issuance or transfer of stock of the Mortgagor, if the Mortgagor is a corporation, or of any interest in the Mortgagor if the Mortgagor is a partnership or joint venture, whether by sale, exchange, conveyance, merger, consolidation, or otherwise; or

(c) a conveyance of an interest in the mortgaged property to a trustee of a land trust or a transfer in whole or part of a beneficiary’s interest in a land trust.

The matters mentioned in (a), (b), and (c), above, shall apply to any transaction that is voluntary or occurs by operation of law, other than by death. Any consent to, or waiver by, the Mortgagee of, or any estoppel of the Mortgagee to object to, any matter mentioned in (a), (b), or (c), above, shall apply only to that matter and not to anything thereafter occurring.


235. A mortgagor will note that if it is a corporation listed on a stock exchange, it cannot control transfers of its stock, and that if it is not on an exchange but has a sizeable number of shareholders, the clause should permit transfers and issuance of shares in an amount of, perhaps, a maximum of 25% of the stock existing after completion of all such transfers and issuance. If the number of partners or joint venturers is substantial a comparable provision should be applicable.

Subdivision (b) of the clause inhibits issuance of stock dividends, which could be changed by revising (b) to read:

[b] any issuance of transfer of stock in the Tenant, if the Tenant is a corporation (unless such issuance is to an existing holder of such stock and in the same proportion as such holder owned in the corporation immediately prior to such issuance), or of any interest of the Tenant if the Tenant is a partnership or joint venture, whether by sale, exchange, merger, consolidation, or otherwise.

A sizeable body of cases among the states resulted in a general enforcement of due-on-sale clauses, with some qualifications, exceptions, and conflict. Traditionally, lenders justified this based on risk of default and impairment of mortgage security. This was the original purpose of the clause, but beginning in the 1960s, lenders used it as protection from the risks of inflation. The question is whether a lending institution that makes a twenty- to thirty-year mortgage at a fixed current interest rate must commit itself inflexibly to this bargain in the face of increasing interest rates and inflation, with its consequent reduced ability to pay or attract depositors. Many courts decided that lenders’ use of due-on-sale clauses to retire unprofitable loans when the buyer sold the property was legitimate. But other courts disagreed, reasoning that the clause was an unreasonable restraint on alienation.

In 1982, Congress enacted the Garn-St. Germain Depository Institutions Act, which swept away most of the case law that had denied enforcement to the clause. The act preempts inconsistent state statutory and case law, making the clause generally enforceable, but barring enforcement for the creation of junior liens and various personal transfers, sometimes called “nonsubstantive transfers.” They are:

1. the creation of a lien or other encumbrance subordinate to the lender’s security instrument that does not relate to a transfer of rights of occupancy in the property;
2. the creation of a purchase money security interest for household appliances;
3. a transfer by devise, descent, or operation of law on the death of a joint tenant or tenant by the entirety;
4. the granting of a leasehold interest of three years or less not containing an option to purchase;
5. a transfer to a relative resulting from the death of a borrower;
6. a transfer where the spouse or children of the borrower become an owner of the property;
7. a transfer resulting from a decree of a dissolution of marriage, legal separation agreement, or from an incidental property settlement agreement, by which the spouse of the borrower becomes an owner of the property;

237. The best-known decision was Wellenkamp v. Bank of Am., 582 P.2d 970 (Cal. 1978).
[8] a transfer into an inter vivos trust in that the borrower is and remains a beneficiary and which does not relate to a transfer of rights of occupancy in the property; or

[9] any other transfer or disposition described in regulations prescribed by the Office of Thrift Supervision.\(^{239}\)

The regulations take a broad view of federal preemption of due-on-sale clauses. The act does not indicate whether it applies to due-on-sale clauses in leasehold mortgages and in installment land contracts, but the regulations of the Office of Thrift Supervision assert that it does.\(^{240}\)

Since Garn-St. Germain, courts have routinely enforced due-on-sale clauses when the lender employed standard language, and no exception for a “nonsubstantive transfer” applies.\(^{241}\) A due-on-sale

\(^{239}\) 12 U.S.C. § 1701j-3(d).

\(^{240}\) 12 C.F.R. § 591.2(h):

Loan secured by a lien on real property means a loan on the security of any instrument (whether a mortgage, deed or trust, or land contract) which makes the interest in real property (whether in fee, or in a leasehold or subleasehold) specific security for the payment of the obligation secured by the instrument.


After a conveyance that would permit the mortgagee to accelerate, a reconveyance to the mortgagor made no difference. Stenger, 677 S.W.2d 376. The same was true of the forfeiture of the purchaser’s interest. Home Fed. Sav. & Loan Ass’n v. Campney, 357 N.W.2d 613 (Iowa 1984).


Inclusion of the clause in the mortgage but not the note was immaterial to its enforcement. Abdul-Karim v. First Fed. Sav. & Loan Ass’n, 462 N.E.2d 488 (Ill. 1984).

Under Louisiana law an ordinary contract of sale did not trigger the clause. First Fed. Sav. & Loan Ass’n v. Botello, 725 F.2d 350 (5th Cir. 1984).
clause is enforced in bankruptcy of the mortgagor. A clause invocable on a change of ownership of the property, or any part thereof, was held enforceable after the mortgagor transferred a half interest therein to her husband. The same was held to the delivery of a purchase option. An installment sale, as well as a land contract sale have been held to trigger the clause. The clause was not activated by the introduction of a new general partner followed by withdrawal and substitution of partners. A clause providing for acceleration after a taking in condemnation of any part of the premises was denied effect after a small part was taken with no showing of an impairment of security. A provision that a sale would accelerate the mortgage was not given effect; an election by the mortgage was necessary.

A loan made by a federal savings and loan institution is enforceable under federal law despite the conversion of the lender into a state institution. A federal bankruptcy court has ruled that a national

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A provision forbidding mortgagor to sell without mortgagee’s consent was held to permit refusal of consent for any reason, and a breach permitted acceleration. Quintana v. First Interstate Bank, 737 P.2d 896 [N.M. 1987].


Darr held that excepting subordinate liens from a due-on-sale clause does not permit an installment sale.


247. Fid. Trust Co. v. BVD Assocs., 492 A.2d 180 [Conn. 1985]. This has long been the law with respect to nonassignment clauses in leases. 1 MILTON R. FRIEDMAN, FRIEDMAN ON LEASES § 7:3.3[B] [Patrick A. Randolph, Jr., ed., 5th ed. PLI 2006].


bank that makes a mortgage loan is not subject to the Garn-St. Germain Act.\textsuperscript{251} The federal bankruptcy court misread the statutory definition of the term “lender.”\textsuperscript{252}

A clause reading, “To protect the security of this Deed of Trust, Grantor agrees . . .” indicates that its purpose was merely to protect the security of the mortgage and is unenforceable unless the mortgagee shows an impairment of security.\textsuperscript{253} A clause that limits transfers to those made with the mortgagee’s consent, such consent not unreasonably to be withheld, has been construed both ways, one holding that the consent may not be conditioned on an increase of interest rate,\textsuperscript{254} and another holding that it is not unreasonable for a mortgagee to demand an increase in interest.\textsuperscript{255} A clause that permits acceleration in limited circumstances does not permit acceleration generally.\textsuperscript{256} A clause that permits the making of a junior mortgage is not activated by the foreclosure of that junior mortgage.\textsuperscript{257}

\begin{footnotesize}
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\item \textsuperscript{251} In re Black, 221 B.R. 38 [Bankr. S.D. Fla. 1998] (lender not subject to statutory prohibition due to transfer resulting from marriage property settlement).
\item \textsuperscript{252} The Act defines lender as “a person or government agency making a real property loan.” 12 U.S.C. § 1701j-3[a][2]. The court incorrectly reasoned that a private bank is not a person.
\item \textsuperscript{253} O’Boskey v. First Fed. Sav. & Loan Ass’n, 678 P.2d 1112 [Idaho 1984], later opinion, 739 P.2d 301 [Idaho 1987] (upholds injunction and class action).
\item \textsuperscript{254} Fogel v. S.S.R. Realty Assoc., 461 A.2d 1190 [N.J. Super. Ct. 1983].
\item Western and Torgerson hold the purpose of the clause is to protect the mortgagee’s interest in the money market as well as to protect his security.
\item A clause providing that a transfer purchaser shall not assume the mortgage unless the mortgage shall immediately become due did not apply to a three-year lease providing for a conveyance thereafter. First Sav. & Loan Ass’n v. Treaster, 490 N.E.2d 1149 [Ind. Ct. App. 1986].
\end{itemize}
\end{footnotesize}
A due-on-sale clause is not self executing. The clause may be waived. The mortgagee has a reasonable time to enforce it, but taking an excessive time is a waiver.

A mortgagee who exercises his rights under the clause is not entitled to a prepayment premium. The premium is collectable on a voluntary prepayment, which is not applicable to mortgagee’s enforcement of the clause.

Transfers completed before Garn-St. Germain are not affected by that statute if they would not have triggered the clause before its enactment. Transactions in a “window period state” during a “window period” are not affected by Garn-St. Germain. If the mortgage was made after the effective date of Garn-St. Germain the

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Contra Auernheimer v. Metzen, 780 P.2d 796 (Or. Ct. App. 1989). The fact that the statute of limitations to collect the debt has not run is immaterial. Cooper, 757 P.2d 483.
Abramoff, 92 B.R. 698, deemed a combination of due-on-sale clause and a prepayment premium a restraint on alienation.
Prepayment penalties are generally limited to mortgagor’s voluntary payments.
265. A “window period state” is one in which enforcement of a due-on-sale clause was denied or qualified before Garn-St. Germain. The “window period” is that beginning with such state’s limitation of enforcement, and ending on the enactment of Garn-St. Germain (Oct. 15, 1982). Loans made during this period are governed by the prior law of the state for a period of three years following Garn-St. Germain (Oct. 15, 1985). The
due-on-sale clause is enforceable, but only if they are nonfederal loans. A mortgagee who agreed to permit grantee to assume a mortgage at 9.5% interest but increased this to 13.5% after execution of a contract of sale was held liable for breach of contract and of promissory estoppel, though not for intentional interference with an advantageous relationship. Several cases permit the use of the due-on-sale clause to protect the mortgagee’s security but not to exact changes in business conditions. Other cases, apparently the majority, hold that a mortgagee’s right to accelerate the debt is absolute, with no standard of reasonableness. A threat to use the clause for unpermitted purposes was window period is considered at length in Geier, *Due-On-Sale Clauses Under the Garn-St. Germain Depository Institution Act of 1982*, 17 S.F. L. REV. 355 (1983); Note, *Garn-St. Germain. Congress Preempts Due-On-Sale—Fills Void Left by De La Cuesta*, 12 STETSON L. REV. 461 (1983). Window period cases are discussed in Annot., 61 A.L.R.4TH 1070, 1087–96 (1988).


A clause included in a window-period mortgage was enforceable because of mortgagor’s refusal to supply information as to whether the security was impaired. Santa Clara Sav. & Loan Ass’n v. Pereira, 211 Cal. Rptr. 54 [Ct. App. 1985]. Florida, a window period state enforced the clause where security would have been impaired because it would have enforced the clause for this reason before Garn-St. Germain. Weiman v. McHaffie, 470 So. 2d 682 [Fla. 1985].

Nevada is not a window period state. Boyes v. Valley Bank, 701 P.2d 1008 [Nev. 1985].

In *Snow*, the mortgagee was deemed unreasonable in demanding a 3% increase in the interest rate and a “balloon payment” after five years. This applies to commercial as well as residential property. *Snow*, 730 P.2d 204.

*Central Nat’l Bank* held that a mortgagee must prove the transfer prejudiced the mortgagee’s security and that the purpose was not solely to increase the interest rate, but cites many cases to the contrary. *Central Nat’l Bank*, 501 N.E.2d 1090 [Ind. Ct. App. 1986].


In *Destin Sav. Bank*, 579 So. 2d 232, there was no legal objection to the mortgagee’s demand of a second mortgage on the mortgagor’s house or the pledge to the mortgagee of a $100,000 certificate of deposit.

(Friedman on Contracts, Rel. #7, 5/09)
held an anticipatory breach of contract for which damages were recoverable.271

§ 3:3.3 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.272 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,”273 to give “all my right, title and interest,”274 or to give “subject to a mortgage”275 are not generally sufficient for this purpose, though on each of these are cases to the contrary.276


273. Tunis v. Dole, 89 A.2d 760 (N.H. 1952), see also Ryan, supra note 272 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 (1965).


276. 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.
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, 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. Exoneration is to be out of undisposed personality 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. 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. Some apply exoneration to mortgages assumed by the testator and others do not. Exoneration is applicable to the extent of the residuary estate, including undisposed realty.

277. In re Estate of Dolley, 71 Cal. Rptr. 56, 61 (Ct. App. 1968); CLEAVELAND supra note 276, at 677–78; Ryan, supra note 272.
278. See Ryan, supra note 272 at 304–05, 4 A.L.R.3d at 1034–36.
280. 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 276, at 677; Ryan, supra note 272, at 292; 4 A.L.R.3d at 1039–43 (1965).
Cases giving exoneration to purchase money mortgages, and denying it to others but not purchase money mortgages, and those drawing no 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 benefit of a third person. In re Estate of Brown, 50 Cal. Rptr. 78 (Ct. App. 1966).
The common law rule has been applied to encumbrances other than mortgages.283 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,284 but here too there are cases contra.285 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.286 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.287

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.288 Because a surviving joint 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.289 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

288. 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 (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.
mortgage obligation. Some cases that deny exoneration have given the survivor pro rata contribution.290

Colorado is apparently the only state that has rejected the common law rule by judicial decision.291

It is doubtful that application of the rule of exoneration carried out the testator’s intent most of the time.292 It was abrogated by statute in England.293 It has been nullified by statutes in California, Maryland, Massachusetts, New Jersey, New York, Oklahoma, Pennsylvania, South Dakota, and Washington.294 Furthermore, the Uniform Probate Code section 2-609 provides that a specific devise passes subject to any 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

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.

290. 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.


292. 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, that is, 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.

293. 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].

294. 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; 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.

(Friedman on Contracts, Rel. #7, 5/09) 3–67
premises.” 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. The Massachusetts, New Jersey, and South Dakota statutes are substantially the same as this. The New York statute was construed to have a substantial effect on the remedies of the mortgagee. The current version of the 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.”

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

296. Former N.Y. REAL PROP. LAW § 250 [Laws 1937, ch. 75], now N.Y. EST. POWERS & TRUSTS LAW § 3-3.6.
298. 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 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.

299. N.Y. EST. POWERS & TRUSTS LAW § 3-3.6.
indicated in the will. Any such interest created or attaching after the will is subject to exoneration.300

   The Pennsylvania statute bars exoneration with respect to any mortgage affecting the property and notwithstanding any general direction by the testator to pay debts.301

   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.302

   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.303

   A dissenting judge cited four cases involving promissory notes in this form that were held installment obligations.304 If the instrument is held an installment obligation and includes no right to accelerate, the holder may recover only for past due installments.305 Furthermore, the statute of limitations, which runs on a demand obligation from its

300. MD. CODE, EST. & TRUSTS § 4-406.
301. 20 PA. CONS. STAT. ANN. § 2514(12.1).
303. 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 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.

inception, runs on an installment obligation only from maturity of the installments.  

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.  

§ 3:4  Purchase Money Mortgages

It is customary, and good practice, to include in a mortgage given to secure part of the purchase of real estate a recital that the mortgage is a purchase money mortgage. This recital generally follows the description of the mortgaged premises and may read substantially as below.

CLAUSE 3-8

Recital: Mortgage As a Purchase Money Mortgage

Being the same premises conveyed to the mortgagor by the mortgagee by deed dated and intended to be recorded simultaneously herewith in the Office of ____________, this being a purchase money mortgage given to secure a portion of the purchase price.

There are advantages in a purchase money mortgage over other mortgages and this recital is of evidentiary value to the mortgagee or subsequent holder of such mortgage. In fact, some statutes afford the benefits of a purchase money mortgage only to those mortgages that expressly recite they secure the purchase price of the property, in whole or in part.

A deed and a purchase money mortgage are presumably a single transaction and the two are construed together. The lien of the purchase money mortgage is presumably coextensive with the
estate passing by the accompanying deed, and this presumption may be sufficient to correct an inadvertent error in drafting the mortgage.\footnote{311} A mortgage may be a purchase money mortgage although not executed the same day as the deed, provided it is part of one continuous transaction.\footnote{312} A purchase money mortgage may be validly given to a third party, provided the money was loaned for use in payment of the purchase price,\footnote{313} and in this event it is a purchase money mortgage only to the extent that the consideration therefore was used for the purchase.\footnote{314} It is a purchase mortgage only with

\footnote{311}{A recital that the mortgage is given to secure purchase money may, therefore, help establish a lien broader than a limited reading of the mortgage might indicate. \textit{In re} City of New York \{Lawrence Ave.\}, 169 N.Y.S. 1018 \{App. Div. 2d Dep't 1918\} [street rights included in deed but omitted from mortgage]; see Annot., 134 A.L.R. 1041 \{1941\}.

\footnote{312}{G. Glenn, \textit{Mortgages} § 345.2 \{1943\}; 55 AM. JUR. 2D \textit{Mortgages} § 13 \{1971\}; 59 C.J.S. \textit{Mortgages} § 231(b) \{1949\}. A mortgage executed eight months after a conveyance by purchaser's corporation and covering only part of the land conveyed was held a purchase money mortgage for the purpose of an anti-deficiency statute. Swenson v. Rampage, 762 P.2d 851 \{Mont. 1988\}. See also Sunshine Bank v. Smith, 631 So. 2d 965 \{Ala. 1994\} [mortgage described the wrong land; corrected mortgage recorded eleven months later qualifies as purchase money mortgage].


\textit{Contra} to \textit{Syracuse Savings \\& Loan Ass'n}, 234 N.Y.S. 514, the priority of a purchase money mortgage was held to cover not only the part thereof used to purchase the property but also the amount intended for construction. Hand Trading Co. v. Daniels, 190 S.E.2d 560 \{Ga. Ct. App. 1972\}; Resolution Trust Corp. v. Bopp, 850 P.2d 939 \{Kan. Ct. App. 1993\}.}
A mortgage, the proceeds of which are not used for the acquisition of the realty, is not a purchase money mortgage.\footnote{315} A purchase money mortgage is a limitation on the title conveyed, not an encumbrance.\footnote{316} It takes precedence over prior judgments recovered against the mortgagor\footnote{318} and over an after-acquired property


\footnote{317. Troyer v. Mundy, 60 F.2d 818, 821 [8th Cir. 1932] (citing many cases).}

clause in a prior mortgage,\textsuperscript{319} is paramount to any dower interest in the mortgagor’s wife despite her failure to join in the execution of the mortgage,\textsuperscript{320} and homestead rights,\textsuperscript{321} and, when made by a corporation, is valid without any stockholder consent that may be required by statute in connection with corporate mortgages generally.\textsuperscript{322} A purchase money mortgage made to a third party is superior to a vendor’s lien.\textsuperscript{323} All this because the parties so subordinated “are no worse off than they were before.” Without the proceeds from the purchase-money mortgage the property would not have been acquired.\textsuperscript{324} But if a purchase money mortgagee fails to record his mortgage, he will be postponed to subsequent innocent purchasers for value.\textsuperscript{325}

The rule applies to a mortgage that is a substitute for a purchase money mortgage. Commerce Sav. Lincoln, Inc. v. Robinson, 331 N.W.2d 495 [Neb. 1983].

The rule was applied despite the mortgagor’s earlier interest in the property as purchaser under an installment sale. Liberty Parts Warehouse, Inc. v. Marshall County Bank & Trust, 459 N.E.2d 738 [Ind. Ct. App. 1984]. Contra to \emph{Liberty Parts} is C&L Lumber & Supply, Inc. v. Tex. Am. Bank/Galeria, 795 P.2d 502 [N.M. 1990], which holds that a mortgage given by a purchaser in possession to pay off a land sales contract is not a purchase money mortgage.

The rule was applied where the deed and purchase mortgage referred to the wrong property and were corrected by instruments eleven months later. Sunshine Bank v. Smith, 631 So. 2d 965 [Ala. 1994].

\begin{itemize}
  \item 322. N.Y. STOCK CORP. LAW § 16 [repealed Sept. 1, 1963]; 7 W. Fletcher, CYCLOPEDIA OF CORPORATIONS § 3117 [rev. 1988]. \emph{But see} Peerson v. Gray, 184 Ala. 312, 63 So. 467 [1913].
  \item 324. Banc Fla. v. Hayward, 689 So. 2d 1052, 1054 [Fla. 1997].
\end{itemize}
money mortgage has been held paramount, under the New Jersey statute, to a mechanic’s lien predicated on work done on the property on behalf of a purchaser.\textsuperscript{326} But this is not invariably true.\textsuperscript{327}

A purchase money mortgage is not a loan or forbearance and involves no usury merely because a seller obtains a higher price than if the consideration were paid wholly in cash.\textsuperscript{328} It has been held consistent with this that the interest rate on a purchase money mortgage may validly be higher than the maximum fixed by usury laws.\textsuperscript{329} This assumes that the transaction is not a cloak for a loan at excessive interest rates. This rationale applies only to purchase money mortgages running to a seller. It would not apply to a third party who loans money for the purchase of real property. A purchase money mortgage was held not secondary financing within the contemplation of a first mortgage that forbade any payments with respect to secondary financing unless the first mortgage was current.\textsuperscript{330}

A purchase money mortgage given by one without authority, therefore, as in the case of an infant, is valid unless and until the accompanying conveyance is repudiated.\textsuperscript{331} The mortgagor cannot repudiate one without repudiating the other. A claim of the grantee-mortgagor arising out of the sale of the property is assertable by the mortgagor in an action to foreclose the mortgage.\textsuperscript{332}


\textsuperscript{327} A mechanic’s lien, based on work visibly done before delivery of the deed, was held paramount to a purchase money mortgage. Summer & Co. v. DCR Corp., 351 N.E.2d 485 (Ohio 1976). The court stated the Ohio mechanic’s lien displaced the doctrine of simultaneous seizin. It said the seller’s remedy is either to record the purchase money mortgage before the construction [an awkward procedure if before the conveyance] or expressly reserve a vendor’s lien [a remedy with some disadvantages].

\textsuperscript{328} S. WILLISTON, CONTRACTS § 1685, at 4766 (rev. ed. 1938); Annot., Advance in Price for Credit Sale as Compared with Cash Sale as Usury, 14 A.L.R.3d 1065 (1967).


\textsuperscript{330} DHNH Realty Corp. v. Marino P. Jeantet Residence for Seniors, Inc., 432 N.Y.S.2d 829 (Sup. Ct. Queens County 1980).


\textsuperscript{332} Snyder v. Potter, 521 N.Y.S.2d 175 [App. Div. 3d Dep’t 1987].
When a purchase money mortgage is given to several persons, it is advisable to have written evidence as to their form of ownership of the mortgage. In the absence of evidence, a Massachusetts court applied a presumption that their ownership should correspond with their former ownership of the property that they sold. In this situation, joint tenants of the property took the mortgage as joint tenants with the right of survivorship, not as tenants in common.

§ 3:4.1 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 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.\footnote{334} Personal liability is not a prerequisite of a mortgage, although consideration is necessary.\footnote{335}

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 insurance—is insufficient to make it unenforceable.\footnote{336} A contract to give a mortgage in “usual” form, with “statutory . . . covenants, conditions and powers of sale” was held sufficiently definite for enforcement.\footnote{337} 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.\footnote{338} The same would,

\begin{itemize}
\item \footnote{334}{Cochran v. Taylor, 7 N.E.2d 89, 93 (N.Y. 1937). \textit{But see} Weidenbaum v. Raphael, 90 A. 683, 684 [N.J. Ch. 1914].}
\item In this event the mortgage will be a valid lien on the property entitling the mortgagee 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].
\item 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. \textit{In re} Home Title Ins. Co., 32 N.E.2d 548 (N.Y. 1940).
\item \footnote{336}{Baker v. Dawson, 141 A.2d 157, 165 [Md. 1958].}
\item \footnote{337}{M. De Matteo Constr. Co. v. Daggett, 168 N.E.2d 276 [Mass. 1960].}
\item 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].
\item 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. \textit{See} Kenimer v. Thompson, 196 S.E.2d 363 [Ga. Ct. App. 1973].
\item 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
\end{itemize}
of course, apply where the principal of the mortgage has been left indefinite.\textsuperscript{339} 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.\textsuperscript{340} New York and New Jersey are in the minority in holding that if no reference is made to maturity or rate of interest then the mortgage is impliedly payable on demand and at the legal rate of interest.\textsuperscript{341} But even in these states this presumption is not applied where the papers negate any intention of creating a demand obligation.\textsuperscript{342} 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.\textsuperscript{343} Other cases refuse to recognize a contract as complete where

\begin{quote}


340. 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].


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].


\end{quote}
details of third-party financing remained open. 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. Other contracts that provided for deferred payments without security have caused difficulty.

It may well be that a provision for a purchase money mortgage will entitle the seller to a mortgage in the form and containing conditions usually found in mortgages affecting similar properties in the community. It has been so held with respect to a farm mortgage. 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. However, a


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 County 1962], aff’d, 249 N.Y.S.2d 858 [App. Div. 2d Dept 1964].


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. This would appear to be the better rule.

If the contract provides for a purchase money mortgage, and the
purchaser or an assignee of the purchaser is a corporation 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

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

Berger, 225 N.Y.S.2d 797 [Sup. Ct. Nassau County 1962], aff’d, 249
N.Y.S.2d 858 [App. Div. 2d Dep’t 1964]; see generally Comment, Sub-

Contracts were held too uncertain for enforcement where the purchase
money mortgage was to be subordinate to a building construction mort-
gage 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
P.2d 419 [9th Cir. 1966] [distinguished in Malani v. Clapp, 542 P.2d 1265
similar contract was upheld where the construction loan was not to exceed
$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

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.
satisfactory to Seller’s attorney, that such mortgagor is a properly organized legal entity and authorized to execute such mortgage.

§ 3:5   Property Covered by the Mortgage

A mortgage must contain a description of the property that is adequate or a reference to another writing, thereby incorporating an adequate description.\(^\text{350}\) In general, courts apply the same standards to mortgages as they do to deeds of conveyance.\(^\text{351}\) If the mortgage properly describes a parcel of real estate, the mortgage automatically conveys appurtenances to that parcel. In a Georgia case, a mortgage included airspace rights over a neighboring parcel, as an appurtenance, when the airspace was improved with part of a parking garage that was chiefly built on the parcel described in the mortgage.\(^\text{352}\)

It occasionally happens that a description is on an exhibit to be attached to a preprinted mortgage form and the exhibit is not attached or is lost before recordation.

In the case of a purchase money mortgage, there would appear to be no reason for question with respect to the scope of the mortgage lien. The mortgagee is selling specified real estate and the mortgage should cover this realty.\(^\text{353}\)

§ 3:5.1   Fixtures and Personal Property

The sale may include not only land and permanent improvements to the land, but also fixtures as well as personal property. If all such property is to be security for the purchase price, it is necessary not only that the contract of sale should so indicate but that proper steps be taken to comply with statutory prerequisites for effecting a lien thereon. Without special provisions a mortgage on real property will, per se, cover fixtures, that is, existing as well as after-acquired fixtures (unless the latter are subject to a purchase money mortgage given to their installer),\(^\text{354}\) but not personal property.\(^\text{355}\)

\(^{350}\) In re Poteat, 176 B.R. 734 (Bankr. D. Del. 1995) (grossly inadequate description, no metes and bounds description, street address, road names, or reference to any other instrument).

\(^{351}\) See generally section 10:7.2.


\(^{353}\) “There is a necessary intent to mortgage back the identical lands conveyed to the mortgagor.” In re City of New York (Lawrence Ave.), 169 N.Y.S. 1018 (App. Div. 2d Dep’t 1918).


\(^{355}\) White v. Murtha, 343 F.2d 831 [5th Cir. 1965]; In re Shore Haven Motor Inn, Inc., 124 B.R. 617 [Bankr. S.D. Fla. 1991] [ski chair lift]; In re
The difference between fixtures and personal property is technical and may not be self-revealing. For instance, in a few states, gas ranges and refrigerators are personal property and are not automatically included in a mortgage of real property. In other states, gas ranges and refrigerators are treated as fixtures, and thereby included, without express provision therefore, in a mortgage or conveyance.

The rule with respect to after-acquired fixtures was unaffected by the mortgagor’s voluntary return of them to the installer for nonpayment. For an extended clause covering existing and future fixtures and personal property in a hotel but appropriate for any high rise building, see In re Johnson, 139 B.R. 208, 210 (Bankr. D. Minn. 1992). The clause was held to cover framed wall paintings.


Friedman on Contracts, Rel. #7, 5/09
number of states, the “assembled industrial plant doctrine” makes machinery that is indispensable to an industry a fixture covered by the lien of a real property mortgage.\textsuperscript{358} In this situation, physical annexation is unnecessary.\textsuperscript{359}

In some cases it may be desirable to obtain a separate security agreement pursuant to Article 9 of the Uniform Commercial Code to cover personal property, but it is possible to include the grant of a security interest on personal property in the real property mortgage.\textsuperscript{360} The New York statutory form mortgage\textsuperscript{361} is construed to include “all fixtures and articles of personal property attached to, or used in connection with, the premises.”\textsuperscript{362} The usual mortgage forms broaden this language to “all fixtures and articles of personal property now or hereafter attached to or used in connection with the premises,” thus purporting to cover after-acquired property as well. Forms prepared for banks and other institutions or prepared especially for a particular transaction contain more elaborate personal property clauses.

It is current practice in connection with mortgages on apartment, office, and industrial buildings to obtain from a mortgagor and file a financing statement under the Uniform Commercial Code, which brings fixtures and personal property under the lien of the real property mortgage. This practice is not applied to one- and two-family houses.

A mortgagor’s claim against the engineer and architect of an office building, based on defective design and construction, was held a personal right under Louisiana law and not included in the lien of a mortgage.\textsuperscript{363}

\section*{§ 3:5.2 After-Acquired Fixtures and Personal Property}

The after-acquired personal property clause mentioned above\textsuperscript{364} may be expanded by a more specific list of articles to be covered and also by a requirement that any owner of the premises deliver further instruments from time to time on the mortgagee’s request to confirm the lien of the mortgage on the articles specified. This makes evidence available in the event of foreclosure to prove the full extent of the lien.

\textsuperscript{359} Metro. Life Ins. Co. v. Kimball, 94 P.2d 1101 (Or. 1939).
\textsuperscript{360} For discussion of the law prior to adoption of the Uniform Commercial Code, see Milton R. Friedman, \textit{The Scope of Mortgage Liens on Fixtures and Personal Property in New York}, 7 FORDHAM L. REV. 331 (1938).
\textsuperscript{361} N.Y. REAL PROP. LAW § 258, Schedule M.
\textsuperscript{362} N.Y. REAL PROP. LAW § 254.
\textsuperscript{364} See section supra 3:5.1.
It also helps to hurdle a difficulty that has historically troubled after-acquired property clauses. A mortgage on after-acquired property is, in legal theory, not a lien *in praesenti*, but merely a covenant to give a mortgage in the future. This covenant is self-effecting as to the mortgagor but, being an affirmative covenant, does not run with the land to bind a subsequent owner who has not assumed the mortgage.\(^{365}\) Therefore, articles of personal property may not come under the mortgage lien, though within the scope of the after-acquired personal property clause, when installed by a subsequent owner. Inasmuch as the articles in question, such as refrigerators and ranges, are replaced comparatively frequently, the problem is practical in a jurisdiction like New York where these articles are personal property. The problem under modern law is confined to real property. The Uniform Commercial Code explicitly authorizes an after-acquired property clause in a security agreement, with no necessity for the debtor to authenticate any additional record in the future when the debtor acquires the after-acquired property.\(^{366}\)

If the mortgagee is relying on the law of mortgages to gain a security interest in after-acquired fixtures, rather than an Article 9 security agreement, then the mortgage clause requiring that the mortgagor execute further instruments permits a solution. The same result may be achieved by a provision permitting foreclosure if any subsequent owner fails on request of the mortgagee to assume the mortgage or at least the obligations under the after-acquired property clause. There is authority that disregards an after-acquired property clause as a covenant for future performance. It rules that a specification in a mortgage of equipment that is part of the realty brings after-acquired property of the specified nature under the lien of the mortgage, regardless of whether the installer of such equipment assumed the mortgage.\(^{367}\) A purchase money security interest in personal property, other than inventory, has priority under the Uniform Commercial Code over a fee mortgagee’s after-acquired personal property clause, but only if it is perfected within twenty days after delivery of the personal property. Otherwise, title to the personal property is subordinated to that of the fee mortgagee.\(^{368}\)


\(^{366}\) U.C.C. § 9-204(a).  


\(^{368}\) U.C.C. § 9-334; see also Regan v. ITT Indus. Credit Co., 469 So. 2d 1387, 1391 n.5 [Fla. Dist. Ct. App. 1984], and cases collected in 3 FLA. ST. U. L. REV. 150, 156 n.26 [1975].
§ 3:6 The New York Statutory Form Mortgage

There is no form that may be called customary in New York. There is a statutory short form of mortgage in New York, and comparable forms in other states, but the New York statutory form mortgage is not complete. For example, it does not contain the “lien clause,” which is necessary to maintain priority of the mortgage lien over some mechanics’ liens, and the statutory acceleration clause contains blanks for “grace periods” and presupposes an agreement as to how these blanks are to be filled in. The New York statutory form is of substantial advantage because its brief clauses are given an expanded statutory construction. The statutory construction governs when the mortgage is in statutory or substantially similar form, but is not lost by inclusion of additional provisions. The statutory rules also apply to the extension and modification of mortgages and other mortgage agreements.

The statutory form is not in general use as such in New York. Its use is permissive, and other forms are not thereby invalidated.


For permissible forms in all jurisdictions, see Martindale-Hubbell Law Directory, volumes on Law Digest, under the various states.

370. The “lien clause” provided for by N.Y. Lien Law § 13(3). See section infra 3:8.7.

371. See section infra 3:7.4.


The advent of short form instruments in England was greeted with a fear of mischief “if an unnatural and secondary meaning is given by statute to words that are prima facie clear and intelligible, for the effect is to increase the difficulty of legal documents to the unprofessional reader.” See W. Rawle, Covenants § 20 (5th ed. 1887). This fear was realized in Albertina Realty Co. v. Rosbro Realty Corp., 180 N.E. 176 (N.Y. 1932). As a result of Rosbro, the acceleration provision of the statutory form mortgage was changed. N.Y. Legis. Doc. No. 65(H)35 (1945). Compare Engel v. Thompson, 146 N.E.2d 657 (Mass. 1957), overruled on other grounds, Silverblatt v. Livadas, 164 N.E.2d 875, 878 (Mass. 1960).


A statute allows the recording office to charge a penalty of $5 for the
recordation of a mortgage with long forms of covenants, but this is rarely invoked. Perhaps the most frequently used forms are those
printed by various title companies for the use of their clients and forms prepared for legal stationers. Lending institutions for the most part have their own forms that are apt to be longer, more detailed, and more favorable to the mortgagee. These are, basically, the statutory
form with some clauses added and others modified. The mortgagee is not entitled, per se, to these additional or expanded provisions. For example, if a clause is included that permits the mortgagee to accelerate maturity of the debt for failure of the owner to maintain the premises in a reasonably good state of repair, after notice, the buyer may properly refuse to execute the mortgage. The same is apparently true if the mortgage permits acceleration upon a sale of the property.

§ 3:7 Clauses of the New York Statutory Form Mortgage

Mortgage forms vary from state to state and within each state. There is considerable variation in the material added to basic forms, the most elaborate being those prepared for banks and other lending institutions. The forms used in New York have been developed to a greater degree than those in some other states. Their clauses should illustrate most of the questions that are apt to arise in all states. For this reason, this section uses as a basis for discussion the New York statutory form mortgage clauses. This section also considers modifications to the statutory form clauses that are often added to amplify the coverage, as well some variations outside New York. Section 3:8 then considers additional clauses that are often added to mortgages in New York and other states. Cases cited to support this discussion are not only from New York, but include other states with the thought of giving a general picture of U.S. mortgages.

377. N.Y. REAL PROP. LAW § 327.
379. Merriam v. Leeper, 185 N.W. 134 [Iowa 1921]. For due-on-sale clauses, see supra section 3:3.1.
§ 3:7.1 Payment of Indebtedness

The New York statutory form mortgage provides:

1. That the mortgagor will pay the indebtedness as hereinbefore provided.  

This clause makes the mortgage serve as a bond as well as a mortgage. It overrides a statutory rule that a "mortgage of real property does not imply a covenant for the payment of the sum intended to be secured . . . ." This means that the failure of the mortgagor to sign a bond or promissory note, or the inability of the mortgagee to find and produce a bond or note, does not prevent the mortgagee from suing the mortgagor for the debt or seeking a deficiency judgment upon foreclosure.

When there are multiple owners of the property, normally all owners sign both the promissory note and the mortgage. Liability issues can become complicated when less than all of the owners-mortgagors sign the note. A mortgagor who does not sign the promissory note can become liable on the note by virtue of a promise to pay in the mortgage.

§ 3:7.2 Insurance

The New York statutory form mortgage provides:

2. That the mortgagor will keep the buildings on the premises insured against loss by fire for the benefit of the mortgagee; that he will assign and deliver the policies to the mortgagee; and that he will reimburse the mortgagee for any premiums paid for insurance made by the mortgagee on the mortgagor’s default in so insuring the buildings or in so assigning and delivering the policies.

In a case of first impression, a court held that a mortgagor complied with the New York insurance covenant by delivery of a "Home Owners
Policy,” that is, a multiple risk policy insuring against liability and other risks in addition to fire.\textsuperscript{385}

Delivery of a fire insurance policy with a standard mortgagee clause is not sufficient in itself to stop the running of the statute of limitations with respect to the mortgage.\textsuperscript{386}

Covenant 4 of the New York covenants\textsuperscript{387} was amended in 1945 to permit acceleration of the mortgage debt for breach of the insurance covenant. Otherwise, the mortgagee would not be empowered to call the mortgage for the mortgagor’s failure to supply the mortgagee with required insurance.\textsuperscript{388}

The insurance clause may be expanded to entitle the mortgagee to extended coverage and war damage insurance when available and to insurance on personal property covered by the mortgage, and to clarify the mortgagee’s right to retain insurance policies that may be unexpired after completion of a foreclosure.

In commercial transactions, the mortgagor often promises to provide “comprehensive all risk insurance.” An “all risk” policy is property insurance that covers damage resulting from all risks, other than those specifically excluded from coverage. The term “all risk” is a misnomer, because “all risk” policies invariably have some exclusions. Policies typically exclude coverage for war, pollution, earthquake, and flood.

Prior to the events of September 11, 2001, “all risk” policies covered property damage caused by acts of terrorism. After 9/11, insurance companies began excluding damage from terrorist attacks from their “all risk” policies. This change in the “all risk” policy has triggered disputes between lenders and borrowers as to whether the borrower must insure against terrorism. \textit{Omni Berkshire Corp. v. Wells Fargo Bank, N.A.}\textsuperscript{389} is illustrative. In 1998, Omni Hotels borrowed $250 million, secured by five hotels located in New York City, Chicago, and Texas. Omni agreed to provide “comprehensive all risk insurance” on the hotels as well as “such other reasonable insurance” as the lender might request. In 2002, when it renewed its “all risk” policy, Omni was unable to find a policy that covered terrorism due

\textsuperscript{386} Greenfield v. Kaplan, 179 N.Y.S.2d 381 [Sup. Ct. Kings County 1958].
\textsuperscript{387} See infra section 3:7.4.
to the reform made by insurance companies. Instead of offering “all risk” policies that insured against terrorism, insurance companies offered separate, stand-alone terrorism policies. The quoted annual premium for Omni’s five hotels was over $1 million. Omni negotiated with Wells Fargo, the servicing agent for the loan, over whether Omni would obtain terrorism coverage. Wells Fargo agreed to accept a $60 million policy at a time when the loan balance was $230 million, but negotiations broke down. Omni brought an action seeking a declaratory judgment that it was not required to obtain terrorism insurance. The court agreed with Omni’s position that its obligation to maintain “all risk” insurance did not require it to purchase terrorism insurance. In the loan agreement, the parties did not define “all risk.” In the insurance industry, “all risk” policies have evolved over time, with companies previously adding exclusions for mold problems and Y2K problems. Thus, Omni’s duty to provide “all risk” insurance was measured not by the policy as it existed in 1998, when the loan was made, but by an evolving standard. The court, however, held that Wells Fargo acted reasonably in requiring $60 million worth of terrorism coverage under the “other reasonable insurance” clause. Omni had a quote for such a policy for an annual premium of $316,000, and evidence indicates that many hotels presently carry terrorism insurance.

[A] Purchase of Insurance by Mortgagee

The mortgagee is under no implied obligation to obtain insurance when the mortgagor fails to insure.390 The fact that the mortgagee has a right to insure is immaterial. But he may make himself liable if he agrees to insure and does not, or if he undertakes to insure and fails to obtain proper coverage,391 as where he omits a garage392 or insures the


Hudson v. Ellsworth, 105 P. 463 (Wash. 1909), holds that a mortgagee’s agreement to procure insurance, made after execution of the mortgage, was a gratuitous undertaking and without consideration though the mortgagor had paid the mortgagee the amount of the premiums. The mortgagee was held liable only for the return of the money paid. In a somewhat similar situation the mortgagee was held liable for fraud. First Nat’l Bank v. Dowdell, 157 So. 2d 221 (Ala. 1963) (overruling defense of ultra vires).

For the comparable rules as between landlord and tenant, see 3 MILTON R. FRIEDMAN, FRIEDMAN ON LEASES § 38:1, at 38-6 to 38-7 [Patrick A. Randolph, Jr., ed., 5th ed. PLI 2006].

The measure of damages for breach of duty to place fire insurance is the amount that would have been due under the policy if it had been obtained. Consequential damages have been recovered. The mortgagee is not responsible for the insolvency of the insurer at the time the claim is filed.

Many mortgages require that the mortgagor make monthly escrow payments to the mortgagee, which the mortgagee customarily uses to pay for real property taxes and insurance premiums. Occasionally, an insurance policy is cancelled when neither mortgagor nor mortgagee timely pays the premium. There is a split of authority as to the mortgagee’s liability to the mortgagor for policy cancellation when the mortgagee holds escrowed funds. Some cases hold that a mortgagee who receives escrow deposits from the mortgagor for payment of taxes and insurance is not liable for failure to pay insurance premiums, but an almost equal number of cases have recognized a mortgagee’s duty to renew the policy or notify the mortgagor of its imminent lapse.

was omitted, reversed a judgment for the owner against the mortgagee and remanded the case to determine if the owner had relied on the mortgagee’s gratuitous undertaking to obtain insurance. The court relied on RESTATEMENT (SECOND) OF TORTS § 323 (1965).


(Friedman on Contracts, Rel. #7, 5/09) 3-89
Similar issues arise when the mortgagee is involved with or knows of the cancellation of the insurance policy. As a general matter, the mortgagee is under no implied duty to notify the mortgagor of a cancellation of the policy, even though the mortgagee is in receipt of a notice of cancellation of the policy sent by the insurer.\footnote{399} The mortgagee may justifiably assume that the insurer also gave notice of cancellation to the mortgagor when the policy is of a type that cannot legally be cancelled without such notice to the mortgagor. In one case, a mortgagee’s return of a policy for cancellation, in the mistaken belief that the policy had been replaced, was held to have no effect on the mortgagor’s rights to enforce the policy.\footnote{400} But another court has held a mortgagee liable for canceling a policy in the mistaken belief that the policy had been superseded by another.\footnote{401}

Credit life insurance has been treated somewhat similarly. A mortgagee who was held under the circumstances to be a broker for the credit insurer was held liable for failure to notify the mortgagor’s widow that the insurer was placed in governmental rehabilitation.\footnote{402} A mortgagee’s breach of an agreement, made simultaneously with the mortgage, to obtain credit life insurance for the mortgagor, was a defense to foreclosure.\footnote{403}

When a mortgagee purchases insurance solely for his protection and with his own funds, the insurer, after paying the mortgagee his loss, is subrogated to the right of the mortgagee against the mortgagor.\footnote{404} But when the policy solely in the mortgagee’s name is procured by the mortgagee pursuant to the authority of the mortgage and at the expense of the mortgagor, the insurer has no right of

\footnotesize{\begin{enumerate}
\item \footnote{399} Beckford v. Empire Mut. Ins. Group, 525 N.Y.S.2d 260 [App. Div. 2d Dep’t 1988]; see Rocque v. Co-Operative Fire Ins. Ass’n, 438 A.2d 383 [Vt. 1981] [in dispute concerning whether mortgagor had received notice of cancellation from insurer, court rejected insurer’s argument that mortgagee who had received notice had duty to inform mortgagor].
\item \footnote{400} Falchook Mkt., Inc. v. Warner Reciprocal Insurers, 388 N.Y.S.2d 100 [App. Div. 1st Dep’t 1976] (“replacement” policy was on other property).
\item \footnote{401} Hatfield v. Minden Bank & Trust Co., 361 So. 2d 901 [La. Ct. App. 1978].
\item \footnote{402} Kinder Mortgage Co. v. Celestine, 635 So. 2d 527 [La. Ct. App. 1994]. \textit{Kinder} discusses cases in comparable situations.
\item \footnote{403} Bonner v. Bank of Coushatta, 445 So. 2d 84 [La. Ct. App. 1984] [mortgage was cancelled].
\end{enumerate}}
subrogation and the proceeds of insurance are applied to the mortgage debt.\textsuperscript{405}

[B] Restoration of Premises

Prior to 1966, the New York statutory covenant to insure gave the mortgagee the choice of applying insurance moneys either to reduction of the mortgage debt (despite repairs or restoration by the mortgagor) or to restoration of the premises.\textsuperscript{406} Most other states, then and now, follow this rule—it being generally held that a provision making insurance proceeds payable to a mortgagee entitles him to these proceeds to the extent of the mortgage debt, and to hold any surplus after extinguishment of the mortgage debt for the benefit of the mortgagor.\textsuperscript{407} A mortgagee’s reasonable delay in asserting its rights to the proceeds will not bar its claim, even if the mortgagee notifies the mortgagor of its election after the mortgagor has completed restoration.\textsuperscript{408} An owner who repairs without getting his mortgagee’s commitment to apply funds to the restoration acts at his peril. But if, after an insured loss, the mortgagee agrees to allow proceeds for

\begin{itemize}
\item \textsuperscript{405} Employers’ Fire Ins. Co. v. British Am. Assurance Co., 131 S.E.2d 36 [N.C. 1963]. In Employer’s Fire, the mortgagor purchased one policy insuring herself with a standard mortgagee endorsement and the mortgagee purchased a policy naming only himself as insured, but he added the premium to the mortgage debt. Charging the premium to the mortgagor was sufficient to bring the case within the rule mentioned. Each insurer was held liable for that part of the loss its policy bore to the total insurance.
\item \textsuperscript{406} Savarese v. Ohio Farmers’ Ins. Co., 182 N.E. 665 [N.Y. 1932], noted in 42 YALE L.J. 788 [1933].
\item \textsuperscript{408} First Fed. Sav. & Loan Ass’n v. Stone, 467 N.E.2d 1226, 1234 [Ind. Ct. App. 1984] [when owners “authorized the repair of the home without an assurance from [mortgagee] that the insurance proceeds would be applied to repair the home, they gambled that [mortgagee] would not elect to apply the insurance proceeds to the mortgage debt and lost”].
\end{itemize}
restoration, such an agreement is enforceable in accordance with
general principles of contract law.\textsuperscript{409}

A few cases entitle the mortgagor to the insurance moneys when
the mortgage is in good standing and the security is not impaired.\textsuperscript{410}
This approach has been criticized for requiring a lawsuit to determine
the value of the remaining security,\textsuperscript{411} but a mortgagor might prefer
litigation to an inability to rebuild.

The operation of the majority rule can be rough on a mortgagor who
paid premiums for years for fire insurance and then learned, after the
event, that by application of the insurance moneys to reduction of the
mortgage, he had half a building and half a mortgage, but no money for
restoration. Some mortgagors have used this situation as a lever to
depart from their bargain by increasing the interest rate or calling a
mortgage they regretted making. A mortgagor’s use of fire damage to
call a mortgage might be justified in the occasional case of a large
mortgage made in reliance on the security of high credit tenants,
where destruction terminated these leases.

Parties to a mortgage are free to enter into an agreement that will
govern application of the insurance proceeds in event of a loss, and
such agreements sometimes allow the mortgagor to use the insurance
money to restore the property rather than to pay the mortgage debt.\textsuperscript{412}
In substantial mortgages, involving a borrower with bargaining power,
the mortgage may expressly require the mortgagor to apply the
insurance moneys to restoration. This may be by payment to the
mortgagor immediately, or not until restoration. Or it may provide for
payment in stages as restoration progresses, with a specified percen-
tage held back until completion. The mortgage may provide for
remission of the moneys to a trustee, usually a bank, to make these
payments.

\textsuperscript{409} See United Bilt Home, Inc. v. Sampson, 832 S.W.2d 502 (Ark. 1992)
(mortgagee and mortgagor agreed, after fire, that mortgagee would reim-
burse mortgagor for cost of repairs; mortgagee’s failure resulted in action
by contractor against mortgagor; mortgagor was liable for compensatory
and punitive damages).

\textsuperscript{410} Schoolcraft v. Ross, 146 Cal. Rptr. 57 (Ct. App. 1978) [but cf. Lee v.
Cont’l Trust Co., 182 A. 551 (Md. 1936); Starkman v. Sigmond, 446 A.2d
S.W.2d 521, 526–27 [Tex. 1983]. Starkman v. Sigmond was disapproved in
Div. 1984), aff’d per curiam, 499 A.2d 1017 (N.J. 1985).


\textsuperscript{412} Hoosier Plastics v. Westfield Sav. & Loan Ass’n, 433 N.E.2d 24, 27 (Ind.
When the mortgagee makes the payments to a contractor who performs restoration work, a written contract should specify the criteria the mortgagee will follow in deciding when and how much to pay. If such a contract agreed to the mortgagor does not require inspections of the work, a court has held that a mortgagee who paid insurance moneys to a contractor, whose work was deficient, was not liable for negligent conduct or as an implied trustee.\(^\text{413}\)

When the mortgagee releases insurance moneys to the mortgagor for the purpose of restoration, the mortgagor’s use for other purposes may be an actionable wrong.\(^\text{414}\)

In 1966 New York departed from the majority rule, which gives the mortgagor no right to use insurance proceeds to restore unless the mortgage expressly allows such restoration. A statute revised the construction of the insurance covenant in statutory form mortgages, providing that the mortgagee hold the insurance proceeds “as trust funds until paid over or applied.”\(^\text{415}\) If the mortgagor notifies the mortgagee of the fire within thirty days thereafter and makes “good the damage by means of such repairs, restoration or rebuilding as may be necessary to restore the buildings to their condition prior to the damage,” then upon presentation of proof the mortgagor becomes entitled to reimbursement from the insurance moneys.\(^\text{416}\) The mortgagor’s right to the insurance proceeds is conditioned on there being no “default by the mortgagor in the performance of any of the terms or provisions of the mortgage on his part to be performed.”\(^\text{417}\) The statute gives the mortgagor a maximum of three years to restore, but he is under pressure to restore promptly because he gets no benefit from the insurance and must pay for restoration, plus taxes and all mortgage charges, with little or no income from the property, until restoration is complete. In essence the mortgagor’s rights depend on restoring the mortgagee to his original security position.\(^\text{418}\)

Inasmuch as the use of the statutory form mortgage is merely permissive, the statutory construction conferring restoration rights on the mortgagor may be avoided by stipulating otherwise in the mortgage. Most mortgage forms prepared for lending institutions


\(^{414}\) Law v. Dewoskin, 447 S.W.2d 361 [Tenn. 1969] (mortgagee allowed to pursue claim after purchasing at foreclosure for full amount of debt due under non-recourse mortgage).

\(^{415}\) N.Y. REAL PROP. LAW § 254(4).

\(^{416}\) Id.

\(^{417}\) Id.

\(^{418}\) The statute does not apply to a purchaser under an installment contract of sale. See infra section 3:7.2[K] infra.
stipulate otherwise by giving the mortgagees the rights they held before the 1966 amendment, though in large transactions this may be changed, as mentioned above. If a mortgage loan was made in reliance on the existence of a lease to a high credit tenant, a mortgagee’s agreement to apply insurance proceeds to restoration may be conditioned on the continuance of the lease after restoration. If a group of such leases is involved, the condition may be that the aggregate annual rents do not drop, by reason of the damage, below a specified sum or percentage.

[C] Application of Insurance Proceeds to Debt

The standard mortgage clause has been called “a pre-appropriation of insurance proceeds to payment of the mortgage debt.”419 Making the insurance moneys payable to a mortgagee does not, per se, give the mortgagee a free hand in their application. When the proceeds of insurance are payable to a mortgagee, with no obligation to apply them otherwise than to the mortgage debt, the mortgagee is usually required to apply them to installments of interest and principal as they fall due. This bars him from foreclosing for current defaults, at a time when an owner may be hard pressed, in order to hold the insurance moneys as security for final installments of the mortgage debt.420 It may also require him to hold the insurance money, if the mortgage has not matured, until the debt or part of it becomes due.421

However, the disposition of insurance moneys may be controlled by agreement between mortgagor and mortgagee, usually found in the mortgage itself. And a mortgage provision permitting a mortgagee to apply the insurance money against the mortgage debt or for other purposes has been held to permit application to the balance of the debt payable at maturity instead of to installments next accruing.422

   But note Ziello v. Superior Court, 42 Cal. Rptr. 2d 251 (Ct. App. 1995), where the mortgage provided that absent a contrary agreement the proceeds of insurance should not postpone the date of the periodic payments or change their amount.
Application to the balance payable at maturity is permitted under the New York statute. 423

[D] Claims of Co-owners and Holders of Other Interests

A mortgagee who plans to pay the proceeds of insurance to an owner should consider the possible rights of a junior lienor or a co-owner in these proceeds. Any such rights would be based on the terms of the mortgage or the insurance policy or both. A mortgagee who might have applied the proceeds, as of right, to the mortgage debt was held liable for the diversion made possible by paying the proceeds to one of several co-owners. 424 If the insurance is for the benefit of first and second mortgagees, the first mortgagee is liable to the second for the proceeds in excess of the first mortgage debt 425 and may not, as against the second mortgagee, remit the proceeds to the mortgagor for purposes of repair. 426 If the first mortgage requires insurance for a stated amount, the first mortgagee is estopped from claiming a greater amount, with the junior mortgagee entitled to apply the excess proceeds to its debt. 427

When senior and junior mortgagees are named in the same policy, their rights inter se may be governed by the terms of the senior mortgage. In this situation, a clause in the first mortgage that gives its holder the choice of applying the proceeds either to reduction of the debt or to repair of the damage has been upheld against a junior mortgagee. 428 A mortgage that permitted its holder to apply the proceeds of insurance to the mortgage debt, to restoration, or for any

427. Knapp v. Victory Corp., 302 S.E.2d 330 (S.C. 1983) [fire insurance proceeds were $225,000, but mortgage only required mortgagor to maintain insurance of $160,000].
428. Application to the first mortgage debt was upheld in Woody v. Lytton Sav. & Loan Ass’n, 40 Cal. Rptr. 560 (2d Dist. Ct. App. 1964).


A first mortgagee was held justified in paying the proceeds to the owner in reliance on an affidavit that restoration had been made. The first mortgagee was held not negligent as a matter of law in relying on the affidavit. Walton v. Gen. Am. Life Ins. Co., 383 S.W.2d 854 (Tex. Civ. App. 1964).
other purpose, without impairment of the lien of the mortgage, was held to justify payment to the owner without regard to restoration.\(^{429}\)

A junior mortgagee, who is not named in a policy insuring the owner and first mortgagee, has been held to have no valid objection to use of the proceeds for restoration\(^{430}\) or even, possibly, for their diversion.\(^{431}\) But query whether a junior mortgagee who is not named in the policy may not on timely application prevent the use of the proceeds for a purpose other than that of repair or reduction of a paramount mortgage. The doctrine of marshalling assets is applicable when two or more creditors of the same debtor have successive claims on the same property, and the creditor prior in right holds additional security. In this situation, equity will compel one creditor to collect from the funds unavailable to the other, where this can be done with justice to all concerned.\(^{432}\) The doctrine of marshalling assets, however, does not apply between a mortgagee and a subsequent purchaser of the property. In \textit{Peoples State Bank v. Marlette Coach Co.},\(^ {433}\) a first mortgagee and the owner agreed, after their collection, to apply the insurance proceeds to an unsecured debt. This agreement was held binding on a junior mortgagee who, though known to the first mortgagee, was not a party to the policy. At the time of the action the junior mortgagee acquired title to the property through foreclosure. This ended its lien and its claim as a creditor. For this reason the court refused to apply the doctrine.\(^ {434}\)

\begin{itemize}
\item\(^{429}\) Meltzer v. Blumberg, 231 N.Y.S. 513 (Sup. Ct. Kings County 1928) (junior mortgagee not named in policy).
\item\(^{430}\) Gordon v. Ware Sav. Bank, 115 Mass. 588 (1874).
\item\(^{431}\) See Meltzer v. Blumberg, 231 N.Y.S. 513 (Sup. Ct. Kings County 1928).
\item\(^{432}\) See Peoples State Bank v. Marlette Coach Co., 336 F.2d 3 (10th Cir. 1964); Bartley v. Pikeville Nat’l Bank & Trust Co., 532 S.W.2d 446 (Ky. 1975). See also Ranier v. Mount Sterling Nat’l Bank, 812 S.W.2d 154 (Ky. 1991).
\item\(^{433}\) Peoples State Bank v. Marlette Coach Co., 336 F.2d 3 (10th Cir. 1964).

Where a second mortgage is paramount to subsequent mortgages, the second mortgagee may have a sale under the first mortgage and seek satisfaction first from properties in which the subsequent mortgagees have an interest. \textit{In re Shull}, 72 B.R. 193 (Bankr. D.S.C. 1986).
\end{itemize}
The existence of a tenant and a paramount mortgage may create a three corner priority. In one case a lease required the tenant to restore after a fire, at the tenant’s expense and with no liability therefor on the landlord, but entitled the tenant to reimbursement to the extent of the insurance. The tenant was required to supply replacement value insurance for the benefit of both landlord and tenant and any paramount mortgagee. After a fire the paramount mortgagee elected to take enough of the insurance proceeds to satisfy its mortgage. The tenant restored at its expense and received the balance of the insurance money, a sum insufficient for full reimbursement. If there were no mortgage the insurance proceeds would have paid for restoration and any balance would have gone to the landlord. To avoid giving the landlord a windfall (satisfaction of its mortgage debt) at the tenant’s expense, the tenant was given a right against the landlord by subrogation to be made whole by deferred payments for the cost of restoration.

The requirement in a first mortgage that the owner insure for the mortgagee was held to give a junior wraparound mortgagee a right to insurance because of the owner’s obligation in the wraparound to comply with the first mortgage.

Suppose an owner of the premises fails to supply the mortgagee with fire insurance, but obtains such insurance for his own benefit. If the owner was under no obligation to insure for the mortgagee’s benefit, the proceeds of such insurance are the sole property of the owner. This is an application of the general rule that one who is not a party to an insurance contract has no claim to its proceeds.

If the owner is liable on the covenant to insure, as in the case of either the mortgagor or a subsequent owner who has effectively assumed the mortgage, this covenant is sufficient in most states to predicate a lien in the mortgagee’s favor on the proceeds of such insurance that is paramount to rights of the mortgagor’s

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437. Bodwitch v. Allen, 459 N.Y.S.2d 148 (App. Div. 4th Dep’t 1983). This was applied to earthquake insurance not required by the mortgage. For this reason Alexander v. Sec.-First Nat’l Bank, 62 P.2d 735 (Cal. 1936), was distinguished. Ziello v. Superior Court, 42 Cal. Rptr. 2d 251 (Ct. App. 1995). In Ziello, the mortgagee’s reference to the provision in the mortgage assigning to the mortgagee all sums due and payable for injury to the property was rebuffed by the holding that insurance is a personal contract and its proceeds are payment on a contract, not a judgment.
creditors. But this lien is subordinate to a junior mortgagee who has the benefit of insurance bearing a mortgagee endorsement in his favor. Furthermore, a covenant to insure does not run with the land, and if in this situation an owner has not assumed the mortgage, he is entitled to receive the proceeds of insurance free of any claim of the mortgagee. Accordingly, it is essential that a mortgagee always have proper insurance policies from the owner. If the mortgage contains the provisions herein discussed, the mortgagee has two remedies: (1) an owner’s failure to supply the mortgagee with insurance is a breach that permits the mortgagee to accelerate the mortgage; or (2) the mortgagee may obtain the insurance himself and add this cost to the mortgage debt. If in this situation the mortgagee insures for himself, the policy is held dual interest insurance, covering the mortgagor and the mortgagee, requiring the mortgagee to apply


In this situation the insurer is not liable to the mortgagee for paying the insurance moneys to the mortgagor if without actual or constructive knowledge of the mortgagee’s rights. Paskow v. Calvert Fire Ins. Co., 579 F.2d 949, 952 [5th Cir. 1978].

A mortgagor’s parol agreement to insure for the mortgagee’s benefit was held binding. Butson v. Misz, 160 P. 530 (Or. 1916).

A mortgage requirement that the mortgagor insure against fire and deliver the policies to the mortgagee was held a covenant to insure for the mortgagee’s benefit, on the ground there was no other reason for delivering the policies to the mortgagee. Winneshiek Mut. Ins. Ass’n v. Roach, 132 N.W.2d 436 [Iowa 1965].

443. The New York statutory mortgage is so construed. N.Y. REAL PROP. LAW § 254(4). Where not so implied, a comparable provision should be expressed. The two remedies are not mutually exclusive. Upon the mortgagor’s default, the mortgagee may elect to pay the insurance premium and proceed to foreclose. Farmers & Merchs. Bank v. Copple, 373 P.2d 219 [Kan. 1962] [mortgagee paid premium on last day of grace period before cancellation of policy].
the insurance proceeds to reduction of the mortgage and depriving the insurer of any subrogation against the mortgagor.\textsuperscript{444}

A mortgagee with insurance in its name is entitled to its proceeds to the exclusion of a prior mortgage\textsuperscript{445} or lien.\textsuperscript{446}

The lien of a mortgagor’s lawyer on the insurance moneys, for effecting their collection, is usually subordinate to the right of the mortgagee thereto.\textsuperscript{447}

\section*{[E] Transfers of Mortgaged Premises or Mortgage Loan}

The fact that an owner who has not assumed the mortgage is not personally liable for the premiums, or for any other part of the mortgage debt, does not preclude the mortgagee from enforcement of the rights given him by the mortgage.

A purchaser of mortgaged property who neglected to have his name substituted on a fire policy for that of his mortgagor-vendor was denied recovery on the policy after a disastrous fire.\textsuperscript{448} The mortgagee recovered enough to satisfy its mortgage, but this sum was less than half the amount of the damage. This result seems unduly technical because the purchaser had assumed the mortgage and paid the insurance premiums, which were included in his payments to the mortgagee.

A mortgagor who sells the property retains an insurable interest if he remains liable for the mortgage debt, despite an assumption of the mortgage by the grantee.\textsuperscript{449}

\begin{flushright}
\textsuperscript{444} In re SPG, Inc., 833 F.2d 413 [2d Cir. 1987]. This is not true with respect to subrogation where a mortgagor’s breach of the policy makes it un-enforceable by the mortgagor.\textsuperscript{444}
\textsuperscript{445} Butler v. Ringrose, 16 P.2d 202 [Wash. 1932].\textsuperscript{445}
\textsuperscript{446} Midland Lumber & Supply, Inc. v. J.B. Builders, 626 A.2d 89 [N.J. Super. Ct. 1993].\textsuperscript{446}
\textsuperscript{448} Am. Family Mut. Ins. Co. v. Walton, 926 F. Supp. 811 [S.D. Ind. 1996]. This case compares with those that involve the right of an insurance company that pays a loss, say, to a landlord, to be subrogated to the amount of its payment against the wrongdoer who caused the damage. This usually involves recovery against a tenant who negligently caused a fire. If the tenant is included in the landlord’s policy, making the tenant an insured, the insurer has no such right of subrogation because the insurer has no right to recover against its insured. But some cases hold that if tenant’s rent expressly includes a charge for insurance or if this is included in rent escalation, then the result is the same and tenant is absolved. Some cases hold that a tenant’s mere payment of rent, with no more, presumably goes in part to pay for insurance and here too tenant is absolved. See 1 MILTON R. FRIEDMAN, FRIEDMAN ON LEASES § 9:10 [Patrick A. Randolph, Jr., ed., 5th ed. PLI 2006].\textsuperscript{448}
\textsuperscript{449} Reid v. Hardware Mut. Ins. Co., 166 S.E.2d 317 [S.C. 1969].\textsuperscript{449}
\end{flushright}
When a mortgagee assigns a promissory note and mortgage, the assignee may become the named mortgagee on the insurance policy if the parties contact the insurer to request a change. This step, however, is often not taken. Failure to do so may jeopardize insurance coverage in the event of casualty, but usually is not fatal. The assignment of the mortgage loan by the initial mortgagee carries with it the assignor’s rights in the insurance unless the insurance policy contains express language voiding the mortgage clause if the current mortgagee’s name does not appear therein. Moreover, an action for reformation may be available to correct the name of the mortgagee.

A policy requirement that the mortgagee give the insurer notice of a change of ownership that comes to his attention is not applied to a transfer to the mortgagee. The latter is already an insured and his increased interest in the property subjects the insurer to no increased risk. The rule applies when the policy has a standard mortgagee clause. The rule is contra where the mortgagee’s interest is reflected in a loss payment clause.

The policy requirement that the mortgagee notify the insurer of a change in ownership is necessary for the mortgagee’s protection, not the mortgagor’s. When a mortgagor sold a house to his brother and the insurer denied coverage after a fire, a court held that the mortgagee was not liable to the mortgagor or his brother for failing to notify the insurer of the ownership change.

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451. Cheperuk v. Liberty Mut. Fire Ins. Co., 693 N.Y.S.2d 304 (App. Div. 3d Dep’t 1999) (fire occurred eleven months after mortgage assignment; granting reformation when failure to change name of mortgagee on policy was inadvertent and company did not claim it would have discontinued coverage had it received notice of change of mortgagee).
[F] Mortgagee Endorsements

Insurance policies name the mortgagor-owner as the insured, but a mortgagee endorsement is invariably added. There are two different types of mortgagee endorsements: (1) the standard or “union” endorsement, and (2) the “open” mortgage or loss payable clause. They vary substantially in their effect.

The standard or union mortgage endorsement is more than a mere assignment to the mortgagee of a right to the proceeds of insurance. It is deemed to create a separate contract between the mortgagee and the insurer. The mortgagee is entitled to its own notice of cancellation.

The primary effect of the mortgagee endorsement is to insulate the mortgagee from any act or omission of the mortgagor. This benefit is highly significant. If the mortgagor should violate some provision of the policy, such as by maintaining inflammables or explosives on the premises, this, too, would not prejudice the mortgagee’s rights under the standard mortgage endorsement. Nor does arson committed by the mortgagor deprive the mortgagee of insurance coverage.

An owner’s failure to file proof of loss does not prevent recovery by a mortgagee under the standard mortgagee clause. In Hartford Fire Insurance Co. v. Moore, an owner’s failure to file proof of loss did not prevent recovery by a mortgagee under the standard mortgagee clause. The owner’s failure to file proof of loss or to begin an action within their respective time limits was waived by the insurer’s full payment to the mortgagee. The mortgagee made proof of loss, and the insurer had taken an assignment of the mortgage. The owner’s action was not for money, but to have the mortgage lien canceled of record. The court noted that the insurer made payment to the mortgagee without disclaiming liability to the owner.

A clause in a policy, typical of Lloyd’s underwriters, terminating the policy in case of reduction in the amount of similar insurance maintained on the premises with other insurers, was held without effect on the mortgagee. A provision voiding the policy for

vacancy of the property for sixty days was held inapplicable to a mortgagee.\footnote{461}{Roosevelt Sav. Bank v. State Farm Fire & Cas. Co., 556 P.2d 823 (Ariz. Ct. App. 1976).}


Despite the foregoing, there is a slight suggestion that a mortgagee is protected by the standard mortgage endorsement only so long as he had no knowledge of the mortgagor’s default or other act.\footnote{463}{See Nassar v. Utah Mortgage & Loan Corp., 671 P.2d 667, 671 [N.M. Ct. App. 1983]; 10A G. COUCH, INSURANCE § 42:735 [2d ed. 1982].}

If the policy is void as to the mortgagor, payment by the insurer to the mortgagee may subrogate the insurer to the mortgagee’s rights against the mortgagor. Many policies expressly entitle the insurer to subrogation in this situation.\footnote{464}{See, e.g., the New York statutory form policy, N.Y. INS. LAW § 168.}

These clauses are enforceable. In the absence of a subrogation clause, some courts deny the insurer subrogation,\footnote{465}{Fields v. W. Millers Mut. Fire Ins. Co., 48 N.E.2d 489, 491 [N.Y. 1943], criticized in 12 FORDHAM L. REV. 289 (1943).}

but others allow it.\footnote{466}{E.g., Twin City Fire Ins. Co. v. Walter B. Hannah, Inc., 444 S.W.2d 131 [Ky. 1969]. See Campbell, Non-Consensual Suretyship, 45 YALE L.J. 69, 101–02 [1935].}

Suppose the mortgagor should obtain a second policy, which insures him alone and results in over-insurance. Whatever effect this may have on the mortgagor’s rights, it does not affect the mortgagee’s.

Proceeds of insurance paid to a mortgagee under a standard mortgage endorsement are for the benefit of both the mortgagor and the mortgagee, and operate to reduce the mortgage debt.\footnote{467}{Liverpool & London & Globe Ins. Co. v. Orrell, 190 So. 552 [Fla. 1939]; see O’Neil v. Franklin Fire Ins. Co., 145 N.Y.S. 432, 438 [App. Div. 4th Dep’t 1913], aff’d, 110 N.E. 1045 [N.Y. 1915].}

The standard endorsement provides that whenever the insurer pays the mortgagee and claims it is under no liability to the mortgagor, the insurer will be subrogated to the rights of the mortgagee under the mortgage. This provision is valid and the right of subrogation is enforceable against the mortgagor.\footnote{468}{Surratt v. Fire Ass’n, 43 F.2d 467 [4th Cir. 1930]; Auto-Owners Mut. Ins. Co. v. Newman, 851 S.W.2d 22 [Mo. Ct. App. 1993]; Larchmont Fed. Sav. & Loan Ass’n v. Ebner, 454 N.Y.S.2d 450 [App. Div. 2d Dep’t 1982].}
is not dependent upon an express provision to this effect in the mortgage clause.\footnote{469}

A literal reading of the mortgagee endorsement indicates that a mere claim of non-liability is sufficient to establish the insurer’s rights against the mortgagor. As it is construed, however, the right of subrogation depends on proof that the policy is void as against the mortgagor.\footnote{470} Cases have arisen in which one of several co-owners was guilty of arson or other intentional injury to the property. Some decisions give full recovery to the innocent owner.\footnote{471} Others have denied recovery.\footnote{472} Still others depend on “a reasonable expectation by the innocent party that his or her individual interest would be protected without reference to the acts committed by the coinsured.”\footnote{473} If the insured is a corporation, then recovery is barred by willful acts of its agents.\footnote{474}

The insurer is not entitled to subrogation unless it satisfied the mortgage in full.\footnote{475} This is an application of the general rule under which a party is not entitled to be subrogated to the rights or security of a creditor until the creditor’s claim has been fully paid.\footnote{476}

When the insurer has paid the mortgagee and has subrogation rights due to its nonliability to the mortgagor, the proceeds of insurance are not applied to reduction of the mortgage debt.\footnote{477}

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\footnote{472}{See id. at 621.}

\footnote{473}{Id.}

\footnote{474}{See id. at 622.}

\footnote{475}{Nat’l Union Fire Ins. Co. v. Price, 99 So. 848 [ Ala. 1924].}

\footnote{476}{But see Garrison v. Great S. Ins. Co., 809 F.2d 500 [8th Cir. 1987], which held that an insurer that paid a mortgagee for its fire loss became subrogated to the rights of the mortgagee against the mortgagor to the extent that the insured paid the mortgage debt. The mortgagor had permitted its interest in the policy to lapse.}

With a standard mortgagee endorsement, analysis can become more complicated when the property is rented and the tenant obtains the insurance policy. In one case, a net lease obligated a department store tenant to purchase insurance, which was issued with a mortgagee endorsement naming the lessor’s mortgagee. The court concluded that the policy was procured for the benefit of the lessor-mortgagor, although not named in the policy, as well as the mortgagee. The mortgagee’s acceptance of the proceeds of insurance was held to require their application in reduction of the mortgage.

The “open” mortgage or loss payable clause is, in substance, an assignment by a mortgagor to a mortgagee. It makes the mortgagee an appointee for collection and gives the mortgagee no greater rights than that of the mortgagor, so that a breach of conditions of the policy by the mortgagor that would bar recovery by the mortgagor acts to bar recovery by the mortgagee. But, under the prevailing authority, the mortgagee under a loss payable clause is not bound by an arbitration or settlement between the insurer and the mortgagor made without his consent.

### [G] Mortgagee’s Acquisition of Title Before Insured Loss

A mortgagee’s right to receive the proceeds of insurance, to the exclusion of the owner-mortgagor, was considered above. That consideration was predicated on two separate interests then vested


When an insurer paid the mortgage debt and took an assignment of the mortgage and debt on the ground of arson by a second grantee-assumer of the mortgage, the insurer’s claim for reimbursement was upheld against the second and the previous grantee against whom there was no claim of arson. Fireman’s Fund Ins. Co. v. Rogers, 712 S.W.2d 311 (Ark. Ct. App. 1986).


In holding that the stockholders of a corporate mortgagor have an insurable interest, a defense on this ground against a loss-payee mortgagee was overruled. Booker T. Wash. Ins. Co. v. Transcon. Ins. Co., 263 F. Supp. 1005 [N.D. Ala. 1966].


481. See supra section 3:7.2[B].
Mortgage Financing § 3:7.2

in the mortgaged property: (1) the fee interest, in the owner-mortgagor, and (2) the mortgage lien, in the mortgagee. If the mortgage interest is converted into a fee by foreclosure or otherwise, the mortgagor’s interest is extinguished and the entire ownership is now in the former mortgagee. If he is still named in a fire insurance policy only by way of a mortgage endorsement, his right to receive the entire proceeds of insurance, to the exclusion of the former mortgagor, depends on several factors.

Under the “union” or standard mortgagee endorsement the proceeds of insurance are payable “as interest may appear.” A preliminary question is whether “interest” means interest in the mortgage debt, or in the mortgaged realty, or both? The prevailing view is that “interest” means both.\(^\text{482}\) Based on this perspective, when the mortgagee acquires title to the realty before a loss, his interest is then in the fee and he is entitled to the full proceeds of insurance regardless of what is left of the debt, that is, the protection of the policy does not end with foreclosure, although the debt is satisfied thereby.\(^\text{483}\) The extent of the coverage depends on the extent of the mortgagee’s interest at the time of the loss, not on the continued existence of the mortgage.\(^\text{484}\)

After foreclosure, in many states the mortgagor has a statutory right of redemption. A mortgagee has been held entitled to insurance proceeds during the mortgagor’s period of redemption\(^\text{485}\) and after

\(^{482}\) For another view, see Hartford Fire Ins. Co. v. Bleedorn, 132 S.W.2d 1066, 1072 [Mo. Ct. App. 1939]: “As its interest may appear’ does not refer to appellant’s interest in the property, but refers to the amount of the debt owed to it secured by the deed of trust” [citations omitted].

\(^{483}\) 495 Corp. v. N.J. Ins. Underwriting Ass’n, 430 A.2d 203 [N.J. 1981].

\(^{484}\) Nationwide Mut. Fire Ins. Co. v. Wilborn, 279 So. 2d 460 [Ala. 1973]; 495 Corp. v. N.J. Ins. Underwriting Ass’n, 430 A.2d 203 [N.J. 1981]. In 495 Corp., the mortgagee recovered the full amount of the loss, to the policy limits, subject to the rights of a superior mortgage. The court ruled that the mortgage endorsement protects the interest of the mortgagee in the insured property. It overcame a difficulty in construing the clause by centering on the words “a mortgagee’s interest in the insurance is not invalidated by foreclosure.” The insurer had argued that the mortgagee’s interest was limited to the debt, and that at the time of the fire there was no debt and therefore no insurable interest in the former mortgagee. The court reasoned that the insurer would reap a windfall if premiums were paid covering a full loss with nobody eligible for payment of the loss for the reason that the former owner lacked an insurable interest. The court distinguished the mortgagee’s post-loss acquisition, where recovery is limited to the deficiency in the mortgage debt and where, if the property is acquired in its full satisfaction, the former mortgagee is not entitled to any proceeds of insurance.

expiration of the redemption period. A mortgagor redeeming during the redemption was held entitled to the insurance.

The requirement in the standard mortgage endorsement that the mortgagee give the insurance company notice of any change of ownership is held inapplicable to the mortgagee’s acquisition of title unless an increase of hazard is involved. It is said that this is no change of ownership, merely an enhancement of the mortgagee’s interest.

A fire occurring after the mortgagee bid the full amount of the debt, but before the mortgagee obtained a deed was treated as a bid made after acquisition of title, and the mortgage moneys were paid to the mortgagee.

A few cases differ from the foregoing and limit a mortgagee’s recovery to the preforeclosure debt for damage accruing after his acquisition of title.

[H] Mortgagee’s Acquisition of Title After Insured Loss

If the mortgagee acquires title to the mortgaged property after the loss, the property in its damaged state is deemed a payment of the mortgage debt to the extent of its then-value. Any recovery of insurance proceeds by the mortgagee without deduction for this value of the property is deemed an impermissible double recovery. This is a
corollary of a more general rule that after payment of a mortgage debt in full, the mortgagee has no right to the proceeds of insurance. 492

A mortgagee’s acquisition of title after an insured loss is often accomplished by foreclosure. Not surprisingly, the casualty often makes it difficult for the mortgagor to continue making timely payments. If the mortgagee bids the full amount of the debt at the foreclosure sale the debt is extinguished 493 and his recovery of insurance proceeds barred. 494 A lesser bid reduces the debt, and his right to insurance proceeds, pro tanto. 495 This makes it advisable for a mortgagee to bid at foreclosure no more than the value of the property in its damaged condition. 496

A Florida case illustrates the importance of preserving the right to insurance proceeds by bidding less than the debt at foreclosure. In Sea Island Operating Corp. v. Hochberg, 497 after hurricane damage, the mortgagee bought the property for $1 million when the mortgage debt was


493. On this rationale there is a series of California cases precluding a mortgagee who purchases the property by a full credit bid, that is, the amount of the debt, from recovering from a third party for waste and other claims; though the cases differ where the claim is for fraud. See Pac. Inland Bank v. Ainsworth, 48 Cal. Rptr. 2d 489 ( Ct. App. 1995).


In this connection it may be said, “As its interest may appear’ does not refer to appellant’s interest in the property, but refers to the amount of the debt owed to it secured by the deed of trust. . . .” Hartford Fire Ins. Co. v. Bleedorn, 132 S.W.2d 1066, 1072 [Mo. Ct. App. 1939] (citations omitted).


was $1,302,635, seeking no deficiency judgment. In an interpleader action, the court awarded the insurance proceeds to the mortgagee as against the mortgagor. The endorsement was apparently standard and, in addition, gave the mortgagee the option to apply the insurance to the debt or to the mortgagor.  

Even if there is a deficit at the foreclosure sale any claim of the mortgagee may be barred if the mortgage debt is deemed satisfied by the mortgagee’s failure to apply for or obtain a deficiency judgment. The New York statute makes failure to apply for a deficiency judgment a presumption that the proceeds of sale in the foreclosure action are in full satisfaction of the mortgage debt. The Nevada statute is even stronger; it renders failure to apply for a deficiency judgment equivalent to a finding that the mortgage debt is extinguished. This defeats a claim by the mortgagee to the insurance proceeds. The California statute bars deficiency judgments, but does not prevent a mortgagee from realizing on other security; and a mortgagee who acquired title on a bid of less than the mortgage debt was held entitled to the proceeds of insurance to the extent of the deficit.


501. NEV. REV. STAT. § 40.455 (1986).

502. Hellman v. Capurro, 549 P.2d 750 [Nev. 1976]. In Mann v. Glens Falls Ins. Co., 541 F.2d 819 (9th Cir. 1976), a mortgagee accepted a deed in lieu of foreclosure and released the mortgagor from liability. Applying Nevada law, the court denied the mortgagee a recovery from the insurer. Denial, however, was based on the mortgagee’s refusal to permit subrogation against the mortgagor, to whom the insurance had not been assigned. Accord Indus. Indem. Co. v. Great Am. Ins. Co., 686 P.2d 1216 (Alaska 1984).

A mortgagee's insurance is on the mortgagee's interest in or lien upon the realty, not upon the realty itself. In a Nebraska case, the mortgagee obtained a fire policy after the mortgagor defaulted, with the policy insuring only the mortgagee. After a fire occurred, the insurer paid proceeds to the mortgagee. Six months after the fire, the mortgagee purchased the property at foreclosure for a price substantially less than the outstanding debt. The mortgagee was denied a deficiency judgment under the Nebraska anti-deficiency statute, which denies a deficiency judgment if either the value of the property or the price bid at foreclosure is at least as much as the mortgage debt. This action terminated the mortgagee's interest in the debt as well as its insurable interest, thereby triggering an obligation on the mortgagee's part to return all insurance proceeds to the insurer. The court distinguished California and Oregon cases holding that denial of a deficiency judgment under comparable statutes does not bar the mortgagee from claiming against a guarantor of the mortgage.

Under the New York statutory insurance covenant, the mortgagee is not required to collect insurance proceeds from the insurer to apply them to the debt. In Crossland Mortgage Corp. v. Douglas, the mortgagee began foreclosure after the destruction of a house by fire. The mortgagors claimed that the mortgagee's "failure to seek payment under a fire insurance policy insuring its interest in the property constituted a complete defense and setoff" against the foreclosure claim. The court rejected the "contention that the availability of fire insurance proceeds is an affirmative defense to a foreclosure action," calling this position "novel" and concluding that the mortgagee was not required to pursue insurance proceeds before foreclosing.

[I] Loss Payable Endorsement

The preceding two subsections considered the right of a mortgagee to proceeds of insurance when claiming under a "union" or standard endorsement. If, instead, the mortgagee's claim is under an open or loss payable endorsement, the mortgagee has no interest other than as assignee of the mortgagor-owner. If the interest of the latter is extinguished, there is nothing that can pass to the mortgagee, and an extinguishment of the interest of the mortgagor is an extinguishment of the interest of both. A Missouri court has explained the rationale for this interpretation:

505. NEB. REV. STAT. § 76-1013.
507. Id. at 274.
508. Reynolds v. London & Lancashire Fire Ins. Co., 60 P. 467 (Cal. 1900); Prudential Ins. Co. v. German Mut. Fire Ins. Ass’n, 60 S.W.2d 1008

(Friedman on Contracts, Rel. #7, 5/09) 3–109
If the clause in question is to be construed as an ordinary open mortgage clause then whatever rights the plaintiff had as mortgagor were terminated when the property was deeded to it under foreclosure. It then became the owner but the defendant did not insure it as such and no rule of construction justifies this court in writing into the policy coverage of an interest that was not stipulated to be insured by the parties.⁵⁰⁹

Just as in the case of a standard mortgage endorsement, a loss payee mortgagee who bids the full amount of the debt loses any right to insurance.⁵¹⁰

[J] Liability of Mortgagee for Insurance Premiums

Cases have arisen with respect to the liability of a mortgagee for payment of premiums on insurance supplied by a mortgagor. Under a loss payable clause the mortgagee is clearly not liable.⁵¹¹ The standard mortgage endorsement is more difficult because of its language, that is, that the interest of the mortgagee in the insurance shall not be invalidated by any act or neglect of the mortgagor, provided that if the mortgagor shall fail to pay a premium the mortgagee shall on demand pay the same. Under the majority rule “provided” is held a condition, not a covenant, that is, if the mortgagee does not choose to pay, the insurance is invalidated as to him.⁵¹² The minority and older cases construe the clause as a covenant by the mortgagee to pay.⁵¹³ The mortgagee should obviously require a standard or “union” endorsement.

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In Lutheran B’hood v. Hooten, 237 So. 2d 23 (Fla. Dist. Ct. App. 1970), which also apparently involved a loss payable endorsement, mortgagee foreclosed and recovered deficiency judgment and was held entitled to recover the proceeds of insurance.

⁵¹⁰. Universal Mortgage Co. v. Prudential Ins. Co., 799 F.2d 458 (9th Cir. 1986) (and cases discussed; bid in error in ignorance of interior damage to structure).


[K] Installment Land Contracts

An installment land contract “provides for payment of the purchase price in installments with periodic interest on the unpaid balance thereof, possession to the vendee at the time of execution thereof, risk of loss and responsibility for procuring fire and liability insurance and payment of real property taxes on the vendee, but retention of title in the vendors until the purchase price is paid in full.”514 As the above quote suggests, when the land includes valuable improvements, the installment land contract often requires the purchaser to buy and maintain fire insurance. Resolving the conflicting claims of vendor and purchaser to insurance proceeds has proven nettlesome, with inconsistent judicial decisions largely due to uncertainty as to the characterization of the installment land contract. It is widely recognized that the installment land contract is a mortgage substitute, but classically courts have not treated such contracts as mortgages per se or as equitable mortgages. Rather, they have applied the general body of contract law to such contracts.

The purchaser is not entitled to a mortgagor’s rights to use the insurance proceeds for restoration when the policy is issued in the vendor’s name only because the New York statutory covenant does not apply515 and there is no such right at common law.516 The purchaser, however, is entitled to have the insurance proceeds on a policy he purchases reduce the balance remaining on the purchase price. This is true even if the purchaser is in default in making payments at the time of the fire.517 Likewise, if the purchaser is in possession during a redemption period following the entry of a judgment of forfeiture, the purchaser is entitled to the insurance proceeds stemming from a casualty taking place during the redemption period.518

Courts sometimes apply mortgage rules for casualty insurance to installment land contract disputes. A New York court has held that the

516. Upham v. Lowry, 485 N.Y.S.2d 680 (Sup. Ct. Madison County 1985) [rejecting argument N.Y. REAL PROP. LAW § 254(4)(a) should apply because land contract is the “equivalent” of a mortgage].
517. Madero v. Henness, 607 N.Y.S.2d 153, 155 (App. Div. 3d Dep’t 1994) [purchasers entitled to specific performance; vendors must accept insurance proceeds in payment of remaining price because purchasers’ default was “not sufficiently egregious to trigger the agreement’s forfeiture provisions”). In Upham v. Lowry, 485 N.Y.S.2d 680 (Sup. Ct. Madison County 1985), the vendors conceded that the purchasers were entitled to apply the proceeds to reduce the contract balance.
518. In re Kelly, 51 B.R. 9 (Bankr. E.D. Mich. 1984) [vendor took possession pursuant to forfeiture judgment seven days after windstorm destroyed barn; forfeiture has effect of eliminating purchaser’s debt, equivalent to foreclosure of mortgage that yields a price equal to full amount of mortgage debt).
vendor under a land contract is treated as a mortgagee under a fire insurance policy obtained by the purchaser, which named the purchaser as owner of the property and the vendor as “mortgagee or secured party.” The insurer denied the purchaser’s claim due to the purchaser’s misconduct, but the court ruled that the insurer was liable to the vendor under a standard mortgagee clause, with the insurer holding subrogation rights against the purchaser to the extent of any payments made to the vendor. The court observed that the parties’ relationship was “the functional equivalent of a mortgagor-mortgagee relationship.” Similarly, another New York court held that a policy insuring a vendor and a purchaser “as interest may appear” was not voided as to the vendor by reason of the purchaser’s arson.

In an appropriate case, the vendor can recover on an insurance policy obtained by the purchaser even though the policy does not name or mention the vendor. In Marbach v. Gnadt, the contract obligated the purchasers “as additional security to keep all buildings on aforesaid premises insured in such company or companies as the said party of the first part may direct for at least the sum of unpaid balance of purchase price.” A forfeiture provision in the installment land contract entitled the vendors to terminate the contract for a breach by the purchasers and to retain all payments in liquidation of damages sustained. The purchasers obtained insurance and after a fire they defaulted in making payments, prompting the vendors to declare a forfeiture. Both the vendors and the purchasers claimed the insurance proceeds. The court allowed the vendors to recover the insurance proceeds, up to the unpaid balance due on the contract, reasoning that they had an equitable lien upon the insurance policies. The vendors’ declaration of forfeiture voided the contract as of the time of the breach, not ab initio. On forfeiture, the vendors were entitled to the land, and after the damage the insurance proceeds stood in its place.

§ 3:7.3 Building Removal

The New York statutory form mortgage provides:

3. That no building on the premises shall be removed or demolished without the consent of the mortgagee.

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520. Id. at 946.
523. Id.
524. N.Y. REAL PROP. LAW § 258, Sch. M.
The purpose of the clause is to give the mortgagee “notice and an opportunity to safeguard his security interest in the event the mortgagor intend[s] to remove or demolish the structure on the mortgaged property.” Thus, the mortgagee’s consent is unnecessary if the government condemns a structure, ordering its demolition as a safety hazard. Likewise, this clause does not obligate the mortgagor to take affirmative steps to prevent strangers from demolishing or injuring a building.

This covenant may be amplified by forbidding material alterations of the buildings on the premises, requiring the mortgagor to maintain the premises in a state of repair and in accordance with requirements of law, and permitting the mortgagee’s inspection to ascertain compliance with these obligations. In the absence of this addition and a satisfactory acceleration clause, a mortgagor is not bound to rebuild or repair structures destroyed by fire or otherwise damaged without his fault, and such condition does not authorize acceleration of the mortgage debt.

When the mortgage allows acceleration for the removal of buildings, the failure to make repairs, or the making of alterations without the mortgagee’s consent, the mortgagee must prove impairment of security in order to accelerate and foreclose. Impairment may exist even though the mortgagee is adequately secured if the removal or change substantially reduced the property value.


526. Id. (demolition apparently needed due to casualty; mortgagor collected insurance proceeds).

527. Garliner v. Glicken, 196 N.Y.S.2d 784 [Sup. Ct. Monroe County 1960] (claim that mortgagor failed “to provide adequate guards or watchmen against vandalism,” thus permitting “cottages in effect to become substantially demolished”).


531. Laber v. Minassian, 511 N.Y.S.2d 516 [Sup. Ct. 1987] (removal of gas station; value with improvements was $233,000 and value without was $220,000; debt was far less).
§ 3:7.4 Acceleration of Debt

The New York statutory form mortgage provides:

4. That the whole of said principal sum and interest shall become due at the option of the mortgagee: after default in the payment of any installment of principal or of interest for ___ days; or after default in the payment of any tax, water rate or assessment for ___ days after notice and demand; or after default after notice and demand either in assigning and delivering the policies insuring the buildings against loss by fire or in reimbursing the mortgagee for premiums paid on such insurance, as hereinbefore provided; or after default upon request in furnishing a statement of the amount due on the mortgage and whether any offsets or defenses exist against the mortgage debt, as hereinafter provided.\footnote{532}

The blanks for numbers of days are to be filled in. Failure to do so raises a substantial risk that the mortgagee has no right to accelerate the debt for the first two reasons mentioned in the clause. One court held that a failure to fill in blanks relating to the “grace period” implied a right in the mortgagee to declare the mortgage due within a reasonable time after default.\footnote{533} There appears to be no justification for this result. Delivery of an executed contract, with blanks, implies authority to fill in the blanks as the parties contemplated,\footnote{534} particularly where the blanks are purely formal.\footnote{535} But, where the blanks indicate a failure even to consider the matter in question, the entire clause is disregarded, as if it were not part of the contract.\footnote{536}

\footnotetext[532]{N.Y. REAL PROP. LAW § 258, Sch. M.}
\footnotetext[533]{Genton Realty Corp. v. Balsamo, 132 N.Y.L.J. 12, Oct. 18, 1954 [Sup. Ct. 1954]. \textit{Compare} Grayson v. LaBranche, 225 A.2d 922 [N.H. 1967] [buyer entitled to benefit of mortgage contingency, which had blank, not filled in, for amount of loan].}
\footnotetext[535]{Kinney v. Schmitt, 12 Hun. 521 [N.Y. 1878] [blank could be filled in with “his” or “her”].}
This clause requires no notice before accelerating for nonpayment of an installment of principal or of interest. The court in Charter One Bank, FSB v. Leone explained:

[W]here, as here, a mortgage contains an acceleration clause in statutory form, neither notice of default nor demand for payment is a condition precedent to the commencement of a foreclosure action, as plaintiff’s act of commencing the action and the filing of a lis pendens constitutes a valid election to accelerate the maturity of the unpaid principal balance and accrued interest.

Notwithstanding the mortgagor’s lack of a legal right to notice of acceleration under the statutory form for default in paying principal and interest, the mortgagee nevertheless should follow the practice of giving notice to the mortgagor, even for five or ten days, for nonpayment of all monetary defaults, just in case the payment is misdirected or the amount of the payment is incorrect. For nonmonetary repairs, involving repair construction, curing violations, etc., the notice should be longer, but should provide that the mortgagor’s beginning with promptness and continuing with reasonable diligence and continuity should prevent acceleration. The mortgagor should be permitted to pay assessments in installments where permitted and to challenge any taxes or other impositions before any lien or penalty is incurred.

The acceleration clause is necessary because the doctrine of anticipatory breach, as the basis for immediate action against one who repudiates an executory contract, has no application to contracts for the payment of money only. Accordingly, the failure of a mortgagor to meet installments of principal or interest, or to pay taxes, assessments, or insurance will not cause the whole debt to mature at once upon default, absent a provision in the mortgage to such effect.

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539. Id. at 514 [citations omitted].
Similarly, a provision for acceleration for failure to pay interest or taxes does not permit acceleration for failure to pay installments of principal.541

The New York covenant explicitly requires notice before accelerating for nonpayment of taxes, water, or assessments.542 When notice of acceleration is given, or required to be given, a notice that the debt may be accelerated is insufficient.543 The notice must be given to the mortgagor or there must be some unequivocal overt act that accomplishes an election.544

Taxes have been held in default under these clauses as soon as the taxes begin to bear interest.545 A mortgagor’s breach of other covenants in the mortgage does not, per se, permit acceleration of the mortgage debt.546 Accordingly, the acceleration clause is sometimes expanded to cover a breach of any of the mortgagor’s covenants, so that the mortgage debt may be declared due and payable on breach of any covenant on the mortgagor’s part that is included in the mortgage. A sentence is sometimes added to the effect that any right the mortgagee may otherwise have for breach of covenant or for injunctive relief is not thereby impaired.

A court may refuse to enforce an acceleration clause where refusal does not impair the mortgagee’s security. This was true in case of

Where a mortgage, but not the accompanying note, contains an acceleration clause there is conflict on the effect of this clause on the note. Some hold the acceleration is limited to a mortgage foreclosure. Others hold the clause permits advancement of the debt for all purposes. See authorities collected in Poultrymen’s Serv. Corp. v. Brown, 185 A.2d 706 [N.J. Super. Ct. 1962]; Note, 15 Ala. L. Rev. 549 [1963]. The question does not arise where the acceleration clause is incorporated in the note by reference, as by a provision permitting the holder of the note to accelerate in case of any default that would permit acceleration of the mortgage, or where the note also contains an acceleration clause. In the absence of an acceleration provision, the statute of limitations runs separately to each installment as it becomes due. Visioneering, Inc. Profit Sharing Trust v. Belle River Joint Venture, 386 N.W.2d 185 [Mich. Ct. App. 1986]. If there is no election to accelerate, the statute does not begin to run until the last date for payment of the principal. In re Lake Townsend Aviation, Inc., 361 S.E.2d 409 [N.C. Ct. App. 1987].

failure to pay real estate taxes and maintain hazard insurance.\textsuperscript{547} It
has also been held true in case of removal of buildings\textsuperscript{548} or waste.\textsuperscript{549}
Equity has denied acceleration when its strict enforcement would
impose an unconscionable hardship on the mortgagor and give the
mortgagor an unconscionable advantage.\textsuperscript{550}

The right to accelerate may be waived.\textsuperscript{551} If a pattern of late
payments leads the mortgagor to believe it may continue, he may be
entitled to notice and warning before the mortgagee elects to accel-
erate.\textsuperscript{552} This would not apply if the mortgagee has made continual
objections and warnings to the mortgagor or if the mortgage provides
for acceleration without notice.\textsuperscript{553} A mortgage clause providing that a
waiver of a right to accelerate upon one default shall not constitute a

\textsuperscript{547} Brady v. Edgar, 415 So. 2d 141 (Fla. Dist. Ct. App. 1982).

\textsuperscript{548} See supra section 3:7.3.

\textsuperscript{549} See infra section 3:8.1.

\textsuperscript{550} United States v. Forrester, 118 F. Supp. 401, 412 [W.D. Ark. 1954]; Mid-
Mortgages § 495(6) [1949].

\textsuperscript{551} The right to accelerate may be waived.\textsuperscript{552} If a pattern of late
payments leads the mortgagor to believe it may continue, he may be
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for acceleration without notice.\textsuperscript{554} A mortgage clause providing that a
waiver of a right to accelerate upon one default shall not constitute a

\textsuperscript{552} See infra notes 565–68, particularly Cardozo, J. in Graf

\textsuperscript{553} Miller v. Uhrick, 706 P.2d 739 [Ariz. 1985], approved,
N.Y.S.2d 190 [App. Div. 1st Dep't 1982].

\textsuperscript{554} Acceleration is disallowed when payment of an installment is impos-

\textsuperscript{555} A statute permitting waiver of notice to accelerate [ME. REV. STAT. ANN.
tit. 11, § 3-511 (1964)] has been enforced. Maine Sav. Bank v. Chee, 576
A.2d 1358 [Me. 1990].

\textsuperscript{556} Miller v. Uhrick, 706 P.2d 739 [Ariz. 1985], approved,
N.Y.S.2d 190 [App. Div. 1st Dep't 1982].

\textsuperscript{557} T.rs. of Wash.-Idaho-Mont. Carpenters-Employers Ret. Trust Fund v. Galleria
clause); Caulder v. Lewis, 338 S.E.2d 837 [S.C. 1986]; Allendale Furniture
Co. v. Carolina Commercial Bank, 325 S.E.2d 530 [S.C. 1985]. For the
comparable rule with respect to rents, see 2 MILTON R. FRIEDMAN, FRIEDMAN ON LEASES § 16:5.1 [Patrick A. Randolph, Jr., ed., 5th ed.
PLI 2006].

\textsuperscript{558} Trs. of Wash.-Idaho-Mont. Carpenters-Employers Ret. Trust Fund v. Galleria
clause); Caulder v. Lewis, 338 S.E.2d 837 [S.C. 1986]; Allendale Furniture
Co. v. Carolina Commercial Bank, 325 S.E.2d 530 [S.C. 1985]. For the
comparable rule with respect to rents, see 2 MILTON R. FRIEDMAN, FRIEDMAN ON LEASES § 16:5.1 [Patrick A. Randolph, Jr., ed., 5th ed.
PLI 2006].
waiver at another time has been enforced, but the circumstances and the jurisdictions in which non-waiver clauses are enforced is the subject of considerable variation.

Some acceleration clauses provide that the mortgage will become due and payable a specified number of days after default. The majority cases hold this clause is not self-operative, but is for the benefit of the mortgagee, who has the option to accelerate or not. Acceleration requires an affirmative act or election by the mortgagee, which may consist of an unequivocal declaration by the mortgagee to the mortgagor that he is exercising the option. Until such election, tender of payment by the mortgagor is permitted. In the case of co-mortgagees, the election to accelerate must be made by both to be effective.

§ 3:7.4 FRIEDMAN ON CONTRACTS


For mortgagee’s ambiguous behavior as a bar to acceleration, see First Fed. Sav. & Loan Ass'n v. Stone, 467 N.E.2d 1226 [Ind. Ct. App. 1984].


The New York cases were distinguished in Creamer v. Aultman, 445 So. 2d 382 [Fla. Dist. Ct. App. 1984], where the owner made half payments to each co-owner, was up to date with one but not the other. The latter was permitted to accelerate and foreclose his part on joining the co-owner as defendant. The court relied on English cases.
Provisions for payment of late charges are enforceable prior to acceleration, but not thereafter, when the mortgagee may refuse to accept installment payments. “Default interest,” that is, higher interest after the mortgagor’s failure to pay at a specified time, has been held enforceable in some cases, but not in others.


Late charges have been approved in bankruptcy. See BANKRUPTCY CODE § 506(b) [1979]; In re LHD Realty Corp., 726 F.2d 327, 333 [7th Cir. 1984]; Shadhali v. Hintlian, 41 Conn. App. 225, 675 A.2d 3 [1996].

561. Sec. Mut. Life Ins. Co. v. Contemporary Real Estate Assocs., 979 F.2d 329 [3d Cir. 1992] [suggesting possibility of contra result if mortgage so provides]; In re Tavern Motor Inn, Inc., note 560 supra. A mortgagee suing under acceleration for the entire debt is not entitled to late charges on an installment. Reis v. Decker, 516 N.Y.S.2d 851 [County Ct. Delaware County 1987]. Somewhat comparable is a New Jersey case holding late charges were applicable to payment of rent but not to nonpayment. Fanarjian v. Moskowitz, 568 A.2d 94 [N.J. Super. Ct. 1989].

Late charges were held inapplicable to the balance of the mortgage debt, that is, to the balloon payment. The mortgage entitled mortgagee to attorneys fees. A different result would give double recovery. Trustco Bank v. 37 Clark St., Inc., 599 N.Y.S.2d 404 [Sup. Ct. Saratoga County 1993].

562. Eyde Bros. Dev. Co. v. Equitable Life Ins. Co., 697 F. Supp. 1431 [W.D. Mich. 1988], allowed default interest. In re Entz-White Lumber & Supply, Inc., 850 F.2d 1338 [9th Cir. 1988], held that a debtor may cure a defaulted mortgage note at the contract interest rate as opposed to the default rate, because curing is supposed to return a claim to its pre-fault condition and is not supposed to enable the mortgagee to impose its distribution scheme on the bankruptcy court. Conversely, in dicta, In re LHD Realty Corp., 726 F.2d 327 [7th Cir. 1984], suggests that a mortgagee may have an allowable claim for a late charge designed to cover the extra expense involved in handling delinquent installments.
Minority states distinguish between notice by the mortgagee (1) of an election to accelerate, which they do not require or whose waiver they permit, and (2) of an intent to foreclose after a completed acceleration, which they do require.

When no definite time is specified a mortgagee’s election to accelerate must be made within a reasonable time after the event that gives rise to the right to accelerate.

A mortgagee who accelerates the mortgage debt may retract the acceleration, but not over the mortgagor’s objection, when the mortgagor has changed his position in reliance on the acceleration.

Once the mortgage debt has been accelerated by reason of default, may the acceleration be annulled by payment of the pre-acceleration arrears? The cases are split when the acceleration was based on nonpayment of interest or an installment of principal. There is less reluctance to annul an acceleration that was based on nonpayment of taxes, because “the puntual payment of interest has an importance to the lender as affecting his way of life, perhaps the very

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ALASKA STAT. § 34.20.070(b) [1990] permits an obligor under a note secured by a deed of trust to terminate a non-judicial sale and undo the effect of an acceleration clause by paying all preacceleration arrears. The statute may be invoked no more than twice. Hagberg v. Alaska Nat’l Bank, 585 P.2d 559 [Alaska 1978]. COLO. REV. STAT. § 38-39-118 [1990] is a similar statute, applicable to mortgage foreclosures, but not to an action on the note only. Smith v. Certified Realty Corp., 585 P.2d 293 [Colo. Ct. App. 1978].
means for his support, whereas the importance of payment of the taxes is merely as an assurance of security.\textsuperscript{568} In bankruptcy cases, annulment of acceleration may be permitted even where state courts would hold otherwise.\textsuperscript{569} Statutes in a number of states permit reinstatement of an accelerated mortgage debt prior to a foreclosure sale on payment of arrears without acceleration.\textsuperscript{570}

The dominant cases hold that the mortgagee’s acceptance of an installment payment after acceleration is a waiver of acceleration, absent some compelling reason to the contrary.\textsuperscript{571}

If a mortgage provides for payment of an installment at a specified time, or permits acceleration at a specified time for nonpayment, and also includes a provision for late charges if payment is not made at a later time, which provision governs? The few cases are not in accord. Some allow the mortgagee to treat the mortgagor as in default before the date on which a late charge is assessable,\textsuperscript{572} but others allow the mortgagor the benefit of a grace period, during which acceleration is precluded.\textsuperscript{573} It would be well to clarify this in the mortgage.

Some mortgages make nonpayment of taxes a default that permits foreclosure with no prior notice. But payment before foreclosure precludes foreclosure.\textsuperscript{574}

The mortgagor may direct, when making payment, whether his payment is to be applied to principal, interest, or taxes, and the mortgagee is bound by this direction.\textsuperscript{575}

\textsuperscript{570} See statutes collected in In re LaPaglia, 8 B.R. 937, 945 [Bankr. E.D.N.Y. 1981]. A statutory modification that eliminated a mortgagor’s right to reinstate a mortgage was held “substantial,” as distinguished from “procedural,” and was denied retroactive effect. Wash. Nat’l Ins. Co. v. Sherwood Assocs., 795 P.2d 665 [Utah Ct. App. 1990].
\textsuperscript{572} E.g., Auto-Plaza, Inc. v. Cent. Bank, 394 So. 2d 6 [Ala. 1980] [fifteen-day late payment charge does not create “grace period”; allowing acceleration when mortgagor tendered payment three days late].
\textsuperscript{573} Baypoint Mortgage v. Crest Premium Real Estate Inv. Ret. Trust, 214 Cal. Rptr. 531 [Ct. App. 1985] [time not of the essence with respect to payment on first of month due to late payment fee]; Fed. Home Loan Mortgage Corp. v. Taylor, 318 So. 2d 203 [Fla. Dist. Ct. App. 1975] [late payment fee creates “grace period” within which mortgagor may pay installment “without further obligation”; acceleration not allowed when mortgagor tendered installment before due and mortgagee had accepted prior past-due installments with late charges included].

(Friedman on Contracts, Rel. #7, 5/09) 3–121
The mortgagor’s payment by mail is not operative as payment unless received, or the mortgagee had consented to payment by mail.576

§ 3:7.5 Appointment of Receiver

The New York statutory form mortgage provides:

5. That the holder of this mortgage, in any action to foreclose it, shall be entitled to the appointment of a receiver.577

This clause entitles the mortgagee to the judicial appointment of a receiver without notice or regard to adequacy of the security of the debt.578 Under the statutory construction, the mortgagor “shall be entitled, without notice and without regard to adequacy of any security of the debt, to the appointment of a receiver of the rents and profits of the premises covered by the mortgage.”579 The New York practice of dispensing with notice does not deprive a mortgagor of due process.580 Under this clause, the mortgagee’s procurement of a receiver does not require him to show probable success in the foreclosure action.581

Without the receivership clause the mortgagee must move for a receiver on notice and on proof of inadequacy of the security.582 In federal courts a showing of more than inadequacy of security and doubtful financial standing of the debtor is necessary to warrant a

577. N.Y. REAL PROP. LAW § 258, Sch. M.
579. N.Y. REAL PROP. LAW § 254[10].
      Life Ins. Co. v. Hodroit Assocs., 606 A.2d 1150 [N.J. Super. Ct. 1992], departs from earlier New Jersey cases and grants a receiver on a comparable clause. If noted, the mortgagor was not liable on the mortgage debt.
      Despite the clause a court has discretionary power to deny the application. See Home Title Ins. Co. v. Isaac Scherman Holding Corp., 267 N.Y.S. 84 [App. Div. 2d Dep’t 1933] (delayed application).
receiver. But when a federal bankruptcy court applies state law, as it must in determining whether a property interest has been perfected, mortgagees filing a claim to cash collateral in the form of rental income entitles the mortgagee to recover rental income where this would be true under state law. Where the mortgagee is the Department of Housing and Urban Development (HUD), a federal interest is involved and federal, not state, law applies. In many jurisdictions a mortgage provision for appointment of a receiver does not entitle a mortgagee to a receiver as a matter of right. These cases hold that the parties cannot force a court of equity to grant a remedy to a party who does not need it.

The receivership clause may also contain the following obligations of an owner of the premises:

1. To pay to the receiver the use and occupational value of the premises.

Absent such provision, the owner may occupy the premises free during the pendency of a foreclosure.


For the Minnesota law, see In re Johnson, 108 B.R. 689 (Bankr. D. Minn. 1989).


Appointment of a receiver is by federal standards, though once appointed his powers are those of the state. For the federal standards, see Midwest Sav. Ass’n v. Riversbend Assocs. P’ship, 724 F. Supp. 661 (D. Minn. 1989).


585. BANKRUPTCY CODE § 546(b).


A prepetition demand by mortgagee had the same effect under a Florida statute that makes mortgagor’s assignment of rents absolute upon mortgagor’s default and mortgagee’s written demand. In re 163rd St. Mini Storage, Inc., 113 B.R. 87 (Bankr. S.D. Fla. 1990).


Though a mortgagee may obtain a receiver without notice, the owner’s liability for rent, or use and occupational value may be fixed only after notice. Essex v. Newman, 632 N.Y.S.2d 636 (App. Div. 2d Dep’t 1995).
2. To permit the mortgagee, in event of default, to take possession of the premises and collect rent from the tenants and use and occupational value from an owner in possession.

This clause, however, is not effective for its stated purpose in New York\footnote{590} and in a number of other states where a mortgage is deemed a lien, as distinguished from the “title” theory states.\footnote{591} In those states, a mortgagee’s right to possession can be predicated only upon a consent of the owner given after default or by the mortgagee’s impounding the rents by receivership or otherwise. Despite this general rule, several states have held that a mortgage default plus a mortgagee’s demand entitles the mortgagee to the rents.\footnote{592} The same

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A mortgage provision entitling a receiver to rent and “use and occupational value” was one factor in disregarding a twenty-year lease at $1.00 a month rent. N.Y. City Cmty. Pres. Corp. v. Michelin Assocs., 496 N.Y.S.2d 530 [App. Div. 2d Dep’t 1985].


\footnote{592} In re Wheaton Oaks Office Ltd. Partners, 27 F.3d 1234 [7th Cir. 1994]; Fed. Home Loan Mortgage v. Tarrytown Corp., 822 F. Supp. 137 [S.D.N.Y. 1993]; Accord Fed. Home Loan Mortgage Corp. v. Dutch Lane Assocs., 775 F. Supp. 133 [S.D.N.Y. 1991] [distinguishing cases where the rent assignment was only for security]; In re 5028 Wis. Ave. Assocs., 167 B.R. 699 [Bankr. D.D.C. 1994] [rents to be used by mortgagee for maintaining property; landlord’s demand before bankruptcy effective]; In re Seaside Co.,
was true where a foreclosure was begun before a stay caused by the mortgagor’s bankruptcy.593

3. To hold the rents and profits of the premises, after default, in trust to pay taxes, carrying charges, and for service of the mortgage debt.

In many states there is now a tendency for the mortgage to provide that the rents belong to the mortgagee immediately on default by the mortgagor and notice of the default by the mortgagee to the mortgagor.594 This avoids the necessity of a receivership, but query if it


This was true even though the instrument permitted the mortgagor to use the rents until default and despite the mortgagor’s filing for bankruptcy a few days after the default. In re Scotsdale Med. Pavilion, 159 B.R. 295 [B.A.P. 9th Cir. 1993].

The distinction between an absolute assignment and one “for further security” was also made in In re Vienna Park Props., 136 B.R. 43 [Bankr. S.D.N.Y. 1992] [Virginia law]. Vienna Park distinguishes between a mortgagee’s perfection of a right to rent, which may be merely by recordation, and its enforcement. The case determines the mortgagee’s right in bankruptcy, In re Scotsdale Med. Pavilion, 159 B.R. 295 [B.A.P. 9th Cir. 1993].

Vienna Park determined that mortgagee’s right to rents failed because it was not enforced prior to bankruptcy. [Accord In re Vienna Park, 976 F.2d 106 [2d Cir. 1992]]. Following Vienna Park, 136 B.R. at 54, In re Mount Pleasant Ltd. P’ship, 144 B.R. 727 [Bankr. W.D. Mich. 1992], ruled that perfection of a lien is putting third parties on notice, while its enforcement realizes the right, and that mortgagee’s notice in bankruptcy [while a stay is in force] has the same effect. Mt. Pleasant was disregarded on the basis of MICH. COMP. LAWS ANN. § 554.232 [1988]; In re Newberry Square, 175 B.R. 910 [Bankr. E.D. Mich. 1994]. Connecticut is in accord with Vienna Park on the distinction of assignment and perfection of the right to rents. It held that an assignment of existing and future rents was sufficient to vest a right to the rents without more, prevailing over a creditor under CONN. GEN. STAT. § 49-10 [1994].


594. Until the mortgagee takes actual possession it has no right to the rents. In re Ledgemere Land Corp., 116 B.R. 338 [Bankr. D. Mass. 1990]. But it has also been held in Massachusetts, a title state, that mortgagor’s default and mortgagee’s demand establish mortgagee’s right to rents, although there was no collection until after mortgagor’s bankruptcy. In re White Plains Dev. Corp., 136 B.R. 93 [Bankr. S.D.N.Y. 1992] [Massachusetts law].

(Friedman on Contracts, Rel. #7, 5/09) 3–125
assures the tenants who pay the rents that they will receive the maintenance and services they are entitled to from the mortgagor. A federal court sitting in New York enforced such a clause. But a clause stating it is absolute but permitting the mortgagor to collect rents until a default or otherwise, qualifying its enforcement, is construed as merely for security and not an absolute assignment. In Colorado and New Jersey an assignment of rents clause in a mortgage may be self-executing upon default, as distinguished from a pledge of rents as a security device that requires affirmative action by the mortgagor. In Indiana an assignment of rents to a mortgagee as security, followed by a mortgagor’s default, a foreclosure, and appointment of a receiver, did not give title to the rents to the mortgagee where all this was followed by the mortgagor’s bankruptcy under Chapter 11, with the mortgagor as a debtor in possession. The mortgagee’s receiver was held a mere custodian of the rents without title. Title was held in the

In practical terms, the difference between a “lien theory” and a “title theory” as to the nature of a mortgage is that under the latter the mortgagee may enter into possession of the mortgaged premises upon default and before foreclosure, whereas under the “lien theory” there is no right of possession; the mortgagee must await sale of the mortgaged property and obtain satisfaction of the mortgagor’s debt from the proceeds of sale. Maglione v. BancBoston Mortgage Corp., 557 N.E.2d 756, 758 [Mass. App. Ct. 1990].


Even in Florida, a pledge of rents requires a mortgagee to take possession or obtain a receiver. In re Ormand Beach Assocs., Ltd. P’ship, 204 B.R. 336 [Bankr. D. Conn] [citing Florida cases].

Wisconsin upholds provisions entitling a mortgagee to rents on default, although it disapproves of them because they afford an easy way of evading the lien theory. In re Century Inv. Fund VIII Ltd. P’ship, 937 F.2d 371, 377 [7th Cir. 1991]. In Century the court noted that the mortgagor had taken further affirmative action.
estate of the debtor. In Delaware, a lien state, an absolute assignment was held merely for security in the face of inconsistent language. The case noted that some title states would reach the same result. Iowa holds that a mortgage that grants rents, in distinction to pledging them, entitles the mortgagee, as against the mortgagor, to rents from the inception of the mortgage with no further action by the mortgagee. Other states hold that an unconditional assignment of rents to the mortgagee entitles the mortgagee without more, other than possible remand, on the mortgagor’s default. In a “title” state then the mortgagee is automatically entitled to the rents on the mortgagor’s default, but this is not always true in the bankruptcy of the mortgagor.

A mortgagee who was barred from enforcing his right to rents, by reason of an automatic stay in the bankruptcy of his mortgagor, was held entitled to receive rents collected by the trustee in bankruptcy after the stay was lifted.

The effect of the mortgagor’s bankruptcy on the mortgagee’s right to post-petition rents should be noted. In a title theory state, a


mortgagee’s right accrues on default in the mortgage, which is not changed by bankruptcy. In the lien states there is a split. There it has been held that bankruptcy of the mortgagor, and its consequent automatic stay, does not bar the mortgagee’s right to rents if he files a post-petition notice of this claim under section 546(b) of the Bankruptcy Code. However, there is solid authority contra.

By obtaining a receiver instead of being a mortgagee in possession the mortgagee avoids the responsibility of a mortgagee in possession. A mortgagee in possession has the right and duty to collect rents and is liable for waste or gross mismanagement of the property or its depreciation due to a failure to make necessary and proper repairs.

The right of a mortgagee in possession or a receiver to collect rents that are past due when the receiver is appointed or the mortgagee takes possession is the subject of slight authority.


606. In re Colter, Inc., 46 B.R. 510 [Bankr. D. Colo. 1984]. Saline State Bank v. Mahloch, 834 F.2d 690 [8th Cir. 1987] [construing Nebraska law], involved Chapter 11 proceedings that were begun before the mortgage went into default. It held that the mortgagee’s right to rents did not accrue upon the post-petition default, but not until the mortgagee’s application to sequester the rents.


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Mortgagee’s suggestion of the name of a receiver who is subsequently appointed does not make the receiver an agent of the mortgagee or make the mortgagee liable for deterioration of the property during the receivership. In re Greenlief Apts., Ltd., 158 B.R. 456 [Bankr. S.D. Ohio 1993].

Acceptance of rent by a mortgagee in possession does not convert him into a landlord or preclude him from purchasing at foreclosure and terminating a lease. Reilly v. Firestone Tire & Rubber Co., 764 F.2d 167, 172 [3d Cir. 1985]; 51 C.J.S. Landlord & Tenant § 93[5], at 309 [1968].

609. MDFC Loan Corp. v. La Salle Nat’l Bank, 834 F. Supp. 275 [N.D. Ill. 1993], awarded such rents to the receiver after a good discussion and citing older cases that are not clearly applicable. It remarked that a mortgagor in default is in no position to object to back rents being applied to the debt, but indicates a different position if nonpayment was due to collusion.
A substantial mortgage of commercial property may include a broad rent pledge covering “rents, issues, revenues, and profits,” or the like. If the mortgagor operates a business that generates income from the operation of real estate, as well as from business operations, there may be a conflict on what is included in the rent pledge. The scope of rent pledges by hotels has proven to be a vexing problem. The majority cases hold that income from hotel rooms is not rent.\footnote{In re Tollman-Hundley Dalton, L.P., 162 B.R. 26 (Bankr. N.D. Ga. 1993); In re Shore Haven Motor Inn, Inc., 124 B.R. 617 (Bankr. S.D. Fla. 1991); In re Punta Gorda Assocs., 137 B.R. 535 (Bankr. M.D. Fla. 1992); In re Nendels-Medfor Joint Venture, 127 B.R. 658 (Bankr. D. Or. 1991) [also holding income from food and beverages not rent; distinguishing In re Mid-City Hotel Assocs., on ground of broad language quoted above]. Contra In re T-H New Orleans Ltd. P’ship, 148 B.R. 456 (E.D. La. 1992); In re S.F. Drake Hotel Assocs., 131 B.R. 156 [Bankr. N.D. Cal. 1991]. See Donahue & Edwards, The Treatment of Assignments of Rents in Bankruptcy; Emerging Issues Relating to Perfections, Cash Collateral, and Plan Confirmation, 48 BUS. LAW. 633, 639–40 (1993). The majority cases are the subject of an extended criticism for their reasoning as well as their result in diluting a lender’s security and making financing difficult for hotels. Boyce, Hotel Revenues in Bankruptcy: An Analysis and Analytic Framework, 28 REAL PROP. PROBATE & TR. J., 535–92 (Fall 1993).} One case ruled that room charges were not rent, but were included in “issues and revenues.”\footnote{In re Mid-City Hotel Assocs., 114 B.R. 634 (Bankr. D. Minn. 1990). In Great W. Life Ins. Co. v. Raintree Ins., 837 P.2d 267 (Colo. Ct. App. 1992), the assignment clause was broad enough to include the entire hotel income. Accord In re Churchill Props., Ltd. P’ship, 164 B.R. 607 [Bankr. N.D. 1994] (“rent issues and profits sufficient to make hotel income rents”); Great W. Life & Annuity Assurance Co. v. Park Imperial Canton, Ltd., 177 B.R. 843 [Bankr. N.D. Ohio 1994] (“profit,” as distinguished from rent, includes hotel revenues—room revenues, food, beverages, etc.; remanded to determine if filing sufficient under Ohio statute); Travelers Ins. Co. v. First Nat’l Bank, 621 N.E.2d 209 [Ill. App. Ct. 1993] [same], contra In re Tri-Growth Centre City, Ltd., 133 B.R. 524 [Bankr. S.D. Cal. 1991].} Income from the restaurant and bar was not included, nor was income from the sale of tangible items.

Similar problems arise for other businesses. Revenues from a nursing home were deemed based mainly on service and not rent.\footnote{In re Hillside Assocs., Ltd. P’ship, 121 B.R. 23 [B.A.P. 9th Cir. 1990].} Income of a golf course—fees, receipts of bar and restaurant, and sales—were not rent.\footnote{In re McCann, 140 B.R. 926 [Bankr. D. Mass. 1992] [Ohio law].} A storage bin agreement was held a lease and payments thereunder cash collateral.\footnote{In re Safeguard Self-Storage Trust, 2 F.3d 967 [9th Cir. 1993] [California law].} “Tipping fees,” that is, charges

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\item \footnote{In re Kearney Hotel Partners, 92 B.R. 95, 99 [Bankr. S.D.N.Y. 1988], indicates that longer hotel stays and other circumstances may make hotel income rent more of a lease.} in re Kearney Hotel Partners, 92 B.R. 95, 99 [Bankr. S.D.N.Y. 1988], indicates that longer hotel stays and other circumstances may make hotel income rent more of a lease.

\item \footnote{In re Hillside Assocs., Ltd. P’ship, 121 B.R. 23 [B.A.P. 9th Cir. 1990].} in re Hillside Assocs., Ltd. P’ship, 121 B.R. 23 [B.A.P. 9th Cir. 1990].


\item \footnote{In re Safeguard Self-Storage Trust, 2 F.3d 967 [9th Cir. 1993] [California law].} in re Safeguard Self-Storage Trust, 2 F.3d 967 [9th Cir. 1993] [California law].
\end{itemize}
for depositing waste in a landfill, are not “rents or profits of property,” but instead are revenues derived from a business operation.615

§ 3:7.6 Payment of Taxes and Charges

The New York statutory form mortgage provides:

6. That the mortgagor will pay all taxes, assessments or water rates, and in default thereof, the mortgagee may pay the same.616

The statutory construction makes the mortgagee’s advances for these purposes additions to the mortgage debt.617 This part of the statute is unnecessary. It merely codifies the mortgagee’s common law rights.618 Advances so made by the holder of a junior mortgage remain subordinate, under the majority rule, to the lien of a paramount mortgage.619 If the tax is legal on its face, it is immaterial that the

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616. N.Y. REAL PROP. LAW § 258, Sch. M.
617. N.Y. REAL PROP. LAW § 254(6) [if mortgagee pays taxes, “the mortgagor will repay the same with interest, and the same shall be liens on said premises and secured by the mortgage”].

The mortgagee is entitled to reimbursement only on showing he paid the taxes. Law v. Dewoskin, 447 S.W.2d 361 (Tenn. 1969).


It is immaterial whether the mortgage expressly permits the mortgagee to add the advance to the mortgage debt, Buskirk, 169 S.E. 738, or includes no such provision, Pearmain, 92 N.E. 497. A junior mortgagee who pays the taxes thereby bars the senior mortgagee from foreclosing for nonpayment, and may not thereafter assert their existence as against the senior mortgagee, Laventall, 188 N.E. 271.

A mortgagor cannot buy a tax title and assert it successfully against a mortgagee. Danforth v. Gautreau, 556 A.2d 217 (Me. 1989) [mortgagor failed to pay real estate taxes].

The minority cases are collected in Annot., 84 A.L.R. 1366, 1393 (1933).
mortgagor claims that it is invalid. The mortgagee need not contest its legality at his own expense or let it go unpaid at his peril. The liquidation of charges for real estate taxes, water charges, and assessments is necessary because the liens of these items are paramount to existing mortgages.

A mortgage is paramount to a federal tax lien subsequently filed against the mortgagor. Advances made by the holder of such mortgage for taxes, water, insurance, and other charges are also paramount to the federal tax lien, even though the advances were made after the federal lien was filed. This is one change effected by the Federal Tax Lien Act of 1966. Before this, advances made after the filing of the federal lien were subordinate thereto, although made to protect a prior mortgage.

§ 3:7.7 Estoppel Certificate

The New York statutory form mortgage provides:

7. That the mortgagor within ___ days upon request in person or within ___ days upon request by mail will furnish a written statement duly acknowledged of the amount due on this mortgage and whether any offsets or defenses exist against the mortgage debt.

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A provision for payment of taxes when due was held enforceable, although no tax foreclosure was possible for three years. Resolution Trust Corp. v. Friesen, 783 F. Supp. 1292 [D. Kan. 1992].

622. I.R.C. § 6323[a] [1954]. A requirement that mortgagor pay all taxes and assessments that may become liens was held inapplicable to income taxes. Denise v. Paxson, 413 S.E.2d 433 [Ga. 1992].

A statute requiring the notice of federal lien to contain a description of the property is not binding on the federal government. The notice was held sufficient as against a subsequently recorded mortgage. United States v. Union Cent. Life Ins. Co., 368 U.S. 291 [1961].


625. N.Y. REAL PROP. LAW § 258, Sch. M.
This statement is known as an “estoppel certificate.” A mortgage securing a bond is a nonnegotiable instrument and an assignee takes subject to any defenses good as against the mortgagee. In New York the assignee is also subject to any latent equities that may exist in favor of unknown third parties. This rule is limited almost entirely to New York. The same is true where the mortgage secures a nonnegotiable note. This rule does not apply to agreements that are merely collateral to the mortgage and are not a part of the consideration that was the basis or foundation of the mortgage or was expressed in the mortgage. No well-advised party will accept an assignment of such mortgage without an estoppel certificate, and this clause entitles the mortgagee to one whenever the occasion requires.

More points should be noted about assignments of mortgages. An assignment of a mortgage or other security agreement, without including the mortgage note or bond or other evidence of the debt, is a nullity and vests no rights in the assignee. Conversely, one who pays a mortgage note, negotiable or not, or a mortgage bond without obtaining a surrender of such instrument is chargeable with notice of its possible assignment to a third person or some other defect in the payee’s position, and runs the risk of having to pay again to the then-owner of the instrument. An assignor of a mortgage warrants by implication that the mortgage is what it purports to be, that is, an existing valid legal obligation enforceable against the property ostensibly


For a discussion of estoppel certificates, the effect of duress in obtaining them, and of the assignee’s knowledge of defenses, see Hammelburger v. Foursome Inn-Corp., 431 N.E.2d 278 (N.Y. 1981).

627. In re Levine, 23 B.R. 410 (Bankr. S.D.N.Y. 1982); Schafer v. Reilly, 50 N.Y. 61 (1872); 55 AM. JUR. 2d Mortgages § 1042 (1996). Protection against the debtor is possible by an estoppel certificate from the debtor. This is not possible against unknown third persons.

628. 55 AM. JUR. 2d Mortgages § 1303 (1971); 59 C.J.S Mortgages § 371 (1948).


secured thereby, without guaranteeing its collection.\textsuperscript{633} Adding “without recourse” to the assignment indicates merely that there is no guaranty the debtor will pay the debt, but does not eliminate the implied representation that the mortgage is valid and effective.\textsuperscript{634}

\section*{§ 3:7.8 Notices}

The New York statutory form mortgage provides:

8. That notice and demand or request may be in writing and may be served in person or by mail.\textsuperscript{635}

In the absence of this provision, notice or demand by a mortgagee, or under any agreement or statute, generally must be made in person.\textsuperscript{636} This may be as difficult at times as the service of process.

\section*{§ 3:7.9 Warranty of Title}

The New York statutory form mortgage provides:

9. That the mortgagor warrants the title to the premises.\textsuperscript{637}

Without such covenant the mortgage does not impliedly warrant title; it operates only upon the present right of the mortgagor and an after-acquired right or title does not inure to the benefit of the mortgagee.\textsuperscript{638} But, if there is an express warranty of title in the mortgage, then if an interest that the mortgage purports to cover is not owned by the mortgagor at the inception of the mortgage, the mortgagor’s subsequent acquisition of such interest brings the same under the mortgage, on theory of estoppel.


\textsuperscript{635} N.Y. REAL PROP. LAW § 258, Sch. M.

\textsuperscript{636} Steinhardt v. Bingham, 75 N.E. 403 (N.Y. 1905) [seller’s contract obligation to give buyer notice of name of steamship and quantity of goods “within five days of the date of bill of lading” requires actual notice].

\textsuperscript{637} N.Y. REAL PROP. LAW § 258, Sch. M.


Operation of the warranty on after-acquired title may involve priorities vis-à-vis bona fide purchasers. \textit{See} section 8:12[D].

\textsuperscript{(Friedman on Contracts, Rel. #7, 5/09) 3–133}
The cases conflict on the application of this rule to purchase money mortgages. Some courts have distinguished purchase money mortgages from others, refusing to apply the doctrine of estoppel by deed, reasoning that any initial shortage results from the mortgagee-vendor’s failure to convey enough. This would not apply where the purchase money mortgage runs to a third person advancing part of the purchase price.

§ 3:8 Other Mortgage Clauses

The following sections discuss additional clauses, besides the New York statutory clauses in their original or amplified versions, which mortgagees often add to their instruments, in New York and in other states.

In New York, where the statutory form is amplified and added to, a provision may be included to the effect that the additional provisions shall be deemed in addition to and not exclusive of the statutory provisions, and that the latter shall receive the statutory construction. The purpose of this clause is to avoid the few questionable decisions that limit a statutory construction to mortgages following the statutory form literally.

§ 3:8.1 Waste

Most mortgage covenants have a waste clause, which in its simplest form merely codifies the mortgagor’s common law obligation not to commit waste: either voluntary waste, which consists of the mortgagor removing or damaging improvements; or permissive waste, which consists of the mortgagor failing to make necessary repairs or

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640. Robinson Shore Dev. Co. v. Gallagher, 133 A.2d 353 [N.J. Super. Ct. App. Div. 1957], rev’d on other grounds, 138 A.2d 726 (N.J. 1958), holds that where both deed and purchase money mortgage, which are part of the same transaction, contain covenants of title, the mortgagee is not entitled to a lien on an after-acquired title of the mortgagor, but is restricted to the title that he had conveyed to the mortgagor.

A grantee is not estopped from recovering against his grantor on a covenant against encumbrances by reason of a similar covenant in a purchase money mortgage running from the grantee to the grantor. Haynes v. Stevens, 11 N.H. 28 (1840). But where the purchase money mortgage contains a warranty of title, and the deed is without warranty, an after-acquired title of the mortgagor inures to the benefit of the mortgagee. Saunders v. Publishers’ Paper Co., 208 F. 441 [D.N.H. 1913].

otherwise take proper care of the property. Permissive waste generally includes keeping the property in reasonable and customary repair, but does not include restoration or rebuilding occasioned by a major casualty. The impairment may be by physical damage to the property or economic loss to the mortgagee.\textsuperscript{642} A California court held it was not waste for a mortgagor to fail to repair damage to buildings from an earthquake and a fire.\textsuperscript{643}

Most waste actions against mortgagors take place after the mortgagor has acquired title to the property through foreclosure. In most states, a mortgagee may maintain an action for waste prior to foreclosure and prior to any default by the mortgagor in paying the debt.\textsuperscript{644} This applies whether the state is a lien or title state.\textsuperscript{645} The owner of the property is liable for waste whether or not he is liable on the mortgage debt\textsuperscript{646} and even though he is solvent.\textsuperscript{647}

The mortgagee's recovery for waste prior to foreclosure is limited to the sum then owing on the mortgage debt\textsuperscript{648} and must be applied toward the mortgage debt.\textsuperscript{649}

\begin{itemize}
\item \textsuperscript{642} See Travelers Ins. Co. v. 633 Third Assocs., 14 F.3d 114 (2d Cir. 1994); Genesco, Inc. v. Monumental Life Ins. Co., 577 F. Supp. 72, 84 [D.S.C. 1983], aff'd, 747 F.2d 253 [4th Cir. 1984].
\item \textsuperscript{643} Krone v. Goff, 127 Cal. Rptr. 390 [Ct. App. 2nd Dist. 1975] (fire not due to mortgagor's negligence; mortgagee, a purchase-money mortgagee, would have been barred from recovery of deficiency judgment by anti-deficiency judgment statute). Cf. Watson, Impairment of Purchase Money Security by Disaster and Anti-Deficiency Judgment: The Sounds of Silence, 47 LA. B. Bull. 146 (1972).
\item For cases requiring mortgagee to foreclose and establish a deficiency as a prerequisite to recovery of damages for waste, see Hummer v. R.C. Huffman Constr. Co., 63 F.2d 372, 374 [7th Cir. 1933].
\end{itemize}
Under one line of cases, waste is actionable only if there is impairment of security. This is the majority rule in lien theory jurisdictions, which hold that the mortgagee does not have title to the mortgaged property, only a lien. The competing line of authority allows an action for waste prior to foreclosure, regardless of how well-secured the mortgagee happens to be. The value of any security remaining after any such recovery and application is immaterial, because the mortgagee bargained for such security.

The measure of damages for waste is either the cost to restore the premises or the decrease in market value resulting from the waste. A mortgagee who is out of possession need not mitigate damages.

Foreclosure and sale changes the analysis with respect to a mortgagee's waste claim. A mortgagee's bid for the full amount of the mortgage debt bars a claim for waste because he cannot thereafter establish a claim for impairment of security. This "full credit bid rule," however, does not necessarily bar other actions the mortgagee may have against the mortgagor. A mortgagee who bid the full amount of the debt in foreclosure was barred from recovering damages.

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despite his claim that the value of the property was less.\footnote{657} When the mortgagee purchases at foreclosure for a price less than the outstanding debt, his waste action against the mortgagor is preserved to the extent of the deficiency.\footnote{658}

In California, an action for “bad faith waste” against the mortgagor survives a foreclosure, despite the anti-deficiency judgment, to the extent that the foreclosure price is less than the debt.\footnote{659}

Whether nonpayment of real estate taxes is waste is the subject of conflicting cases.\footnote{660} The Restatement takes the position that it is waste when the mortgagor “fails to pay before delinquency property taxes or governmental assessments secured by a lien having priority over the mortgage.”\footnote{661} The issue usually is important only if the mortgage is non-recourse or is subject to anti-deficiency judgment legislation.

\section*{§ 3:8.2 Non-Recourse}

In substantial commercial transactions it is very common for the parties to include a nonrecourse provision in the promissory note and mortgage that purports to release the mortgagor from all personal

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\footnote{658.} A similar analysis follows with respect to a mortgagee’s claim against a third party who causes injury to the mortgage property. See Moseley v. Bi-Lo Supermarket, Inc., 341 So. 2d 222 [Fla. Dist. Ct. App. 1976] [after settlement of foreclosure action, mortgagee allowed to pursue action against judgment creditor of mortgagor based on pre-foreclosure damage incident to writ of execution]. For mortgagee’s recovery generally against mortar, its right to participate in mortgagor’s recovery against third party guilty of the waste, and the effect of mortgagor’s settlement with third parties on mortgagee’s rights, see Stevenson v. Goodson, 924 P.2d 339, 348–53 [Utah 1996]. Leipziger, The Mortgagee’s Remedies for Waste, 64 Cal. L. Rev. 1086 (1976), is a comprehensive consideration of the entire subject.


\footnote{661.} \textsc{Restatement [Third] of Property \cite{Mortgages} § 4.6(a)(3) [1997].}
The mortgage instruments may validly provide that the mortgagor will not be personally liable for the mortgage debt, thus limiting the remedy of the mortgage to the mortgaged premises. In the past, clauses for this purpose tended to give the mortgagor a complete release. A complete non-recourse mortgage leaves the mortgagor with the beneficial interest in the property, but subjects the lender to the risk of loss from all possible uninsured harm to the property, including failure to repair, failure to comply with all federal and local laws, misuse of the income of the property, etc.

Today, few institutional lenders make complete non-recourse loans. Modern non-recourse provisions generally have express “carve-outs,” which call for personal liability of the mortgagor for various, specified claims.

A provision making the mortgage nonrecourse does not absolve the mortgagor from personal liability for waste, although at times the nature of waste may not be certain. This is a default rule; a mortgagee may seek to include an express carve-out for waste, but in its absence many courts will protect the mortgagee from at least some types of serious waste. In Travelers Insurance Co. v. 633 Third Associates, a broadly worded non-recourse provision barred “any action or proceeding wherein damages or any money judgment shall be sought . . . , except a foreclosure action against the Mortgaged Property.” The mortgagee brought an action based on the mortgagor’s failure to pay real property taxes. The court ruled that this language precluded a tort action for damages for waste, but largely unwound this determination by holding in a subsequent appeal that the mortgagee could pursue claims in equity, seeking injunctive relief and specific performance of the mortgagor’s promise to pay taxes. Decisions such as Travelers demonstrate why mortgagees are better served by drafting express, precise carve-outs for waste, rather than leaving the matter to the courts.

662. This is exemplified in section 4.03(c)(ii) of the contract of sale for New York office, commercial, and multi-family residential premises, prepared by the Real Property Committee of the Association of the Bar of the City of New York, distributed by Julius Blumberg, Inc. (Form No. 154), New York, N.Y. 10013.
664. See Travelers Ins. Co. v. 633 Third Assocs., 14 F.3d 114 (2d Cir. 1994).
666. Travelers Ins. Co. v. 633 Third Assocs., 14 F.3d 114 (2d Cir. 1994). Query, would the clause in Travelers absolve a mortgagor from liability from an express clause not to remove buildings? In other words, to what extent will an exculpatory clause be enforced? See 2 MILTON R. FRIEDMAN, FRIEDMAN ON LEASES, ch. 17, Exculpatory Clauses [Patrick A. Randolph, Jr., ed., 5th ed. PLI 2006].
Some mortgage commitments expressly exclude waste from the nonrecourse provision and specify many other detailed items excluded from the mortgagor’s exculpation. The mortgagee seeks to limit the release to the mortgage debt alone, preserving personal liability for waste or the financial equivalent of waste. A sample clause for this purpose appears below:

A (1) Notwithstanding anything to the contrary contained in this mortgage, except as set forth in Subdivision B of this Article, the obligation of the mortgagor for payment of the mortgage debt is limited solely to recourse against the property secured by this mortgage; and in no event shall the mortgagor be personally liable for breach of this mortgage or the obligation hereby secured.

(2) The provisions of Subdivision A(1) shall apply to any bond, note, or collateral instrument evidencing the debt secured by this mortgage.

The provisions of Subdivision A of this Article shall not apply to any liability the mortgagor might have, but for said Subdivision A, for the commission of waste to the mortgaged premises or for the breach of any obligation of the mortgagor under this mortgage, or any instrument referred to in Subdivision A(2) of this Article, by: cancelling or modifying any lease, collecting any rent in advance of the current monthly rent, or failure to apply the net proceeds of any insurance against casualty or the net award of partial condemnation, which shall be paid to or applied on behalf of the mortgagor, to repair or restoration of the premises damaged by an event insured so against or by such condemnation, or for failing to hold the rents and profits of the mortgaged premises, after default, in trust to pay for real estate taxes, carrying charges of said premises, and for service of the mortgage debt.

It is unnecessary to include in the foregoing clause any reference to possible fraud or affirmative misrepresentation by the mortgagor in obtaining the mortgage because of the mortgagee’s other remedies for this.

Some lenders agree to non-recourse, but insert so many carve-outs as to leave the exculpation from liability with little value.


668. See the items listed and discussed in Morrison & Senn, Carving Up the “Carve-Outs” in Nonrecourse Loans, REAL PROP., PROB. & TR. J., May/June 1958.
Waste is not the only implied exception from the non-recourse provision. An Ohio court has ruled that a non-recourse clause does not bar the effect of an assignment of rent clause.\(^{669}\)

The non-recourse provision should provide for personal liability for liens affecting the property that are superior to the mortgage; and for liens subordinate to the mortgage, which are likely to involve personal liability of the mortgagor, except to the extent that the proceeds thereof have been applied to improvements.\(^{670}\) Query, should reference be made at this point to fraud or affirmative misrepresentation in obtaining the mortgage because the mortgagee has remedies for these? It has also been suggested that the carve-outs should include bad-faith cancellation of leases and unknown environmental problems.\(^{671}\) For some of these, reference is made to “milking” and the absolute assignment of rent to a mortgagee.

In effect, the diversity as to the nature and extent of carve-outs means that there are not just two types of mortgage loans: recourse and non-recourse. Rather, there is a broad spectrum ranging from unlimited personal liability to “complete non-recourse,” that is, no express carve-outs. In considering where to position itself within that spectrum, the mortgagee should give thought to the fiscal responsibility of the mortgagor, as well as to the amount of the equity vested in that party.

A clause excusing a mortgagor from liability for principal and interest leaves the mortgagor liable for other, possibly substantial, obligations.\(^{672}\) A line of Florida cases deal with variations of clauses providing that the mortgaged property is the “sole security” for the debt, highlighting the need for careful drafting if the mortgagor desires a non-recourse loan.\(^{673}\)

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\(^{671}\) These are included in a more extended discussion in Stein, Nonrecourse Carveouts: How Far Is Far Enough?, 1997 REAL ESTATE REV. at 3 (Winter 1997).

\(^{672}\) See Fed. Home Mortgage v. Inland Indus., 869 F. Supp. 99 (D. Mass. 1994) (mortgagee may collect late fees, attorneys’ fees, and other items under clause barring personal liability for principal and interest, but expressly preserving personal liability “for the payment of all other amounts payable under the Note and for the performance of all other covenants” in mortgage).

\(^{673}\) Mellor v. Goldberg, 658 So. 2d 1162 (Fla. Dist. Ct. App. 1995) (language stating land “shall be the sole security for the indebtedness . . . and a deficiency judgment shall not be obtained against the mortgagor in the event of foreclosure” is ambiguous; parol evidence is admissible to
The use of nominees or straw men to execute mortgage instruments in order to insulate the real party in interest from liability for the mortgage debt, is an alternative to mortgage execution by the real party in interest with the addition of non-recourse provisions.674

§ 3:8.3 Maintenance of Premises in Good Condition

In 1984, New York added a new statutory construction for a mortgagor’s covenant to maintain the premises and improvements in “good condition or repair” for a mortgage on property with residences for four or more families.675 Such a covenant means the mortgagor must keep the property “free from violations of applicable municipal or state laws, codes or regulations.”676 If a government agency certifies to the existence of a violation “involving a serious danger to the health and safety of the occupants” of the mortgaged property, the mortgagee is authorized to accelerate the debt and foreclose, unless the mortgagor cures the violation within a reasonable period of time, which is not less than thirty days.677 A 2008 amendment extended the construction to authorize acceleration and foreclosure upon the judicial appointment of an administrator, at the instance of tenants, to collect rents and apply them to remedy conditions dangerous to life, health, or safety.678

A clause permitting the mortgagee to declare the mortgage debt due and payable for failure to maintain the premises in a state of repair is generally not enforced unless the deterioration has impaired the mortgagee’s security.679

determine whether parties intended to allow mortgagee to bring action on the note); Thomas v. Hartman, 553 So. 2d 1256 [Fla. Dist. Ct. App. 1989] (language stating land “shall be the sole security for the note” does not bar personal judgment on debt); Heim v. Kirkland, 356 So. 2d 850 [Fla. Dist. Ct. App. 1979] (language stating land was sole security with no further recourse against the maker-mortgagor bars any claim for deficiency); Policastro v. Rudt, 180 So. 2d 472 [Fla. Dist. Ct. App. 1965] (personal judgment precluded by language in mortgage stating land shall be “sole security for payment of all sums” evidenced by note and mortgagor shall not “be personally liable” on note, even though note itself had no such language).

674. The use of nominees and straws is discussed in sections 6:1 and 6:1.3.
675. N.Y. REAL PROP. LAW § 254(4-a).
676. Id.
677. Id.
678. N.Y. Laws 2008, ch. 529, § 1, codified at N.Y. REAL PROP. LAW § 254(4-a) (cross referencing to N.Y. Real Property Actions and Proceedings article 7-a).

In Mahoney v. Furches, 468 A.2d 458 [Pa. 1983], a purchase money mortgagor sought without success (1) to subdivide and sell parts of the mortgaged property, and then (2) to prepay the debt. Neither was provided for in the mortgage. The court ruled that a right of prepayment depends on the language in the mortgage and the intent of the parties. It held a mortgage, otherwise silent, is presumably prepayable. Hatcher v. Rose, 407 S.E.2d 172 [N.C. 1991], is in accord, \textit{rev’d}, 389 S.E.2d 442 [N.C. Ct. App. 1990]. This was said to conform to the early common law rule. Alexander, \textit{Mortgage Prepayment: The Trial of Common Sense}, 72 CORNELL L. REV. 288, 292 \textit{et seq.} (1987) [hereinafter Alexander]. \textit{See also} the dissent in Brannon, 683 So. 2d 994. But the common-law rule is a matter of dispute. \textit{See} Hatcher v. Rose, 407 S.E.2d 172, 177 [N.C. 1991]. \textit{Mahoney} was a hard case and, it is submitted, makes bad law. A presumption of prepayment is a retroactive change in the law that may wreak havoc on existing mortgages, and future mortgages prepared on old forms. For a discussion and authorities on the retroactive and prospective effects of overruling decisions, see Mendes v. Johnson, 389 A.2d 781, 787 \textit{et seq.} [D.C. 1978]; Erhard v. F.W. Woolworth Co., 372 N.E.2d 1277 [Mass. 1978]; Van Dyke v. Chappell, 818 P.2d 1023 [Utah 1991]. There has been no custom to expressly negate a right of prepayment [despite Connolley and Hartford Life Ins. Co., cited \textit{infra} this note] except when giving a mortgagor a qualified
right (e.g., no prepayment for three years). Prepayment may abort an investment, and an installment sale that triggers an otherwise avoidable capital gains tax on a mortgagee. The court’s statement that a contra rule would be a restraint on alienation strikes the author as correct, but not the majority of courts that rule on the converse situation of payment under due-on-sale clauses.


Prepayment can impose daunting economic sacrifices upon a mortgagee, not the least of which include the loss of the bargained-for rate of return, an increased tax burden, and unanticipated costs occasioned by the need to reinvest the principal, and, for those creditors anxious to ensure regular payments not unlike an annuity, it undoes the mortgagee’s purpose in making the loan. Arthur v. Burkich, 520 N.Y.S.2d 638, 639 (App. Div. 3d Dep’t 1987).


A right to prepay if the owner paid an additional 2% premium was held not to justify the mortgagee’s retention of this 2% when payment was effected by mortgagee’s resort to proceeds of fire insurance. Chestnut Corp. v. Bankers Bond & Mortgage Co., 149 A.2d 48 (Pa. 1959). Accord, as to eminent domain, Associated Schs., Inc. v. Dade County, 209 So. 2d 489 (Fla. Dist. Ct. App. 1968); see Berenato v. Bell Sav. & Loan Ass’n, 419 A.2d 620 (Pa. Super. Ct. 1980) (discussing cases on eminent domain and insurance proceeds). But a mortgagee’s right to a prepayment premium on exercising an election to accelerate the mortgage debt on a sale of the

(Friedman on Contracts, Rel. #7, 5/09)
It follows that an express right to pay the principal does not include a right to make part payment.\textsuperscript{681} The importance of a prepayment right was highlighted in a case upholding a mortgagee’s right to exact a bonus of $2,000 as a condition of accepting prepayment of a mortgage on which less than $15,000 was owing.\textsuperscript{682} The cases hold generally

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property was left open in Kadner v. Shields, 97 Cal. Rptr. 742 (2d Dist. Ct. App. 1971).

A mortgage clause permitting prepayment of 20\% of principal each year was held to prevail over another clause requiring monthly payments of $1,491.15 “or more.” Aronoff v. W. Fed. Sav. & Loan Ass’n, 470 P.2d 889 [Colo. Ct. App. 1970].

A contract providing for monthly payments of not less than $223.84 was held to permit prepayment of the balance as part of any monthly payment. Peters v. Fenner, 199 N.W.2d 795 (Minn. 1972).

A provision for releases from the mortgage in parcels, on specified payments, has been held the equivalent of a right to prepay. A requirement that mortgagor file a subdivision map before becoming entitled to releases was held inapplicable to payment of the entire mortgage. Davlick Constr. Co. v. Krohn Assocs., Inc., 242 N.Y.S.2d 647 (Sup. Ct. Nassau County 1963).


For cases in accord, see 86 A.L.R.3d 599, 613 [1978].


A mortgage payable “within” a specified time may be paid off at any time. However, a mortgage that is payable “within” a specified number of years is not so prepayable if it calls for installments in an amount that will eveny amortize the debt by the end of the specified time. See Bloomfield Sav. Bank v. Howard S. Stainton & Co., 159 A.2d 443 [N.J. Super. Ct. 1960]; Mahoney v. Furches, 454 A.2d 1117, 1119 [Pa. Super. Ct. 1983], rev’d on other grounds, 468 A.2d 458 [Pa. 1983]; Annot., \textit{Construction and Effect as to Interest Due of Real Estate Mortgage Clause Authorizing Mortgagor to Prepay Principal Debt}, 86 A.L.R.3d 599 [1978].
that in case of prepayment, either under a right given in the mortgage or under an agreement made thereafter, a premium is properly collectible that, when added to the interest, does not bring the aggregate payments above the legal maximum for the original term of the mortgage, but that when payment is involuntary, as where the mortgagor elects to accelerate, the sum payable may not bring the interest above the legal maximum to the date of payment.\(^{683}\) Prepayment requires payment of only such interest as accrues to the date of


An institutional mortgagee is justified in requiring a reasonable premium for prepayment by reason of loss of interest pending reinvestment of the money. Furthermore, although the borrower pays the cost of the loan, putting a mortgage on the company's books entails expense, if only in overhead. Prepayment may be more serious to the holder of a purchase money mortgage given in connection with an installment sale, under which the seller-mortgagee returns as income that percentage of the buyer's payments that the gross profit on the sale bears to the total contract price. I.R.C. § 453(b) (1954). In this situation prepayment may substantially alter the mortgagee's tax position to his possible detriment. Chapp v. Paterson, 397 P.2d 5 [Nev. 1964].

In Williams v. Fassler, 167 Cal. Rptr. 545 [5th Dist. Ct. App. 1980], a 50% penalty on the amount voluntarily prepaid was held not unconscionable where reasonably related to vendor's anticipated increased tax liability. A prepayment charge of about $2.5 million on a mortgage of $15 million was disallowed in bankruptcy as unreasonable. In re Skyler Ridge, 80 B.R. 500 [Bankr. C.D. Cal. 1987]. Cf. Teachers Ins. & Annuity Ass'n v. Butler, 626 F. Supp. 1229 [S.D.N.Y. 1986]. A detailed criticism of Skyler Ridge appears in Stark, Prepayment Charges in Jeopardy: The Unhappy and Uncertain Legacy of In re Skyler Ridge, 24 REAL PROP., PROB. & TR. J. 191 [1989], for its "blatant result-oriented basis." There are other instances in which very high recoveries have been denied where they are based on prospective damages. Under present and prior bankruptcy laws landlords have been limited in recovery based on future rents under long term leases. Bankruptcy Reform Act of 1978, § 502[b][6]; 2 MILTON R. FRIEDMAN, FRIEDMAN ON LEASES § 16:2.4 [Patrick A. Randolph, Jr., ed., 5th ed. PLI 2006]. Landlords have been denied enforcement in tenant bankruptcy of lease provisions authorizing cancellation of the lease on tenant's bankruptcy. Enforcement would give landlord the "bonus value" of the lease and prevent continuance of

(Friedman on Contracts, Rel. #7, 5/09) 3–145
payment. But interest paid in advance, in accord with a requirement for payment in advance, is not refundable. A mortgagor’s right to prepay the mortgage debt without penalty and without payment of interest beyond the time of payment may be created by language stating that payment shall be “on or before” or “within” a specified time or “not less than” a specified amount. If prepayment is for the full amount of the mortgage debt the interest on this debt ceases after this payment. The same is true of partial prepayments under most mortgages, but this may be unclear in the face of required prepayment premiums. If the mortgage is an installment mortgage (that is, providing for fixed payments applicable first to interest and then to principal) and the mortgagor makes a payment as of right, larger than the installment due, the mortgage principal is reduced more than that contemplated by the original schedule and the mortgagee is entitled only to lesser interest than that computed upon the original payment schedule.

tenant’s business, that might create assets for tenant’s other creditors. Bankruptcy Reform Act of 1978 §§ 365[b][2], 365[e][1]; FRIEDMAN, supra. After breach of a contract of sale of real property the wronged party has at times recovered, and at times been denied, increased financial charges occasioned by the breach.

Anot., Construction and Effect as to Interest Due of Real Estate Mortgage Clause Authorizing Mortgagor to Prepay Principal Debt, 86 A.L.R.3d 599 (1978).


Providing for interest payments “on or before” the fifteenth of a month gave no right to prepay the principal. Comarron W. Props. v. Lincoln Loan Co., 860 P.2d 871 [Or. Ct. App. 1993] [installment sale of realty; distinguishing Phillips v. Johnson, 514 P.2d 1337, 1344 [Or. 1973], on this ground].

The right to prepay the mortgage is often subject to a prepayment premium. Cases generally hold that the premium is applicable to voluntary prepayment and not to condemnation awards or insurance proceeds, but the mortgage terms may provide otherwise. The premium may be substantial when computed to preserve the mortgagee's bargain. If interest rates fall, the premium may be the difference between the rate on government bonds with a maturity close to that of the mortgage and the mortgage rate computed to the expiration of the original mortgage term. At least this sum may be discounted to its then-value.

An obligation to pay a prepayment premium is generally limited to a voluntary prepayment by the mortgagor and does not apply, inter alia, to a mortgagee's right to proceeds of insurance, a condemnation award, or to payment under a due-on-sale clause, or other form of acceleration.\textsuperscript{688} But a provision expressly making a prepayment


premium applicable to involuntary prepayment has been enforced, but not in bankruptcy of the debtor. A prepayment premium was held enforceable after an intentional default for the purpose of avoiding the prepayment premium. Retraction of acceleration, when permitted, restores the mortgagee’s right to a prepayment premium.


The rule is codified, as to condemnation, in CAL. CIV. PROC. CODE § 1265.240; MASS. GEN. LAWS ch. 183, § 57. Other statutes require the condemning to pay prepayment charges. ARIZ. REV. STAT. ANN. § 11-965; CONNECT. GEN. STAT. § 8-282 (1983); OKLA. STAT. tit. 27, § 10; S.C. CODE ANN. § 28-11-30.

Prepayment premium is generally denied to a mortgagee when prepayment is made for a reason other than under the mortgagor’s option. Annot., 86 A.L.R.3d 599, 605 (1978).


Provision in the same contract for a prepayment penalty, late charges, and an increased rate of interest after a default have all been enforced. TMG Life Ins. Co. v. Ashner, 898 P.2d 1145, 1161 [Kan. Ct. App. 1995].


Some statutes and regulations entitle a homeowner to prepay at a modest or no premium.\(^{693}\) Federal regulations, however, may preempt state statutes that prohibit prepayment premiums. A New Jersey case, *Glukowsky v. Equity One, Inc.*,\(^{694}\) considered prepayment penalties charged on alternative mortgage transactions (AMTs). An AMT is any home mortgage loan with an interest rate or finance charge that may be adjusted or renegotiated. Beginning in the 1980s, home lenders began offering various types of AMTs as alternatives to the standard self-amortizing fixed-rate loan. Many states prohibited state-chartered financial institutions from offering AMTs or imposed substantial restrictions on such loans. In contrast, federal regulations allowed federally chartered lenders to offer AMTs. Congress enacted the Alternative Mortgage Transaction Parity Act of 1982 to allow state-chartered institutions to offer AMTs. The act grants rulemaking authority to the Office of Thrift Supervision (OTS) to prevent discrimination against state-chartered institutions. In 1996, the OTS enacted a regulation authorizing state lenders to charge prepayment penalties in AMTs. This regulation conflicted with a New Jersey statute, which prohibited prepayment penalties. The regulation, if valid, preempted conflicting state laws. In *Glukowsky*, a borrower obtained a balloon loan in 1999 and sold his home in 2001. The loan documents provided for a 2% prepayment fee, which the borrower paid under protest. The appellate division held for the borrower on the ground that the OTS regulation was beyond the scope of the agency’s rulemaking authority. In a four-to-three decision, the Supreme Court reversed, reasoning that the OTS is entitled to substantial deference in deciding how to enforce the Parity Act. The OTS rescinded the regulation effective July 2003. After reexamining the issue, it concluded that preemption of state prepayment laws was not essential to achieve the goals of the Parity Act. Nonetheless, the regulation was valid and enforceable when it applied, between 1996 and 2003.

When the mortgagor has the right to prepay without a premium, it may be necessary to determine whether a charge imposed by the lender is a prepayment charge or a premium. To facilitate prepayment, institutional lenders generally provide a payoff statement upon

\(^{693}\) 38 C.F.R. § 36.4310 (no premium or fee for loans insured by Veterans Administration); MO. REV. STAT. § 408.036 (forbids penalty after five years and allows maximum of 2% until then); N.J.S.TAT. § 46:10B-2 (no penalty); N.Y. BANKING LAW § 393(2) (allowing limited penalty during first twelve months for loans from savings and loan associations).

\(^{694}\) Glukowsky v. Equity One, Inc., 848 A.2d 747 [N.J. 2004].
request, and they sometimes charge a fee for such statements. Courts have rejected borrowers’ contentions that such fees are proscribed prepayment charges. 695

Partial payment of a mortgage generally reduces the interest payable thereafter to that accruing on the diminished principal. It was so held under a mortgage making installment payments applicable first to interest and then to principal, and also giving the mortgagor a right of partial prepayment. 696 The Connecticut Supreme Court noted that the mortgagee could bar this only by using one of three methods: a mortgage barring prepayment; a mortgage to secure an aggregate sum of the principal, plus an amount equal to the interest for the entire term; or a mortgage including a prepayment premium.

When a mortgage requires interest at higher than the market rate it is to the mortgagor’s advantage to pay off the mortgage and refinance at current rates. If the mortgage does not permit prepayment, the mortgagee need not accept payment. 697 Any right to voluntary prepayment probably requires payment of a premium. 698 If the mortgagor defaults on an installment and the mortgagee accelerates maturity of the entire debt, the mortgagee is generally not entitled to the prepayment premium. 699 The mortgagor is tempted, therefore, to try to escape from the onus of a high interest rate by defaulting on an

695. Krause v. GE Capital Mortgage Serv., Inc., 731 N.E.2d 302 [Ill. App. Ct. 2000] (borrower gets first payoff statement free, but pays $15 for each additional statement and pays $10 if sent by fax); Colangelo v. Nw. Mortgage, Inc., 598 N.W.2d 14 [Minn. Ct. App. 1999] ($10 fax fee is for special service; borrower can prepay without payoff statement or by getting one through mail); Cappellini v. Mellon Mortgage Co., 991 F. Supp. 31 (D. Mass. 1997) ($25 payoff statement fee and $15 fax fee are not prepayment charges; payoff statements are often used for purposes other than prepaying loan, such as financial planning).


Annot., Construction and Effect as to Interest Due of Real Estate Mortgage Clause Authorizing Mortgagor to Prepay Principal Debt, 86 A.L.R.3d 599 (1978).


698. If not forbidden by statute the mortgage may provide otherwise.


§ 3:8.4 FRIEDMAN ON CONTRACTS

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installment to compel acceleration.\textsuperscript{700} It is not easy for the mortgagee to counter this unless there is a right to partial foreclosure. In New York there is a statutory right, when the entire debt is not due, to foreclose against the property to satisfy the amount of the debt then due, subject to the continuing lien of the mortgage against the property for the debt not then due and unpaid.\textsuperscript{701} Outside New York the amount of relevant law is sparse and not consistent.\textsuperscript{702} In New York the reported cases indicate little use of partial foreclosure. When partial foreclosure is not available, mortgagees have sought to collect the rents of the property when available without foreclosure or consent of the mortgagor.

A provision often sought by a mortgagor is the right of prepayment, to be available whenever refinancing may be in order. This right is often conditioned upon prior written notice of between thirty and ninety days and payment of some additional sum in order to compensate the mortgagee for the delay, trouble, and expense of reinvestment. In some mortgages, there may be a right of partial prepayment, usually in multiples of at least several thousand dollars, thus avoiding a necessity on the mortgagee’s part of accepting sums too small for practical use.

Suppose a mortgagor who has a right to prepay in whole or in part on, for example, thirty days’ notice, gives notice of an election to prepay the entire mortgage debt or a substantial part of it. May the mortgagor withdraw the election? The mortgagee may have taken steps or made commitments in anticipation of receipt of the money. Under the usual prepayment clause, it would appear that the mortgagor may rescind his election. For this reason it may be advisable to provide that the mortgagor’s election to prepay shall, ipso facto, make the mortgage debt become due at the time and to the extent of the mortgagor’s election.

A sample prepayment clause reads as follows.

\textbf{CLAUSE 3-10}

\textbf{Prepayment Clause}

Any owner of the mortgaged premises shall be privileged to prepay the debt hereby secured [in full or in multiples of ____] on at least ____ days’ prior written notice to the Mortgagee.


(Friedman on Contracts, Rel. #7, 5/09) 3–151
On the giving of such notice that a specified sum shall be prepaid, such sum, together with the interest thereon accrued, shall become due and payable hereunder at the time in such notice specified with the same force and effect as if this mortgage made such sum payable at the time in such notice specified.

Any partial prepayment of the debt hereby secured shall be credited to the final installment or installments due hereunder, and shall not postpone the accrual of any installment of interest or principal becoming due after such prepayment.

If a mortgage requires installment payments, and permits an owner to prepay part of the debt, there may be a question of whether an owner who has made partial prepayment may rightfully skip paying one or more installments, on the ground that these were covered by the prepayment. The mortgagee could never be certain just when he could expect the next payment. The little authority on point indicates that partial prepayment does not postpone the installment next due but is to be credited against the final payment. It is best for the mortgage to avoid any question by specifying how, in this respect, partial prepayment is to be treated, as in the final paragraph of the preceding form.

§ 3:8.5  “Brundage” Clause

The Brundage clause permits acceleration of the debt in the event of any change in state or local laws “for the taxation of mortgages or mortgage debts for state or local purposes, or the manner of the collection of any such taxes.” The clause has apparently been used since 1888 and was named after an upstate New York assemblyman.


704. Oppenheim v. McGovern, 100 N.Y.S. 712 [App. Div. 1st Dep't 1906] [quoting full clause].
who sponsored a bill that directed assessors to tax an owner of real estate only for its value in excess of the amount of mortgages thereon.\textsuperscript{705} Because the Brundage clause is not included in the statutory short-form mortgage, courts have held that a lender may not add it to a mortgage on the basis that it is “implied as a part of the mortgage called for by the contract.”\textsuperscript{706}

\section*{§ 3:8.6 Sale in One Parcel}

This clause provides for the sale of the mortgaged premises in one parcel in the event of foreclosure. It seeks to overcome any rule that only so much of the premises shall be sold as shall be necessary to pay the mortgage debt.\textsuperscript{707} The reason for requiring a sale in parcels rather than a whole, where feasible, is to open the sale to more bidders, obtain better prices, and permit the mortgagor to redeem part of the property if unable to redeem the whole.\textsuperscript{708}

In the absence of this clause, there is no general requirement that an undivided parcel must be sold in foreclosure in parcels,\textsuperscript{709} but the outcome will turn on the particular circumstances involving the property, including its conveyancing history and mortgage.

The “sale in one parcel” clause is not necessarily effective where several parcels are included in a single mortgage.\textsuperscript{710}

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\textsuperscript{706} Ansorge v. Belfer, 161 N.E. 450 (N.Y. 1928).
\textsuperscript{707} Where the mortgaged tract is laid out in parcels the sale should be in parcels. Ellsworth v. Lockwood, 42 N.Y. 89, 101 (1870); Ames v. Lockwood, 13 How. Pr. 555 (N.Y. 1856).


\textsuperscript{708} J.H. Morris, Inc. v. Indian Hills, Inc., 212 So. 2d 831, 843 (Ala. 1968); 2 C. Wiltsie, MORTGAGE FORECLOSURES § 685 (5th ed. 1939).

The rule is judge-made but incorporated in many statutes and rules of court. See Wiltsie § 682. In New York, premises within the same city lot are to be sold together. N.Y. REAL PROP. ACTS. LAW § 231[5]. For qualifications of the rule, see Lamerson v. Marion, 8 Barb. 9 (N.Y. 1850); Griswold v. Fowler, 24 Barb. 135 (N.Y. 1857); Wiltsie § 682 et seq.

\textsuperscript{710} N.Y. REAL PROP. ACTS. LAW § 231[5]: “5. If the property consists of two or more distinct buildings, farms or lots, they shall be sold separately, unless otherwise ordered by the court; but where two or more buildings are situated in the same city lot, they shall be sold together.” The California, Minnesota, and North Dakota statutes permit waiver. CAL. CIV. CODE (Friedman on Contracts, Rel. #7, 5/09) 3–153
§ 3:8.7  

**Lien Clause**

This provides that if the mortgage is recorded less than four months after completion of improvements, repairs, or alterations to the premises [the time within which notice of mechanics’ liens may be filed], the mortgagor will receive advances on the mortgage loan and the right to receive such advances in trust, first, for the payment of these items. By including this provision, the mortgagee takes precedence over mechanics’ liens filed within the time specified, and the party supplying the work or materials is protected by the trust fund. The words “the right to receive such advances,” added in 1942, protect potential lienors against frustration of this protection by assignment of advances prior to their actual receipt. The lien clause is unnecessary in a purchase money mortgage.

The Texas mechanic’s lien statute requires the owner to retain 10% of the contract price for “30 days after the work is completed.” To reach the retained funds, mechanics must file a lien affidavit within that thirty-day period. The time for a subcontractor to file a lien affidavit runs from the termination of the general contract. In *Page v. Structural Wood Components, Inc.*, a subcontractor completed its work on a remodeling project in mid-March. Other work continued and, after a dispute between the owner and the general contractor, the owner terminated the general contract on April 14. Thirty-one days later [May 15] the subcontractor filed a lien affidavit. The owner hired replacement contractors, who finished the remodeling work on July 21. The trial court and court of appeals held the lien affidavit was timely-filed, reasoning that the retainage period continues until completion of all work contemplated by the original contract, even if accomplished by a replacement contractor. The supreme court reversed, interpreting the statute to restrict retainage and lien filings to individual contracts. Two justices vigorously dissented.

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§ 2924g(b) (“When the property consists of several known lots or parcels, they shall be sold separately unless the deed of trust or mortgage provides otherwise.”); *In re Kjeldahl*, 52 B.R. 916 [Bankr. D. Minn. 1985]; Prod. Credit Ass’n v. Henderson, 429 N.W.2d 421 [N.D. 1988].

711. N.Y. LIEN LAW § 10(1). The four-month period applies to work on a single-family dwelling. For work on other improvements, a mechanic’s lien may be filed within eight months of completion. *Id.*

712. N.Y. LIEN LAW § 13(5).


714. TEX. PROP. CODE § 53.101.

715. *Id.* § 53.103.

§ 3:8.8 Condemnation

A condemnation clause is generally added to entitle the mortgagee to all payments, to the extent of the mortgage indebtedness, plus his counsel fees, for a taking of the property or any appurtenances, or for a change of grade. A mortgagee has first right to condemnation awards without this provision, but would not otherwise be entitled to an award for change of grade. A mortgagee has been held to have a lien on the mortgagor’s claim against a third party for damages to the mortgaged premises.

In case of partial condemnation, an apparent majority holds the mortgagee is entitled to the entire award up to the amount of the mortgage debt. But some courts award a mortgagee no more than enough to avoid impairment of his security.

§ 3:8.9 Attorneys’ Fees

Another clause provides that if the mortgagee participates in any legal proceedings affecting the mortgage, other than an action to foreclose the mortgage or collect the mortgage debt, the mortgagee’s expenses of litigation shall be added to the mortgage debt. This clause


A mortgage clause assigning “all award” to the mortgagee was held to transfer a claim for restoration against the United States as tenant. Sampson v. United States, 529 F.2d 1299 [ Ct. Cl.], cert. denied, 426 U.S. 921 [1976].


(Friedman on Contracts, Rel. #7, 5/09) 3–155
is enforceable. Provisions for attorneys’ fees are valid where not forbidden by local law.\footnote{722}

A provision for attorneys’ fees is applicable to litigation other than to enforce the mortgage, in which protection of the mortgage lien is necessary.\footnote{723}

\section*{§ 3:8.10 Corporate Execution}

Prior to 1963, in the case of a mortgage made by a corporation under New York statutory law required consent by the holders of at least two-thirds of the corporate stock entitled to vote thereon.\footnote{724} It was then customary for a corporate mortgage to contain a recital of such shareholder consent. This was sufficient to create a presumption of compliance with a statutory requirement that became conclusive after one year if the proceeds of the loan were paid to the corporation.\footnote{725} Under present statutory law, no vote or consent of stockholders is required for a corporate mortgage unless the certificate of incorporation provides otherwise.\footnote{726} Accordingly, it is now prudent for a New York mortgage made by a corporation to recite approval by the board of directors and an affirmation that the certificate of incorporation requires no other action, including shareholder approval.\footnote{727}

\section*{§ 3:8.11 Lease Modification}

An “anti-milking” clause provides that no important lease shall be modified, cancelled, or merged in the fee without the mortgagee’s consent. The clause may define such a lease as one with a rent over $10,000 a year and an unexpired term of over two years. Without such provision, mortgagees were helpless during the 1930s when a mortgagor’s last act before foreclosure might be the cancellation of an

724. Former N.Y. STOCK CORP. LAW § 16.
725. Former N.Y. STOCK CORP. LAW § 17.
726. N.Y. BUS. CORP. LAW § 202(a)[5] (corporation has power, “subject to any limitations provided in this chapter or any other statute of this state or its certificate of incorporation,” to “mortgage or pledge, or create a security interest in, all or any of its property, or any interest therein, wherever situated”).
727. See N.Y. BUS. CORP. LAW § 911: “The board may authorize any mortgage or pledge of, or the creation of a security interest in, all or any part of the corporate property, or any interest therein, wherever situated. Unless the certificate of incorporation provides otherwise, no vote or consent of shareholders shall be required to approve such action by the board.”}
important lease in return for a substantial payment. Sometimes the purpose of this provision is effected otherwise by collateral assignment of an important lease to the mortgagee. The clause may also forbid the mortgagor to collect substantial amounts of rent in advance and thereby interfere with the administration of a foreclosure receiver or a mortgagee in possession. It may also entitle the mortgagee to statements of the financial operation of the premises and a summary of leases. Savings banks tend increasingly to require this data, often at the suggestion of state banking supervisors, in order to keep informed about their collateral.

A New York statute, which became effective on July 1, 1960, permits restriction of an owner’s power as against a mortgagee, without the mortgagee’s consent, to cancel, abridge, or otherwise modify leases or subleases, or accept prepayment of rent. Under this statute, a provision in a recorded mortgage or agreement affecting a mortgage which so limits an owner, binds existing tenants and subtenants after their receipt of written notice and a copy of the provision. After July 1, 1960, the recordation of such a mortgage or agreement is made sufficient notice to a tenant or subtenant who acquires his interest after such recordation. The statute is inapplicable to leases and subleases that are primarily for residential purposes or that have, at the time of the restriction, an unexpired term of less than


An express covenant by a mortgagor not to cancel or modify leases was enforced in Mut. Life Ins. Co. v. Gotham Silk Hosiery Co., 39 N.Y.S.2d 310 [Sup. Ct. N.Y. County], aff’d, 43 N.Y.S.2d 514 [App. Div. 1st Dep’t 1943].

729. The collateral assignment does not preclude the landlord-mortgagor-assignor from enforcing the lease against a tenant while the mortgage is in good standing. Fifty States Mgmt. Corp. v. Pioneer Auto Parks, Inc., 355 N.Y.S.2d 856 [App. Div. 4th Dep’t 1974].

The collateral assignment bars any modification or cancellation of the lease without consent of the mortgagee-assignee. F.W. Woolworth Co. v. Buford-Clairmont Co., 769 F.2d 1548, 1554–55 [11th Cir. 1985] [and authorities cited].

730. This clause was enforced in eviction proceedings by a receiver against tenants. Dickens v. Smith, 180 N.Y.S.2d 565 [Mun. Ct. Manhattan 1958].

A similar clause in a recorded New Jersey mortgage was enforced against tenants under subsequent subordinate leases. Payment of rents in advance was held not binding on the mortgagee. Kirkeby Corp. v. Cross Bridge Towers, 219 A.2d 343 [N.J. Super. Ct. 1966].

731. N.Y. REAL PROP. LAW § 291-f.
five years. The statute is also inapplicable to a present assignment of rent.⁷³² After a present assignment, landlord and tenant may not cancel the lease as against the assignee.⁷³³

§ 3:8.12 **Survival of Mortgagor’s Liability**

Sometimes a “survival clause” is added to prevent a release of the personal liability of the mortgagor or a subsequent obligor by events subsequent to a conveyance of the premises. In general, an agreement between the mortgagee and a subsequent owner of the premises extending the time of payment of the mortgage or otherwise modifying its terms without the consent of the mortgagor, releases the latter from personal liability. If the subsequent owner assumed the mortgage by an agreement made with the mortgagor, the subsequent agreement discharges the mortgagor completely;⁷³⁴ otherwise, the release is to the extent of the value of the property at the time of the modification agreement.⁷³⁵ A conveyance of the mortgaged property by a subsequent owner to the mortgagee, in settlement of a foreclosure, has also released the original mortgagor.⁷³⁶ It may be wondered how the only party liable on an instrument can be treated like a surety. The answer is that, in legal theory, after a conveyance the land is deemed primarily

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⁷³² The statute specifies that a stipulation with respect to it should mention the statute. But E. N.Y. Sav. Bank v. 520 W. 57th St. Corp., 611 N.Y.S.2d 459 (Sup. Ct. 1994), holds that a provision in a mortgage that was somewhat similar to the statute without mentioning it barred a mortgagor of a residential cooperative tenant building from reducing rents after application of a receiver in a foreclosure action.


An assuming grantee’s demolition of buildings, with the mortgagee’s consent, released the mortgagor. Lundquist v. Nelson, 395 N.Y.S.2d 568 (App. Div. 4th Dep’t 1977). The rule with respect to leases differs. A lease that permits tenant to assign only with landlord’s consent is deemed to imply that landlord may consent. Consequently, such consent does not release a surety. See 1 MILTON R. FRIEDMAN, FRIEDMAN ON LEASES § 7:5.2 (Patrick A. Randolph, Jr., ed., 5th ed. PLI 2006). Here, regardless of consent, demolition was a substantial impairment of security.


The release is limited in this situation because the mortgagor, who paid the mortgage debt, would have a limited right of reimbursement or subrogation, *that is*, against the mortgaged property.

⁷³⁶ Prigal v. Kearn, 557 So. 2d 647 (Fla. Dist. Ct. App. 1990) [mortgagee then resold property at twice amount of mortgage].
liable for the debt and the mortgagor only secondarily so. The
survival clause provides, in the event of any agreement between
the mortgagee and a subsequent owner modifying the mortgage, that
the liability of the mortgagor shall continue nevertheless but modified
in accordance with the tenor of the agreement. This provision is
valid. The clause may further provide that after a conveyance of
the premises the mortgagee shall not be required, as a result of any
demand by the mortgagor, to foreclose the mortgage or enforce pay-
ment of the mortgage debt. This rule, just mentioned, releasing a
mortgagor, has been carried to this extreme: if the mortgage falls due
after a conveyance by the mortgagor and continues in existence though
not formally extended, and the mortgagee accepts an installment of
interest a few days before it is fully earned, there is a rebuttable
presumption of an extension of the mortgage to the date when such
interest will be so earned, with a possible release of the mortgagor.

Accordingly, some mortgages lacking a full survival clause preclude

737. See generally Milton R. Friedman, Discharge of Personal Liability on
Mortgage Debts in New York, 52 YALE L.J. 771 (1943); Stevens, Extension
Agreements in the “Subject To” Mortgage Situation, 15 U. CIN. L. REV.
58–60 (1941); Annot., 41 A.L.R. 277 (1926); Annot., 72 A.L.R. 389 (1931);
Annot., 81 A.L.R. 1016 (1932); Annot., 112 A.L.R. 1324 (1938); 59 C.J.S.
Mortgages § 400 (1949); 55 AM. JUR. 2d Mortgages § 1391 (1971).

738. Kohn v. Beggi, 264 N.Y.S. 274 (Sup. Ct. N.Y. County 1933). The clause is
construed strictly against the mortgagee, First Fed. Sav. & Loan Ass’n v.
Rothschild, 160 N.Y.S. 164 (Sup. Ct. N.Y. County 1916), modified, 163
N.Y.S. 1124 [App. Div. 1st Dep’t 1917], aff’d, 123 N.E. 880 [N.Y. 1919];
and is inapplicable to a modification beyond the scope of the consent,
First Fed. Sav. & Loan released a mortgagor because of a modification
agreement between mortgagee and a subsequent owner. Strict construc-
tion of a survival clause against mortgagee was based on an apparently un-
tended significance of a comma. Punctuation is not often given this
importance in determination of intent. See 2 MILTON R. FRIEDMAN,
FRIEDMAN ON LEASES § 26:5.6 (Patrick A. Randolph, Jr., ed., 5th ed. PLI
2006); 3 A. CORBIN, CONTRACTS § 552, at 209 (1960); 26 C.J.S. Deeds
§ 88 (1956).

739. Thus, avoiding the possible effect of Pain v. Packard, 13 Johns. 174 [Sup.
Ct. 1816], a rule applicable in a minority of the states. See A. STEARNS,
SURETYSHIP § 16 [4th ed. 1934]; 10 S. WILLISTON, CONTRACTS § 1236
[3d ed. 1967]; Milton R. Friedman, Discharge of Personal Liability on
Mortgage Debts in New York, 52 YALE L.J. 771, at 796 [1943].

aff’d, 76 N.E. 1095 [N.Y. 1906]. The rule is in disfavor. Kings County Trust
Co. v. Giovinco, 194 N.E. 60 [N.Y. 1934]; Milton R. Friedman, Discharge
this possibility by a provision that in such event the mortgagee shall have the right to return unearned interest or apply it in reduction of principal.

§ 3:8.13 Escrow Deposits

Many mortgages, particularly those on houses, require the mortgagor to make periodic deposits with the mortgagee to accumulate funds for payment of taxes and, often, insurance premiums. These provisions do not supersede any obligation of the mortgagor to pay taxes, and impose no liability on the mortgagee if the deposits are insufficient. Nor is the mortgagee obligated to seek a separate tax assessment if the assessment of the mortgaged premises includes other property. A mortgagee with sufficient payments from the mortgagor, who fails to pay the taxes, is guilty of breach of fiduciary duty and liable to the mortgagor for damages. A general acceleration clause, permitting its exercise for any breach, was held applicable to a mortgagor’s failure to make deposits for taxes and insurance premiums.

Some authority entitles the mortgagor to interest on these funds. Other authority is contra. A New York statute, applicable to a

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of Personal Liability on Mortgage Debts in New York, 52 YALE L.J. 771, 784 (1943).

Cases pro and con are collected in Shelly v. Bristol Sav. Bank, 26 A. 474, 476 (Conn. 1893).

A general discussion of this is in Annot., Rights in Funds Representing Escrow Payments Made by Mortgagor in Advance to Cover Taxes or Insurance, 50 A.L.R.3d 697 (1973). A mortgagor’s right to such deposits is restricted by CAL. CIV. CODE § 2954 (1990).


Id.


Derenco, Inc. v. Benjamin Franklin Fed. Sav. & Loan Ass’n, 577 P.2d 477 (Or. 1978), noted in 13 REAL PROP., PROB. & TR. J. 814 (1978) [good discussion and collection of cases], a class action, held mortgagors entitled to interest at passbook rates on tax and insurance deposits made under compulsion, but not on insurance deposits made voluntarily. The decision is based on unjust enrichment-quasi contract and constructive trust. The court stated it is the first case of last resort in the country to hold this after a trial.

mortgage on a one- to six-family residence occupied by the owner and located in New York State, requires a mortgage investment institution to pay interest on the average deposits, at a rate to be fixed by the State Banking Board, but at no less than 2% per annum.\textsuperscript{748} This has been extended to residence property owned by a cooperative corporation.\textsuperscript{749} These deposits may not be reached by creditors of the mortgagor.\textsuperscript{750}

\section*{§ 3:8.14 Transferable Development Rights}

In \textit{Newport Associates, Inc. v. Solow},\textsuperscript{751} a zoning law permitted a landowner to improve his land with a building with floor space equal to (1) the maximum allowed such land under the applicable zoning law, plus (2) unutilized floor space of adjoining property that was under lease to such owner.\textsuperscript{752} The owner held one parcel in fee simple and held a long-term leasehold in a contiguous parcel. Pursuant to the zoning law, he transferred development rights from the leasehold parcel to the fee parcel. The court held that this appropriation of space, made without the lessor’s consent, barred full use of the allowable floor space of the leased premises for an indefinite period. Under this rule, a mortgagor could presumably divert to adjoining property unutilized space within the mortgaged premises, to the prejudice of a mortgagee. A clause, for inclusion in a mortgage,

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\textsuperscript{748} N.Y. GEN. OBLIG. LAW § 5-601. This statute applies to mortgages made after its effective date, July 1, 1974, and to those theretofore made unless the latter expressly provide no interest is to be paid. This statute was fully upheld in Jamaica Sav. Bank v. Lefkowitz, 390 F. Supp. 1357 [E.D.N.Y.], aff’d, 423 U.S. 802 [1975], and in Fed. Nat’l Mortgage Ass’n v. Lefkowitz, 390 F. Supp. 1364 [S.D.N.Y. 1975]. \textit{Jamaica} deemed it unnecessary to determine, as did Carpenter v. Suffolk Franklin Sav. Bank, 291 N.E.2d 609 [Mass. 1973], that the deposits were a trust fund.

The Massachusetts statute, MASS. GEN. LAWS ch. 183, § 61, is applicable to a first mortgage on a dwelling of four or fewer units occupied in whole or in part by the mortgagor.

\textsuperscript{749} CONN. GEN. STAT. § 49-2a \textit{but cf. id.} § 49-2c applies to owner-occupied residential property of up to four units and housing cooperatives occupied solely by shareholders thereof.

\textsuperscript{750} N.Y. GEN. OBLIG. LAW § 5-601, as amended by N.Y. Laws 1979, ch. 32.

\textsuperscript{751} N.Y. GEN. OBLIG. LAW § 5-601.

\textsuperscript{752} Id.
forbidding this is set forth below. It involves development rights, colloquially called "air rights."753

CLAUSE 3-11

Development Rights Clause

Mortgagor shall not permit the mortgaged premises or any part thereof to be used to qualify for fulfillment of any municipal or other governmental requirements for the construction or maintenance of any building, structure, or other improvement on premises not mortgaged hereunder; and mortgagor hereby assigns to mortgagee all rights to consent to such use. No building or other improvement now or hereafter constructed on the mortgaged premises shall rely on any premises not mortgaged hereunder in order to qualify for fulfillment of any municipal or other governmental requirements. Mortgagor shall not impair, or permit impairment of, the integrity of the mortgaged premises as a single zoning lot or lots separate and apart from other premises. Any attempt by mortgagor to violate any of the provisions of this paragraph shall be void.754

Without such a clause, a court might protect the mortgagee under some circumstances. In a Florida case, the mortgagor’s transfer of development rights, which diminished the value of the property and made the mortgagee’s lien insufficient security, resulted in giving the


754. Based on a clause made available through the courtesy of B. Harrison Frankel, Esq., of the New York Bar. A comparable provision should be included in any lease that could empower the tenant to appropriate unutilized space in the leased property for the benefit of other property.
mortgagee a lien on the property to which the rights were transferred.\textsuperscript{755}

\section*{§ 3:9 Junior Mortgages}

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\textsuperscript{756} 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.

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.\textsuperscript{757} 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 relendo a similar sum to the mortgagor at an increased rate of interest.\textsuperscript{758} In a Kentucky case a first mortgage was subordinated to a bank mortgage that was not to exceed $125,000. Subsequently, the bank mortgage

\begin{itemize}
\item \textsuperscript{755} Gordon v. Flamingo Holding P’ship, 624 So. 2d 294 (Fla. Dist. Ct. App. 1993). The court noted that this remedy would be sparingly applied.
\item \textsuperscript{756} 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).
\item \textsuperscript{758} Zelnick v. Kings County Sav. Bank, 232 N.Y.S.2d 541 (Sup. Ct. N.Y. County 1962).
\end{itemize}

\cite{Friedman on Contracts, Rel. #7, 5/09} 3–163
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.\footnote{759. 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.}

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.\footnote{760. In re Henson, 103 F.3d 470 (5th Cir. 1997).} 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.\footnote{761. 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 exhausts 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.\footnote{762. Statland Holliday, Inc. v. Stendig Dev. Corp., 362 N.Y.S.2d 2 (App. Div. 1st Dep’t 1974).}

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.\textsuperscript{763}

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

\textbf{CLAUSE 3-12}

\textbf{Subordination Clause in Junior Mortgage}

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

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 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 \underline{______}% 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


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\textit{(Friedman on Contracts, Rel. \#7, 5/09) 3–165}
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.\(^\text{764}\) The agreement may include a waiver of amortizations\(^\text{765}\) as well as an increase in interest rate\(^\text{766}\) 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.\(^\text{767}\) The agreement is nonbinding on the junior mortgagee in an action to foreclose the paramount mortgage and cut

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off the junior lien if it is prejudicial to the junior lienor.\textsuperscript{768} 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.\textsuperscript{769} In this situation some authorities subordinate only that part of the modification that is prejudicial to the junior mortgage.\textsuperscript{770}

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 secondary obligor, except where liability is preserved by a prior consent provision incorporated in the note or otherwise given.\textsuperscript{771}

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.\textsuperscript{772}

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.\textsuperscript{773}

\begin{itemize}
\item \textsuperscript{769} 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).
\item \textsuperscript{773} 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.
\end{itemize}
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.\footnote{774}

Holders of various liens may alter the order of priority by agreement between themselves, without consent of the mortgagor-owner.\footnote{775} A subordination agreement is subject to the statute of frauds,\footnote{776} but the statute may be inapplicable where there is an equitable estoppel after an advance made in reliance on a subordination.\footnote{777}

In a Virginia case, a purchaser under a sale-leaseback arrangement fraudulently induced the seller to sign a subordination agreement.\footnote{778} 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\footnote{779} 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

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Substantially contra to \textit{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 \textit{Metropolitan Life}. The latter case holds a foreclosing paramount mortgagee has the option of cutting off or confirming a subordinate lease. In \textit{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.


779. VA. CODE § 55-22.
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.

A mortgage whose proceeds were used to satisfy a prior mortgage may generally be subrogated to the lien of the prior mortgage as against intervening liens, \(^{780}\) except where the intervening liens may be adversely affected. \(^{781}\) In the ordinary case, the lender who refinance


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.


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].
the prior mortgage is ignorant of the intervening lien due to a faulty
title search. Eastern Savings Bank v. Pappas 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.

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

(THIRD) OF PROPERTY (Mortgages) § 7.6 (1997)).
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 supple-
mented 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
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, the Washington State Supreme Court has disagreed. This may be more easily accomplished when the original mortgage specified the mortgagee’s lien was “together with all renewals thereof.” This rule inures to the benefit of an assignee of the superseding mortgage, but not to the benefit of one who assumes or is liable for the payment of the intervening lien. The priority of the superseding mortgage is to the

784. **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).

785. 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].

786. 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.


788. J. Pomroy, 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].

Another example of the “a mortgagor cannot prefer a mortgage he owns to a mortgage he owes but does not own” doctrine (Quackenbush v. Quackenbush, 225 N.Y. Supp. 152 [Sup. Ct. Cattaraugus County 1927]), is Milbrandt v. Huber, 440 N.W.2d 807 [Wis. 1989], and Peat Marwick, Mitchell & Co. v. Bates, 839 P.2d 208 [Okla. Ct. App. 1992]. The doctrine may be illustrated by the following: (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. X’s liability on the second mortgage precludes any priority of mortgage A that X owns. See more cases discussed in Transamerica Fin. Serv., Inc. v. Lafferty, 856 P.2d 1188, 1193
extent of the earlier mortgage, as of the time of its cancellation, less any sums applicable in reduction of the superseding mortgage. A mortgagee cannot avoid result by “filter through,” that is by acquiring the mortgage from a bona fide purchaser. Chergosky v. Crosstown Bell, Inc., 463 N.W.2d 522 [Minn. 1990]. 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. Burkhart, Freeing Mortgages of Merger, 40 VAND. L. REV. 283, 362 [1987]. 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. See also In re Estate of Grozier, 587 N.E.2d 77 [Ill. App. Ct. 1992].

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. 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 & Mortgage 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, that is, 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]. 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].
equities.\textsuperscript{790} Where the superseding mortgage is foreclosed with joinder of a junior mortgage,\textsuperscript{791} 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,\textsuperscript{792} 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.\textsuperscript{793}

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.\textsuperscript{794}

\textsuperscript{790} 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 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].

\textsuperscript{791} In Levenson v. G.E. Capital Mortgage 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.

\textsuperscript{792} 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].


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. 795

A second mortgage will not be extinguished by foreclosure of a prior mortgage, or its assignee, if the junior mortgage can show a collusive or fraudulent scheme between the holder of the prior interest and the mortgagor to eliminate the junior lien. 796

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. 797 "The primary issue in each case is whether the lender in fact would be enriched unjustly if he were permitted to enforce the debt." 798 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. 799

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.\(^800\) The result is contra in case of express conditions imposed on


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


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 subordination. It has also been held that a lender’s failure to 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. 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.

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).


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. Nevada 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].


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.

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. 804 Recordation of the junior interest is not, as a rule, notice to the prior interest. 805

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. 806

A subordination is valid if made by the mortgagor and subordinator. It is unnecessary for the party whose lien is thereby elevated to be a party. 807

A junior mortgagee who perfects his right to the rents, as against a paramount mortgagee, is entitled to keep the rents collected on his 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. 808 In this

805. Id.


situation the senior mortgagee’s right to rents depends on his obtaining a receiver or an extension of an existing receivership.\footnote{809}

On foreclosure of a junior mortgage any surplus goes to the mortgagor rather than to the holder of a prior mortgage.\footnote{810}

A wraparound mortgage is a junior mortgage that provides for aggregate payments that are sufficient to pay \(1\) debt service on the sum advanced under the mortgage ("advance" for this purpose possibly meaning a purchase money obligation), plus \(2\) debt service on a prior mortgage. The wraparound mortgage may be used when an existing mortgage is relatively small, is not prepayable, or prepayable only at a substantial premium. Inasmuch as interest on the wraparound is usually higher than on the paramount mortgage, the wraparound mortgagee who pays the lower interest on the paramount mortgage receives a premium on the interest. If the wraparound mortgagee collects the mortgage payments but fails to pay the paramount mortgagee, the mortgagor-owner is in substantial trouble. Questions of usury have arisen in this connection.\footnote{811}

When a wraparound mortgage is foreclosed the net proceeds of sale are credited to the entire outstanding debt, including the wrapped debt. This is true even though the mortgagor took the property subject to and did not assume the wrapped debt. This is the "outstanding balance" method, as distinguished from the "true debt" method.

\footnotesize{\begin{itemize}
\item \footnote{809. Depan, Eichenberger & Knowles, Inc. v. Greenbriar Props. I, 607 N.Y.S.2d 177 [3d Dep’t 1994]. For discussion of receivership, see supra section 3:7.5.}
\item \footnote{810. Bohra v. Montgomery, 792 S.W.2d 360 [Ark. Ct. App. 1990].}
\end{itemize}}
Under this method a surplus results if the bid exceeds the entire outstanding debt; if less there is a deficit.  

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. 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.

§ 3:10 Discharge of Mortgage

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. 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

813. 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.
party prevails. A mortgage that is mistakenly discharged may be re-recorded and its position is restored as of the time of the rerecording.

§ 3:10.1 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. But to have this result, the transfer must be to the same person in the same capacity. A mortgage executed by a husband on his property to his wife was held merged and cancelled when the wife received the property under her husband's will.

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." Although the existence of merger is largely one of intent, the union of mortgage and realty in one who is primarily liable for the mortgage debt is virtually certain to result in merger, except possibly, as against intervening encumbrances.

816. 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).

817. 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. In re Cameron.


A conveyance by a mortgagor to a mortgagee does not as a rule merge the mortgage against junior liens. \(^{824}\) A conveyance to a mortgagee does not, by weight of authority, merge the mortgage as against the intervening encumbrances. \(^{825}\) An intention to keep the mortgage alive is presumed where this is to one’s interest. \(^{826}\) A few cases come out the other way, applying merger to the mortgagee’s disadvantage. \(^{827}\)

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. \(^{828}\)

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


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).


\(^{827}\) *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].


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. County of Suffolk, 599 N.Y.S.2d 457, 459 (Sup. Ct. Suffolk County 1993).
New York case, a mortgagee assigned his mortgage by an instrument that was never recorded and thereafter acquired the fee.\(^{829}\) 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.\(^{830}\) Not all states would go so far.\(^{831}\)

A recital in such conveyance that the mortgage is not to merge will generally be given effect.\(^{832}\) But an intention to this effect will not be enforced where the result would be inequitable.\(^{833}\) Merger is generally disfavored where its result will be inequitable.\(^{834}\)

### § 3:10.2 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.\(^{835}\) 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

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830. 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.
835. See supra section 3:1.
its fairness and is subject to being overturned. A Florida case upheld a conveyance to the mortgagee pursuant to the settlement of foreclosure litigation. Title examiners must satisfy themselves of the fairness of a conveyance of a deed in lieu of foreclosure and its freedom from being a disguised mortgage.

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836. 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 Lieu of Foreclosure: Practical and Legal Considerations, 26 REAL PROP., PROB. & TR. J. 459–534 [1991], 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.

837. 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 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.
preferential payment or a fraudulent conveyance.\textsuperscript{838} On the other hand, a mortgagee need not accept a deed at any time tendered by the mortgagor.\textsuperscript{839} The effect of the conveyance as a merger of the mortgage is considered above.\textsuperscript{840}

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.\textsuperscript{841} A feasibility study of the property by an expert would help the mortgagee determine its course of action.

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. Junior leases are similarly situated.\textsuperscript{842} 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


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.


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.

\textsuperscript{840} See section 3:10.1 supra.

\textsuperscript{841} Americans with Disabilities Act, codified at 42 U.S.C. §§ 12101 to 12213.

\textsuperscript{842} 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].
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.\textsuperscript{843}

\section*{§ 3:11 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.\textsuperscript{844} In 1948, statutory changes in New York authorized mortgage notes as an alternative to bonds.\textsuperscript{845} A transition to the general use of notes with corporate mortgages was delayed by \textit{General Motors Acceptance Corp. v. Higgins},\textsuperscript{846} which left some doubt between nontaxable corporate notes and taxable corporate obligations. Since 1966, 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.\textsuperscript{847} In case of

\begin{footnotes}
\begin{enumerate}
\item United States Leather, Inc. v. Mitchell Mfg. Group, Inc., 276 F.3d 782 (6th Cir. 2002) (\$1.5 million judgment lien for unpaid purchase price of goods sold to mortgagee). In \textit{U.S. Leather}, the mortgagee granted a security interest in the note and 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 subsidiary had colluded to forestall collection of a just debt.
\item N.Y. BANKING LAW § 235(6).
\end{enumerate}
\end{footnotes}
inconsistency between the mortgage and the note or bond, the note or bond prevails.\footnote{848}

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.\footnote{849}

\section*{§ 3:12 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.\footnote{850} 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.\footnote{851} 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.\footnote{852} A requirement that the mortgagor pay the mortgage recording tax does not make the mortgage usurious,\footnote{853} even when the statute imposes the tax on the mortgagee.\footnote{854}

\section*{§ 3:13 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

\footnotesize{848. Moss v. McDonald, 772 P.2d 626 (Colo. Ct. App. 1988); Adler v. Berkowski, 175 N.E. 323 (N.Y. 1930), noted in 31 COLUM. L. REV. 328 (1931).}
\footnotesize{851. 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).}
\footnotesize{852. 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.}
\footnotesize{853. Lassman v. Jacobson, 146 N.W. 350 (Minn. 1914); Seamen’s Bank v. McCollough, 151 N.Y.S. 600 (App. Div. 1st Dept’1915), aff’d, 117 N.E. 1083 (N.Y. 1917); 1918F L.R.A. 383.}
\footnotesize{854. 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).}
The mortgagee cannot be compelled to accept part of the mortgage debt and release a corresponding part of the mortgaged property. 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. 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.

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. 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 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.

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,

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855. 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.
857. For forms of release clauses, see supra sections 3:13.1, 3:13.2, and 3:13.3.
plus interest thereon accrued to date of payment. Some clauses have not been this clear.\textsuperscript{861} 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.\textsuperscript{862}

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.\textsuperscript{863} The same is presumably true of payments made from proceeds of insurance or from an award for a partial taking in eminent domain. These are, in effect, payments out of the mortgaged property, the making of which dilutes the mortgagee's security pro tanto.\textsuperscript{864}

\textsuperscript{861.} 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. \textit{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. \textit{Henderson Mill Ltd. v. McConnell}, 229 S.E.2d 660 [Ga. 1976]. \textit{Accord Agric. Alumni Seed Improvement Ass’n v. Diaz}, 432 So. 2d 788 [Fla. Dist. Ct. App. 1983]; \textit{Baldwin v. Benedict}, 82 N.W. 956 [Iowa 1900].

\textsuperscript{862.} \textit{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.


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. \textit{See} \textit{Myers v. Lewis State Bank}, 462 So. 2d 530, 533 [Fla. Dist. Ct. App. 1985].

\textsuperscript{864.} \textit{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. \textit{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. \textit{Tel. Sav. & Loan Ass’n v. Guaranty Bank & Trust Co.}, 385 N.E.2d 97 [Ill. App. Ct. 1978].
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.\textsuperscript{865} 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.\textsuperscript{866} 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 breach.\textsuperscript{867} 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 mortgagor shall be in default. Under a provision of this kind, a mortgagor is entitled to a release if he qualifies when he

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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].

\textsuperscript{866} See the discussion in Rolfes v. O’Connor, 844 P.2d 1230 [Colo. Ct. App. 1992].


In \textit{Goldman} the mortgage was nonrecourse and a release would reduce the mortgagee’s security because no payment was specified for the release.
requests it, despite a subsequent default. He is also entitled to a release when the concomitant payment cures a default.

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. 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.

The owner’s usual remedy for the mortgagee’s failure to deliver partial releases is specific performance. A judgment for damages is also possible. 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


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).


870. 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.

871. 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.

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.

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. 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.

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].

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.

See infra section 5:3.1.
CLAUSE 3-13

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.\(^876\)

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.\(^877\) 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.

§ 3:13.1 Sample Forms of Release

FORM 13-1\(^878\)

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__, 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”:

<table>
<thead>
<tr>
<th>Release Parcels</th>
<th>Considerations for Release</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>$____________</td>
</tr>
<tr>
<td>B</td>
<td>$____________</td>
</tr>
<tr>
<td>etc.</td>
<td>$____________</td>
</tr>
</tbody>
</table>

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 section 3:13.2 below.]

**FORM 13-2**

If the Mortgagor or any successor of the Mortgagor shall file a subdivision map of the mortgaged premises, with all necessary approvals 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__.

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879. 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.

880. Form 13-2 should be considered in light of discussion in section 3:13 supra, and should be compared with Forms 3-1 and 3-3.
(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. 881 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 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

881. 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.”

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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 13-3**

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 $______ 882 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. 883 For the purpose of this article, acreage shall be taken as the aggregate of the acre of the lots to be released, excluding therefrom the area of any road abutting such lots to the center of such road.

(iv) The Mortgagee shall not be obligated to deliver any release of less than _____ acres.

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882. This sum is the original amount of the mortgage debt.
(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.