NYSBA
SUMMER 2000 | VOLUME 28 | NO. 3

N.Y. Real Property Law Journal

A publication of the Real Property Law Section of the New York State Bar Association

A Message from the Section Chair

Seller's Disclosure Bill on Governor's Desk

At the time of this writing, a property condition disclosure bill is on Governor Pataki's desk awaiting his veto or signature. The Executive Committee disapproved the bill, in its current incarnation, during the May 5, 2000 meeting. As discussed before in the Section Chair's message (*see*, 27 N.Y. Real Prop. L.J. 121, 122 (1999)), this legislation's purpose is to require sellers of one- to four-family dwellings to deliver a property condition disclosure statement (PCDS). For over a year, our Section, largely through the efforts of the Task Force on Disclosure led by Karl Holtzschue, has spent a considerable amount of time working with the New York State Association of Realtors (NYSAR) to reach a compromise on modifications that would make this bill acceptable to both groups. Most importantly, our efforts have been directed at making this a consumer bill that protects both buyers and sellers.

Unfortunately, our modification recommendations (see Legislation Report dated May 30, 2000 herein) were not included into the legislation recently passed by the state Senate and Assembly. A summary of the Section's objections to the bill, as currently constituted, is as follows:

1. A seller would be required to answer all PCDS questions to the "best" of their knowledge. "Knowledge," as defined in the bill, includes "constructive" knowledge. This unfairly exposes an unwary seller to claims. No other state uses any standard other than "actual" knowledge.

2. The bill allows delivery of the PCDS to the buyer after they have signed the purchase contract and can be bound by the seller's signature. To properly protect the buyer, the PCDS must be delivered before the buyer is bound to the purchase contract.

3. The bill fails to provide any remedy for the buyer against a seller who fails to provide a PCDS in a timely manner.

4. The bill fails to prohibit a rescission remedy for the seller after the transfer of title, as most other states do. It also fails to provide for rescission after the contract is signed (and prior to closing) if the seller delivers a disclosure revealing a material defect in the property.

Inside

Photos from the Section's Summer Meeting in Paris! See pp. 82-86.

NYSBA

5. Questions repeatedly ask if there are any "defects;" "defect" being defined vaguely as a condition having a "material adverse effect" on value, health or safety. The average seller would be at a loss when deciphering these definitions within the context of the questions.

6. Environmental questions and definitions are so broad as to be completely overreaching and are unanswerable because of incorporation by reference of definitions in other statutes. These questions are derived from commercial transactions and are inappropriate for sales of residences. Other states limit their environmental questions on residential sales to specific topics, such as fuel storage tanks, lead paint, asbestos and radon.

7. Most of the questions in the bill are stated in vague language that unnecessarily exposes an unwary seller to claims.

We are disappointed that this piece of legislation passed in its current form but resolve to continue working with all parties to draft a bill that will benefit both buyers and sellers without the proliferation of litigation that could ensue if this bill became law. In response to the Legislature's actions, I have, in conjunction with outgoing Section Chair Steven G. Horowitz, forwarded copies of our Legislation Reports and a letter describing our Section's objections to Governor Pataki urging him to veto this measure.

On a lighter note, the eagerly anticipated Real Property Section's Summer Meeting was held from July 19th-23rd at the Hotel Inter-Continental in Paris. Section members had the opportunity to indulge in a fabulous reception and dinner at the Museum d'Orsay, participate in tours of France, England and Belgium, as well as enjoy a dinner cruise on the River Seine. Additionally, a multicultural smorgasbord of continuing legal education programs included: European real estate, foreign investor disclosure requirements, title insurance on European properties, landmark preservation, compliance with the Foreign Corrupt Practices Act and much more. Thanks to all who make our meetings such a continual success.

James S. Grossman

Legislation Report

REAL PROPERTY LAW SECTION

REPORT NO. 76 July 8, 1999

S.5039-A	By:	Senator Libous
A.1173-C	By:	M. of A. Brodsky
	Senate Committee:	Judiciary
	Assembly Committee:	Judiciary
	Effective Date:	lst day of January in the year succeeding the year it shall have become a law

AN ACT to amend the real property law, in relation to disclosure of defects by owners of residential real property upon the sale thereof

REPORT PREPARED BY THE REAL PROPERTY LAW SECTION (#1)

THIS BILL IS DISAPPROVED

The above legislation calls for the addition of a new Article 14 of the Real Property Law which would require the delivery of a property condition disclosure statement by sellers of one to four family dwellings.

While we agree that the purpose of this bill may be laudatory in principle, the mechanism adopted in portions of the bill is flawed in the following manner:

1. The number of disclosure items, *forty-six in all,* is longer than the lists of which we are aware in other states. This puts an unnecessary burden on sellers to attempt to answer questions of which they may be unsure and which may be of significance to the purchaser. The list should not include items that the purchaser could discover by an ordinary home inspection, such as fire damage and above-ground fuel tanks.

2. Several items use the catch-all phrase “other” defects, which place an unfair burden on the seller (items 18 [environmental defects], 23 [structural defects], and 46 [mechanical system defects]).

3. It is unclear what the last sentence in §462(1) about “as is” contracts is intended to do. All bar association contracts of which we are aware contain “as is” clauses and “merger” clauses (merging into the contract prior written statements such as a property condition disclosure statement). With such contracts, this disclosure statement adds nothing legally, other than perhaps assisting a purchaser in attempting to prove a claim of fraudulent misrepresentation. It should be clear that an “as is” contract is not undermined by the required certification set forth at the end of §462(2).

4. What is the consequence under the bill if the seller fails or refuses to sign and deliver the disclosure statement? Is the contract invalid, as might be implicit in § 462(1), Lines 16-19? Section 465 says that any person who provides the statement and “willfully” fails to perform the duty (presumably, deliver a truthful statement), shall be liable for actual damages (which also seems to undermine the concept of an “as is” contract). Presumably, this is intended to exclude punitive and other damages. attorneys fees and court costs. If the contract is not invalid, is it intended that a seller who fails to deliver the statement be liable for those other damages in addition to actual damages? Other states impose statutory penalties (e.g., Connecticut requires the seller to pay the purchaser $300 for failure to deliver the disclosure statement [which contains 32 items] *Ct.* Gen. Stat. Ann ~20-327-c).

5. We assume that the statement in §462(2) that the disclosure statement is not a warranty is intended to protect a seller who makes a false statement but does not know it to be false.

6. If disclosure is important for home sales, why are sales of condominiums and cooperative apartments excluded?

7. What was the model for this bill? Was it patterned on a particular statute of another state or is it a combination? How does it differ from statutes of other states?

8. The timing of delivery of the disclosure statement is problematic. Unless it is intended that a purchase contract is invalid without the disclosure statement being signed by both parties, the statement should be delivered to the purchaser before the purchaser is bound. In the proposed bill, the seller must deliver the statement before the seller accepts a contract signed by the purchaser. How would the purchaser then retract the signed contract if the subsequently delivered disclosure statement suggested that protective provisions should be added to the contract or. even worse, was so bad that the purchaser no longer wanted to buy at the contract price? The timing and mechanics of delivery of the disclosure require clarification.

9. Does the bill give the purchaser a right of rescission if the disclosure statement is not delivered? If the disclosure statement turns later out to be wrong? If the seller delivers a correction to the original disclosure statement (most states allow rescission after delivery of a correction)? Some state statutes expressly state that there is no right of rescission after the closing (e.g., Cal. Civ. Code ~l 102.13).

10. We note the statement in §467 that existing remedies are not limited, but the bill is unclear in various respects (as discussed above) as to whether and how remedies against sellers may be expanded.

Because of these concerns and questions, the proposed bill is DISAPPROVED.

Chair of the Section: Steven G. Horowitz

Legislation Report

REAL PROPERTY LAW SECTION

REPORT NO. 119	May 30, 2000	
S. 5039	By:	Senator Libous
A.1173-C	By:	M. of A. Brodsky
	Senate Committee:	Judiciary
	Assembly Committee:	Judiciary
	Effective Date:	1st day of January in the year succeeding the year it shall have become a *law*

AN ACT to amend the real property law, in relation to disclosure of defects by owners of residential real property upon the sale thereof

LAW AND SECTIONS REFERRED TO: Amends the real property law by adding a new article 14

REPORT PREPARED BY THE REAL PROPERTY LAW SECTION (#2)

THIS BILL IS DISAPPROVED

The proposed legislation above calls for the addition of a new Article of the Real Property Law (PCDA) which would require the delivery of a property condition disclosure statement (PCDS) by sellers of one to four family dwellings. This Report supplements our prior Report dated July 8,1999.

While we agree that the purpose of this bill may be laudatory in principle, the mechanism adopted in portions of the bill is flawed in many respects. We represent sellers as well as buyers. We believe that a PCDA should protect both sellers and buyers. The primary protection for buyers should be professional inspections and tests, not a questionnaire filled out by a seller in the midst of a transaction for a residential purchase. A PCDA could benefit buyers by requiring disclosure of facts that will supplement information to be provided by professional inspections. At the same time, the questions to be answered by the seller should be stated in a manner that is readily understandable by the average seller and be capable of being answered based on the actual knowledge of the seller. The mechanism of the PCDA should be workable and provide appropriate remedies, without interfering with existing law. In this report we list the flaws in the bill and then discuss modifications to the bill that would make it acceptable to Real Property Law Section.

FLAWS IN PROPOSED BILL

The principal flaws in the proposed bill are the following:

(a) The bill wrongly calls for the seller to answer all questions to the "best" of seller's knowledge and defines knowledge' to include "constructive" knowledge. This would expose an unwary seller to claims that the seller "should have known" of information actually unknown to the seller. Such information may be contained in public records (e.g., flood plain, wetland, code violation, subdivision plat notes) or relate to conditions that might alert a professional inspector but not a seller (e.g., asbestos, lead plumbing, soil depressions or mounds, fence encroachments, evidence of termites). No other state having a disclosure act of which we are aware uses any standard but "actual" knowledge. This bill must be limited to actual damage to protect unwary sellers.

(b) The bill allows delivery of the PCDS to the buyer after the buyer has signed the purchase conrract and can be bound by signature of the seller. The PCDS must be delivered before the buyer is bound to the purchase contract.

(c) The bill fails to provide any remedy against a seller who fails to provide a PCDS in a timely manner.

(d) The bill fails to prohibit rescission after the transfer of title, as most other states do.

(e) The questions often ask if there are any "defects", and "defect" is defined in a vague manner as a condition having a "material adverse effect" on value, health or safety. How is the average seller to bow what that means and how the questions should be answered? The risk of second-guessing is extremely high.

(f) Environmental questions and definitions are so broad as to be completely overreaching and are unanswerable because of incorporation by reference of definitions in other statutes. These questions are derived from commercial transactions and are inappropriate for sales of residences. Other states limit their environmental questions on residential sales to specific topics, such as fuel storage tanks, lead paint, asbestos and radon.

(g) Most of the questions in the bill are stated in vague language that unnecessarily exposes an unwary seller to claims. In the "Instructions to the Seller" in the PCDS, the seller is unfairly asked to "report all known conditions affecting the property". In questions 18, 23 and 46, the seller is unfairly asked a "catch-all" question about other (unspecified) defects. Question *5* asks for tide information that may not be known to the average seller and is better dealt with by a title report and survey reviewed directly by the buyer and the buyer's attorney. Questions 8-10 ask about matters that *maybe* in the public record but ARE actually unknown to the seller. Questions about asbestos and lead plumbing should be left to professional inspectors. Questions about tests SHOULD BE limited to tests done by the seller.

PROPOSED MODIFICATIONS TO BILL

After issuing our prior Report dated July 8, 1999, the Real Property Law Section formed a Task Force on Disclosure to review the bill in detail, confer with representatives of the New York State Association of Realtors (NYSAR) and attempt to determine whether the bill could be modified in a manner that would be acceptable both to our Section and NYSAR. The Task Force had several meetings, considered many drafts of modifications, had a lengthy meeting with representatives of NYSAR and exchanged several drafts of modifications with them. This resulted in a set of modifications to the bill proposed by our Task Force (attached hereto) that appear to be acceptable to the representatives of NYSAR. The principal features of the proposed modifications are as follows:

(a) The time of delivery is changed to "prior to the signing by the buyer and seller of a real estate purchase contract or offer that would, subject to the satisfaction of any contingencies, require the buyer to accept a transfer of the residential real property".

(b) Knowledge is limited to "actual" knowledge, "without any independent investigation", not "constructive" or "best' knowledge. This concept is the essential foundation of all the modifications.

(c) Disclosure questions are reworded in plainer language that is easier to understand and easier to answer. Catch-all questions are deleted. The precise text of the questions is very important to our Section.

(d) All references to "defects" have been eliminated, removing a major area of ambiguity.

(e) The question about leaks of hazardous wastes has been limited to petroleum. The questions about testing for leaks of petroleum and hazardous wastes are limited to tests done by the seller.

(f) Many of the questions about defects are changed to " are the [various items] in working order?" (As provided in para. 16(g) of the NYSBA Residential Contract of Sale). No action may be brought on these disclosures after the transfer of title.

(g) The PCDS contains a warning that a false or incomplete PCDS may subject the seller to claims and that the seller may wish to consult an attorney for legal advice in preparing the PCDS.

(h) The remedy of actual damages applies to a seller who does not deliver a PCDS or a revised PCDS, as well as for willful failure to comply with the statute.

(i) The transfer of title may not be invalidated solely because a person falls to comply with the PCDA.

(j) The seller shall not be liable for any error in information provided by a third party if the seller is not grossly negligent in obtaining or transmitting it.

(k) There is one year limit on actions under the PCDA, as is common in other states.

At its meeting on May 5, 2000, the Executive Committee voted to approve the bill s modifies (21 for, 11 against, 5 abstained). Also approved were deletion from the Task Force's proposal of the requirement for delivery of a certificate at transfer of title and addition of the ability to limit actual damages by agreement of the seller and buyer in the purchase contract. These changes are reflected in the attached modifications (see paragraph 18 below).

Our Task Force had recommended that there be a prohibition against rescission prior to transfer of title, but with an exception where the seller delivers the PCDS after the contract is signed (before the transfer), giving the purchaser the right to cancel on 3 business days' notice. The opposition of NYSAR's representatives to rescission was reported to the Executive Committee. After discussion, the Executive Committee voted (17 for, 14 against) to establish a right of rescission during the contractual period for a material misleading disclosure statement or late production of a statement. These changes are not reflected in the attached modifications.

Accordingly, the proposed bill is DISAPPROVED unless modified as recommended herein.

Chair of the Section: Steven G. Horowitz

Attachment

PROPERTY CONDITION DISCLOSURE BILL (A 1173-C)
NEW YORK STATE BAR ASSOCIATION
REAL PROPERTY SECTION TASK FORCE PROPOSED MODIFICATIONS
(5/9/00)

1.) Legislative findings: insert the following after "will" in line 7 of p.I: "supplement information provided by professional inspections and tests to"

2.) 46 *1(5):* delete "or constructive" before "knowledge"; add "without any independent investigation" after "knowledge"; and delete the rest of the definition about "actual notice" [p 2 lines 4345]

3.) 461: delete definitions: (2) Defect, (3) Environment, (4) Hazardous Substance, (6) Petroleum, and (8) Release. [environmental problems in home sales covered by rephrased disclosure items]

4.) 461(7): in (c) replace "lease-purchase" with "lease-with-obligation-to-purchase" [p. 2, line *53*]

5.) 46 1(8): add the following: 8. "Transfer of Title" shall include execution and delivery of a lease or installment land sale contract, as the case may be.

6.) 462: as to time of delivery, replace "prior to seller accepting a real estate purchase contract" with "prior to the signing by the buyer and seller of a real estate purchase contract or offer that would, subject to the satisfaction of any contingencies, require the buyer to accept a transfer of the residential real property" [p. 3, lines 20-21 and 35]

7.) 462: insert "home, pest, radon or other" before "inspections" at p. 3, line 40]. Put in all capital letters: "THE BUYER IS ENCOURAGED TO OBTAIN HIS OR HER OWN INDEPENDENT PROFESSIONAL INSPECTIONS AND Environmental TESTS."

8.) Warning to Seller. Add the following in all capital letters as a new second paragraph on line 42 of page 3 in Purpose of Statement: A MATERIALLY FALSE OR INCOMPLETE STATEMENT BY THE SELLER ON THIS FORM MAY SUBJECT THE SELLER TO CLAIMS PRIOR TO OR AFT'ER THE TRANSFER OF TITLE. THE SELLER MAY WISH TO CONSULT AN ATTORNEY FOR LEGAL ADVICE IN CONNECTION WITH COMPLETION OF THIS FORM.

9.) 462: add to form certain definitions at p. 3, line 42: Certain Definitions: "Residential real property" means real property improved by a one to four family dwelling used or occupied, or intended to be used or occupied, wholly or partly, as the home or residence of one or more persons

10.) delete "(b) report all known conditions and re-letter the remaining sections [p. 3, line 43]

11.) 462: put sentence re "UNKN" in all capital letters. Add: "Checking 'unknown' shall not raise any inference as to the nonexistence or existence of a condition." [p. 3. line 46]

12.) 462: replace "the best of your" with "your actual" or "seller's actual" wherever it appears with "knowledge" [p. 3, lines *49,55; p.* 5, line 47 etc]

13.) Replace all 46 items in the disclosure list in) 462 with the following:

General Information

1. How long have you owned the property?
2. How long have you occupied the property?
3. When was the structure(s) built? NOTE TO BUYER - IF A STRUCTURE WAS BUILT BEFORE 1978 YOU ARE ENCOURAGED TO INVESTIGATE FOR THE PRESENCE OF LEAD BASED PAINT.
4. Have you given to anyone (other than your immediate family residing with you) a lease or other current right of use or occupancy of the property (e.g. to use a road or path or cut crops) or has anyone denied you access to the property? YES NO UNKN NA (if yes, explain below)
5. Are there certificates of occupancy related to the property? YES NO UNKN NA (if yes, explain below)
6. Are there any features of the property shared in common with adjoining landowners, such as walls, fences or driveways? YES NO UNKN NA
7. Has anyone advised you of any utility charges, special assessments or homeowner or other association fees that apply to the property? YES NO UNKN NA (if yes, explain below)

Environmental Information

8. Has anyone advised you that any of the property is located in a designated flood plain? YES NO UNKN NA
9. Has anyone advised you that any of the property is located in a designated wetland? YES NO UNKN NA
10. Has anyone advised you that any of the property is located in an agricultural district? YES NO UNKN NA
11. Was any or all of the property the site of a landfill? YES NO UNKN NA (if yes, explain below)
12. Are there fuel storage tanks on the property? YES NO UNKN NA If yes, are they currently in use? Location? Are they leaking or have they leaked? YES NO UNKN NA (if yes, explain below)

13. Is there asbestos in the structure? YES NO UNKN NA if yes, state location(s):

14. Is there lead plumbing? YES NO UNKN NA if yes, state location(s):

15. Have you had a radon test done? YES NO UNKN NA If yes, attach copy of report.

16. Has petroleum been spilled, leaked or otherwise released that may have an effect on soil conditions or water supply with respect to the property? YES NO UNKN NA

17. Have you had the property tested for the presence of petroleum or any hazardous or toxic substance? YES NO UNKN NA If yes, attach copy of report.

Structural Information

18. Is there any water damage to the property? YES NO UNKN NA If yes, state location(s):

19. Is there any fire or smoke damage to the property? YES NO UNKN NA
If yes, state location(s):

20. Have you had an inspection or treatment for termite, insect, rodent or pest infestation or damage made within the past 5 years? YES NO UNKN NA If yes, state location(s) and attach any reports:

21. How old is the roof? Is there a warranty on the roof in effect now? YES NO UNKN NA
If yes, attach a copy.

Systems, Services and Other Information

22. What is the water source? Circle all that apply: well/private/municipal/other. If municipal, is it metered? YES NO UNKN NA

23. Have you had the water quality and/or flow rate tested within the past 5 years?
YES NO UNKN NA If yes, attach report.

24. What type of sewage system ? Circle all that apply: sewer/septic system/cesspool. If septic system, date last pumped? Frequency of pumping? Is the system in working order?
YES NO UNKN NA (if no, explain below)

25. Are there any flooding, draining or grading problems that resulted in water accumulation in any portion of the property? If no, state location(s):

26. Is the electrical system in working order? YES NO UNKN NA (if no, explain below)

27. Is the plumbing system in working order? YES NO UNKN NA (if no, explain below)

28. Is the heating system in working order? YES NO IJNKIN NA (if yes, explain below)

29. Is the air conditioning system, if any, in working order? YES NO UNKN NA
(if no, explain below)

30. Is the security system, if any, in working order? YES NO UNKN NA (if no, explain below)

31. Is the smoke detector(s) in working order? YES NO UNKN NA How many? Locations?

32. Is the sump pump, if any, in working order? YES NO UNKN NA

33. Does the basement have seepage or dampness? YES NO UNKN NA (if yes, explain below)

34. Is the chimney/fireplace in working order? YES NO UNKN NA Date of last cleaning?

35. Is the hot water heater in working order? YES NO UNKN NA Any leaks in the last 5 years?

36. Are all the wood floors hardwood (not plywood or other material)? YES NO UNKN NA
(if no, explain below)

14.) 462: On page 5, line 47, replace “accurate” with “complete”

15.) 462: On page 5, line 55, insert the following: Time Limit on Action under Property Condition Disclosure Act: Any action brought under the Property Condition Disclosure Act must be commenced within one year of the date of transfer of tide to the property.

16.) In the “Buyers Acknowledgment” [p. 5, line 56] replace “description of the property” with “statement of certain conditions and information concerning the property known to the seller”; insert “home, pest, radon or other” before “inspections”.

17.) 464: On page 6, line 45, replace “inaccurate” with “untrue or incomplete”.

18.) 465. Remedies. Replace this section [p.6, line 52] with the following:

(a) A transfer that is subject to this article shall not be invalidated solely because a person fails to comply with the requirement of this article to deliver a disclosure statement or revised disclosure statement that is true and complete. (b) Any person who willfully fails to perform the requirement of this article to deliver a disclosure statement or revised disclosure statement that is true and complete shall, in addition to any existing equitable and statutory remedy, be liable in the amount of actual damages suffered by a buyer as a result of a violation of this article, except that such damages may be limited by the seller and buyer by express agreement in the real estate purchase contract. (c) No action may be brought under this article after the transfer of title to the property with respect to any disclosure as to working order”. (d) Any action brought under this article must be commenced within one year of the date of transfer of title to the property.

19.) Limitation on Seller Liability- Add new)
468 [p. 7, line 1571: 468. Seller Liability. The seller shall not be liable for any error, inaccuracy or omission of any information delivered pursuant to this article if: (I) the error, inaccuracy or omission was not within the actual knowledge of the seller or was based on information provided by public agencies, licensed engineers, surveyors or architects or professional home inspectors and (ii) the seller was not grossly negligent in obtaining the information from a third party and transmitting it.

Nuggets of New York Commercial Mortgage Law and Practice (A to Z)

By Joshua Stein

Any attorney who closes commercial mortgage finance transactions in New York State must consider a series of issues unique to New York law and practice. Many are major and fundamental, such as the mortgage recording tax, the Lien Law, qualification for the new nonjudicial foreclosure process, and occasional usury problems. These and a few other issues often require overall documentation structures that are unique to New York.

Another dozen or so issues are less substantial. A commercial mortgage finance lawyer must keep even these minor issues in mind when structuring and documenting mortgage loan transactions, but most do not make New York loan documents look fundamentally different from those used in any other state.

This article summarizes many of those minor issues in alphabetical order, with a brief discussion of each one. In a few cases, New York's treatment of an issue is contrasted against general American common law and the recently published Restatement of the Law of Mortgages (the "Restatement").[1]

This discussion limits itself to state-specific issues and concerns, disregarding all generic issues, even fundamentally important ones. Issues, restrictions, and requirements unique to residential mortgage lending are also disregarded.

This article is excerpted, with changes, from a summary of New York mortgage law and practice recently completed by the author, which will soon be published in book form. That summary will address not only the minor issues covered in this article, but also all other state-specific issues that arise in New York mortgage loan transactions, including many of the issues mentioned in, but substantively excluded from, the scope of this article. The author's complete summary of New York mortgage law will include sample language where appropriate.

Because the following discussion will be revised before it is published in book format, comments and suggestions would be much appreciated and should be directed to the author.

(a) Appraisals

If a lender requires an applicant for a loan to pay for an appraisal, New York's Real Property Law (RPL) says the borrower can obtain a free copy of the appraisal upon written request.[2]

Although this statute originally applied only to residential mortgages, it was amended in 1996 to apply to all mortgage borrowers.[3]

Commercial borrowers typically do not realize they have the statutory right to obtain a copy of any appraisal for which they have paid, a right that may be quite helpful with a lender that hesitates to provide a copy of the appraisal.

This statute means a borrower can raise one less issue (or easily "trade away" one fake issue) when negotiating a commitment letter.

If a lender doesn't want to show the borrower the appraisal, the lender might not require the borrower to pay for the appraisal and might instead collect some kind of processing fee. The lender would then pay for the appraisal itself.[4] Because no case at all has ever interpreted this statute, it is not clear whether the courts would regard the proposed substitution of a "processing fee" as being overly creative.

(b) Assignments of Mortgages

When a mortgagee assigns a note, as a general proposition the mortgage follows automatically[5] under both generic American common law and New York common law.

A New York mortgage assignee will, however, often insist upon recording an assignment of the mortgage, precisely because of the occasional case that says possession of the note is not enough and a mortgage assignment is not effective against third parties until recorded.[6]

An assignment of a mortgage constitutes a conveyance within the meaning of New York's recording statute.[7]

A mortgage borrower is not deemed to be on notice of an assignment of the loan, hence may validly continue to pay the assignor, until the borrower has received actual notice of the assignment.[8] Absent such notice, the pledgee bears the risk that the pledgor might accept a prepayment of the entire loan without telling the pledgee, thus destroying the pledgee's collateral without the pledgee's knowledge.

These requirements can create practical problems for any lender that accepts a pledge of multiple mortgage loans as collateral for some other obligation. Such a pledgee may not consider it feasible (or "market-standard") to record assignment documents or notify all underlying obligors when their loans have been collaterally assigned to the pledgee. Some mechanisms have been developed to mitigate this risk,[9] but they are beyond the scope of this discussion.

To record a mortgage assignment in New York, the parties need to sign and deliver to the recording officer an affidavit confirming certain matters intended to help the State enforce its mortgage recording tax,[10] another topic outside the scope of this discussion.

(c) Assignments of Rents

For income-producing property, New York mortgagees typically obtain a separate assignment of rents and leases, a purportedly absolute assignment of the rents from the borrower to the mortgagee. In most cases, consistent with practice elsewhere in the country, the mortgagee then grants the borrower a license back to collect the rents pending a default.

This legal fiction is no more and no less enforceable and reliable in New York than anywhere else. The use of a separate assignment should help perfect the mortgagee's interest in the rents. It should also give the mortgagee a fall-back security measure (a separate property interest and contract right against the borrower) if the mortgage somehow fails. Rather than rely on any assignment of rents, though, a New York mortgagee will typically have a receiver appointed as soon as the mortgagee starts foreclosure proceedings.

New York law creates only a few special issues regarding the form of an assignment of rents and leases. This document will often refer to New York Real Property Law § 291-f.[11] It will often also provide for the appointment of a receiver without notice, particularly if the mortgage does not already cover that issue.

Recording an assignment of rents and leases requires two executed originals of an affidavit stating that the instrument is delivered in connection with a mortgage between the parties. These affidavits are required under New York's mortgage recording tax, a topic otherwise outside the scope of this summary.[12]

(d) Doing Business

Any out-of-state lender should consider New York's "doing business" laws, which say that out-of-state entities "doing business" in New York must "qualify" in New York in order to take certain actions within New York. This may include the commencement of a foreclosure action.

As in most other states, merely holding a mortgage in New York probably does not constitute "doing business." Any failure to qualify when required to do so can ordinarily be cured after the fact without much trouble, other than some delay.[13] Counsel to any out-of-state lender that is considering making its first New York loan should carefully consider these "doing business" statutes, which vary slightly among entity types.[14]

(e) Dragnet Clauses

New York courts will enforce a "dragnet" clause in a mortgage, i.e., a provision by which the mortgage secures not only a specified indebtedness but also any future indebtedness of the same borrower to the same lender.[15]

(f) Due-on Clauses

Due-on-sale clauses are enforceable in New York,[16] as are clauses that accelerate a loan upon the death of a guarantor.[17]

(g) Future Advances

A mortgage can secure future advances (made within 20 years after the mortgage is recorded) provided that the mortgage: (1) says it secures such advances; and (2) specifies the maximum aggregate amount of indebtedness it secures. Priority dates back to the date of recording. The mortgagee should still obtain appropriate title insurance coverage at the time of any future advance, typically in the form of a datedown under a "pending disbursements" endorsement issued at closing. The statutory protection for future advances does not extend to "building loans," a topic otherwise outside the scope of this summary.[18]

(h) Guaranties

When any lender accepts a guaranty of a loan, New York law imposes few state-specific burdens or special concerns on the lender.

New York law does try to protect guarantors in a manner consistent with generic principles of suretyship law in other states.

New York courts seem to apply these suretyship principles in a practical way. Courts applying New York law have been willing to enforce broad and general waivers of suretyship defenses. Thus, a New York guaranty may work perfectly well without including a long tedious laundry list of every possible suretyship defense (or theory for disclaimer of liability), along with a separate "knowing" waiver of each.[19] A short, tedious laundry list may do the job if the waivers listed are broad enough.

In New York, this area is nowhere nearly as complex and troublesome as it is in, for example, California.[20] The same is true of New York's one form of action rules, which apply to guaranties, but are outside the scope of this discussion. Based on those rules, if a New York loan is covered by any form of guaranty, particularly a partial one, the lender may want to structure it as multiple separate loans to maximize the lender's leverage if the loan defaults.

In preparing guaranty documentation, counsel to a New York lender should also try to assure that the guaranty will qualify for certain expedited enforcement procedures available under New York's Civil Practice Law and Rules (CPLR). CPLR 3213 says a creditor can move for summary judgment as part of the complaint if the creditor holds an "instrument for the payment of money only,"[21] which can include a guaranty. By proceeding this way, a lender may save some time in the litigation process.

A garden-variety guaranty of payment should unquestionably qualify for favorable treatment under CPLR 3213, but it never hurts to have the guarantor expressly acknowledge that the guaranty is "an instrument for the payment of money only." This is particularly true if the guaranty has some non-monetary elements as well. Courts have been known to treat an acknowledgment of the type suggested as being, in effect, a guarantor's waiver of any objections to proceeding via CPLR 3213, even if the guaranty does include some non-monetary elements. Of course, there is no assurance that every court will take the same view.

Therefore, if a lender obtains a guaranty of both monetary and non-monetary obligations, the lender might be well advised to break that document into two: a pure guaranty of payment, unquestionably eligible for favorable treatment under CPLR 3213, and a guaranty of performance whose qualification may be less assured.

This approach might prevent the borrower from trying to challenge the lender's eligibility for CPLR 3213 when the lender tries to enforce the pure monetary guaranty. The lender may avoid months of procedural wrangling.[22]

(i) Lien Priority for Unpaid Interest

If the principal balance of a mortgage increases because unpaid interest is added to principal, the mortgage will secure the interest component with the same priority as the original mortgage, provided that the mortgage describes the terms of repayment.[23] If, however, the parties expressly "capitalize" interest by adding it to principal, this transaction may then incur a mortgage recording tax. It should not be undertaken lightly.

(j) Mortgages vs. Deeds of Trust

New York is a "lien theory" state rather than a "title theory" state,[24] hence favors mortgages over deeds of trust. New York lenders universally use mortgages.

(k) Options Held by Mortgagees

If a mortgagee obtains an option to purchase an interest in the collateral or an equity interest in the borrower, in connection with any loan of $2.5 million or more, then a New York statute expressly says the mortgagee may enforce such an option, provided it is not triggered by the borrower's default.[25] For any loan below $2.5 million, though, an option to purchase held by the mortgagee may still create issues regarding "clogging of the equity of redemption," an issue outside the scope of this summary.

(l) Powers of Attorney

New York law provides for a statutory short form of power of attorney, but its use is not mandatory.[26] To grant affirmative authority to an attorney-in-fact under the statutory short form, the principal must not only sign and acknowledge the power of attorney, but also remember to initial certain paragraphs within that document. If the principal merely signs and acknowledges the document without initialing the particular paragraphs, the document may fail to achieve its intended purpose.[27]

A power of attorney may be recorded against the real property it affects, or recorded once and then used repeatedly for multiple properties. Either way, it should be recorded before the mortgage and must be acknowledged in the same manner as a deed.[28]

An attorney-in-fact cannot convey or mortgage an interest in land, other than entering into a lease for a year or less, unless the instrument of appointment expressly grants such authority.[29]

New York statutes expressly contemplate that a corporation may act through a power of attorney, the same as any other legal entity.[30] Caution is advised, however, when planning a closing where a corporation will act through a power of attorney. New York real estate lawyers and title insurance companies often frown on the idea of having a corporation act through a power of attorney. If one plans to do it, one should first make sure no one else will be able to successfully object.

At least one New York case holds that an attorney-in-fact cannot sign an affidavit on behalf of its principal.[31] This type of limitation is of particular (and peculiar) relevance given the number of affidavits required for New York real estate closings. (New York closing affidavits go far beyond the two mentioned in this summary.) Title insurance companies may refuse to accept an affidavit signed by an attorney-in-fact. To solve such a problem, one can often have the affidavit signed by anyone else who knows about the underlying facts and is willing to sign the affidavit. Typically, counsel for either party will have the knowledge but may lack the willingness.

When an attorney-in-fact signs a document to be recorded, New York's newly enacted statute on acknowledgments expressly states that the acknowledgment of the attorney-in-fact's signature, like an acknowledgment of any other signature, "must conform substantially with" the new statutory form.[32] The statute prescribes no special treatment whatsoever for attorneys-in-fact.

The author has been advised that, despite the unequivocal statutory language, when an instrument signed by an attorney-in-fact is submitted for recording, some recording offices have begun to require that the acknowledgment be customized to describe the power of attorney under which the attorney-in-fact was authorized to sign.[33] This represents an unfortunate and unnecessary reintroduction of complexity and pitfalls[34] into an area where, in a rare blow for simplicity in New York real estate closings, the Legislature has already decided the issue. The recording offices should simply do what the Legislature says. Until they decide to do so, practitioners should beware of these possible special requirements.

(m) Prepayment

Unless a loan expressly says it is prepayable, the lender can reject a prepayment, and the borrower has no general legal right to prepay.[35]

Consistent with the general enforceability of prepayment restrictions in New York, prepayment premiums are enforceable in New York.[36] The loan documents should (and most already do) say that the borrower will owe a prepayment premium not only for a voluntary prepayment, but also for an involuntary one triggered by acceleration.[37]

(n) Security Deposits

New York law requires a property owner to turn over security deposits to the transferee upon any conveyance of the property, including foreclosure. Failure to do so is a misdemeanor. When the transferee receives the security deposits, the transferee becomes legally responsible for them.[38]

If the mortgaged property is a rental apartment building, the mortgagee will usually be responsible for the tenants' security deposits after foreclosure, regardless of whether the mortgagee actually received them.[39]

This collection of statutory provisions suggests that, for nonresidential property, a mortgagee should, as a matter of law, have no liability after foreclosure for security deposits it did not receive. No available case actually confirms this result. If a mortgagee of nonresidential property can effectively disclaim liability for security deposits it did not receive, and if that mortgagee were concerned about legal exposure only (as opposed to practicalities), then that mortgagee might not worry about what happens to the security deposits after foreclosure. If the mortgagee agreed to "nondisturb" the tenant, though, the issue would probably come back onto the radar screen and lead the mortgagee to add exculpatory language to the nondisturbance agreement.[40]

Practically speaking, for loans on New York apartment buildings, or even for nonresidential collateral, a prudent mortgagee will usually care very much about security deposits. A mortgagee will often seek assurances that the borrower will not misapply security deposits, so that they will be available to the new owner of the building after any foreclosure. A mortgagee might, for example, want to control the security deposits itself or address the issue through personal guaranties from the borrower's principals.

(o) Separate Notes?

For a multistate multiproperty loan, New York mortgage loan attorneys typically do not believe that anything about New York mortgage law or practice dictates the use of a separate promissory note for the New York properties, or for each New York property separately.

The parties may, however, want to use separate notes for other reasons. In a multistate loan, for example, some states, like California and Colorado, have procedural traps that may favor breaking one large loan into multiple separate notes. Even for a purely intrastate loan, if a mortgagee obtains partial or complete guaranties of the indebtedness, the mortgagee may want to use multiple notes to try to maximize leverage after a default.[41] Nothing in New York mortgage law or practice substantively disfavors the use of multiple notes, although they create an extra layer of complexity[42] in an area already more complex than it needs to be.[43]

(p) Tax Escrow Fees

A mortgagee cannot charge a fee for administering a tax escrow.[44]

* * * * *

The small collection of issues discussed in this article represents only the tip of the iceberg of state-specific issues that arise in New York mortgage loan closings. The minor issues discussed here do arise from time to time in any commercial mortgage loan practice, and this article is intended to assist the practitioner by providing a convenient set of answers. The author's upcoming summary of the law in this area, as described above, will address a broader range of issues.

Endnotes

1. Restatement (Third) of Property: Mortgages (1996). *See also* Dale A. Whitman, *Mortgage Drafting: Lessons from the Restatement of Mortgages*, 33 A.B.A. Real Prop. Prob. & Tr. J. 415 (Fall 1998).
2. N.Y. Real Prop. Law § 254-c(1) (McKinney 1999).
3. New York L. 1996, ch. 80, § 1 (May 1996).
4. The sequence demonstrates in a tiny way the unexpected consequences that often follow whenever the Legislature decides to rewrite private contractual relationships, and how any such legislative efforts often end up requiring further legislative and regulatory efforts, often without end, to respond to private sector ingenuity. *See, e.g.,* 9 N.Y.C.R.R. §§ 2050.1-2530.1 (about 300 pages of regulations governing apartment rents, but only the tip of the iceberg).
5. *See Flyer v. Sullivan*, 134 N.Y.S.2d 521, 522-523 (App. Div. 1954). The proposition that "the mortgage follows the note" tracks the traditional majority view under American common law, subject however to random cases, even in New York, holding just the opposite. As an example, see the *Parmann Mortgage Associates* case described in the next endnote. *But see* Restatement (Third) of Property § 5.4 (1996). The Restatement would change the traditional common law approach. The Restatement says that, unless the parties agree otherwise, if either the note or (except where the UCC requires otherwise) the mortgage is transferred, then the other automatically follows. While this approach sounds fair

and reasonable, it may create uncertainty if a fraudulent assignor were to assign note and mortgage to two separate assignees simultaneously. Of course, that merely underscores the benefits of taking an assignment of the note and also searching title and recording an assignment of the mortgage, hence avoiding the issue entirely.

6. *See Parmann Mortgage Associates v. Patterson*, N.Y.L.J., Dec. 15, 1999, at 25. Here, the holder of the mortgage sold it twice. The first purchaser obtained only a recordable assignment of the mortgage, but didn't bother to require delivery of the original promissory note. The second purchaser obtained only the original promissory note, but didn't bother to perform a title search or record an assignment. The first purchaser recorded the assignment and won, even without holding the original promissory note. Dictum suggests the possibility of a different result if the second assignment had been collateral, rather than absolute—i.e., the first assignee's rights would depend not entirely on the nature or implementation of the first assignment itself but instead on what happened later—much the same as the Restatement's reference to the UCC as described in the preceding endnote. This case should not be regarded as a statement of New York "black-letter law," which normally says "the mortgage follows the note," as is typical under American common law. Instead, this case demonstrates the occasional randomness of results in this area. It shows why an assignee would want to obtain possession of the note and also record a notice of the assignment. For good measure, the assignee would also be well advised to notify the borrower of the assignment. Just how far to go with all this would depend largely on the assignee's view of the credit and reliability of the assignor.

7. *See Weideman v. Pech*, 92 N.Y.S. 493, 495 (App. Div. 1905); *see generally* 92 N.Y. Jur. 2d § 70 (1998) (discussing the meaning of conveyance in the recording act). Assignments of mortgages, whether absolute or collateral, are not taxed in the state.

8. *See* N.Y. Real Prop. Law § 324 (McKinney 1999). The borrower/obligor is deemed to have notice of the assignment if it was recorded before the deed to the borrower/obligor, i.e., if the obligor took the property "subject to" an existing mortgage that had been assigned before the borrower/obligor took title. This proposition is consistent with expecting any purchaser to perform a full search of title.

9. For more on the practicalities and common law of loan assignments, both in and out of the state, with an emphasis on the risks of collateral assignments, see James I. Hisiger and Joshua Stein, *Acquisition Loans Pose Added Risks for Lenders*, Nat'l L.J., Sept. 29, 1997, at B11; Joshua Stein, *Mortgage Loan Assignments: A Primer in Two Parts*, Prac. Real Estate Law., July-Sept., 1997. *See also* N.Y. U.C.C. § 9-502(a) (McKinney 1999) ("on default the secured party is entitled to notify an account debtor or the obligor on an instrument to make payment to [the secured party] . . . and also to take control of any proceeds to which [the secured party] is entitled under § 9-306").

10. *See* N.Y. Real Tax Law § 275 (McKinney 1999).

11. *See* N.Y. Real Prop. Law § 291-f (McKinney 1999). This statute gives a mortgagee the right to notify certain commercial tenants that the mortgage restricts the landlord's right to modify, amend, or cancel leases, or accept prepayments of rent. The mortgagee must satisfy some technical conditions, including a requirement that the mortgage mention the statute. If those conditions are satisfied and the mortgagee gives the necessary notice, then the tenants are bound by the restrictions in the mortgage.

12. *See* N.Y. Tax Law § 255 (McKinney 1999). Without this affidavit, an assignment of rents and leases may be taxed as a mortgage.

13. Delay can, of course, be deadly (and embarrassing to counsel) once the loan goes into default.

14. *See* N.Y. Bus. Corp. Law §§ 1301, 1312 (McKinney 1999); N.Y. Limited Liability Corp. Law §§ 803, 808 (McKinney 1999); N.Y. Partnership Law §§ 121-902, 121-907 (McKinney 1999).

15. *See State Bank of Albany v. Fioravanti*, 51 N.Y.2d 638 (1980). As in so many other mortgage-related issues that would be routine in most states, the mortgage loan practitioner must again beware of the mortgage recording tax.

16. *First Federal Savings & Loan Ass'n v. Jenkins*, 441 N.Y.S.2d 373 (Sup. Ct. 1981) (stating that, although decided on federal law, New York law would produce the same result). If a mortgagee has agreed not to withhold unreasonably its consent to a transfer of the property subject to the mortgage, then the mortgagee cannot use its consent right to require the new owner of the property to pay a higher interest rate, assuming the purchaser is otherwise not reasonably objectionable. *See Silver v. Rochester Savings Bank*, 424 N.Y.S.2d 945, 946 (App. Div. 1980) (requiring mortgagee to consent to the sale, without increasing the interest rate, where mortgagee's consent to a transfer was not to be unreasonably withheld and mortgagee had admitted the purchaser's credit was "impeccable and better than" the original mortgagor's). No available New York case addresses the validity of due-on-encumbrance clauses in the state. These "due-on" issues have produced astonishingly few reported cases here, particularly when compared against California, where the issue has spawned one of many vast bodies of state-specific mortgage-related jurisprudence.

17. *See Bank of New York v. Spring Glen Associates*, 635 N.Y.S.2d 781 (App. Div. 1995).

18. *See* N.Y. Real Prop. Law § 281 (McKinney 1999). As with so much else in the world of New York mortgages, counsel must also consider the mortgage recording tax. That tax will be due when the parties record the mortgage. The tax will apply based on the stated maximum principal amount of the mortgage, whether or not advanced, even if the parties add language to the mortgage to try to limit the secured indebtedness to some lower amount on an interim basis. If the parties think the borrower will repay the loan and then be able to reborrow (a routine "revolver"), then they may face serious new problems under the mortgage recording tax. *See* Robert A. Simins, *Avoiding Mortgage Tax on Revolving Credit Loans*, N.Y.L.J., at 53; Joshua Stein, *New York Mortgage Recording Tax on Revolving Loans: The Problem and a New Solution for Multistate Transactions*, 22 NYSBA *Real Property Law Section Newsletter*, Winter 1994.

19. *See Compagnie Financiere de CIC et de L'Union Europeenne v. Merrill Lynch, Pierce, Fenner & Smith Inc.*, 188 F.3d 31, 35 (2d Cir. 1999) ("the waiver set forth in the Guarantee Agreement was broad enough").

20. Over many decades and many decisions, the California courts have seized on various theories to excuse guarantors from performing under their guaranties. Each new theory has led to a new paragraph of standard boilerplate waiver language in all future guaranties, with the result that a well-drafted California guaranty is a remarkable document indeed, in which a nugget of substance is completely buried, even overwhelmed, by paragraph after paragraph of waivers, disclosures, caveats, and recitations of every possible circumstance that might ever arise in the future life of a loan. New York law on guaranties is not as highly developed, and hence neither are New York guaranties. For an overview of the California rules, see Dennis B. Arnold, *Anti-Deficiency Protection in Multi-State Transactions*, 441 PLI/Real 973, May-June 1999; Peter J. Gregora, *Guarantees, Letters of Credit and Comfort Letters in Mortgage Financing*, 441 PLI/Real 1121, May-June 1999.

21. N.Y. C.P.L.R. § 3213 (McKinney 1999). The guarantor will then defend the motion for summary judgment and the

lender's enforcement activities may return to the slow track. The lender will, however, have saved the time that normally would have elapsed between filing a complaint and moving for summary judgment.

22. In a multistate transaction, the lender should not become so swept up by the speediness of N.Y. C.P.L.R. 3213 that the lender loses sight of the risks of obtaining a judgment on a note if any collateral is located in a single-action state such as California.

23. *See* N.Y. Real Prop. Law § 291 (McKinney 1999). Does this mean the mortgagee should attach a copy of the note to the mortgage? Such a practice is not typical in New York.

24. *See* Grant S. Nelson & Dale A. Whitman, 1 Real Estate Fin. Law § 4.2 (3rd ed. 1994) (describing New York as a leader in the development of the lien theory in United States mortgage law because of New York statutes that circumscribed the mortgagee's interest in the real estate before foreclosure). *See also* Restatement (Third) of Property § 4.1, note on mortgage theories followed by American jurisdictions (1996) (in New York, "[a] mortgage gives the mortgagee only a lien" and the title theory has been "abolished," citing *Ganbaum v. Rockwood*, 308 N.Y.S.2d 436 (App. Div. 1970)).

25. *See* N.Y. Gen. Oblig. Law. § 5-334 (McKinney 1999). In applying the monetary threshold, multiple advances are aggregated, as are advances to be made by multiple lenders.

26. *See* N.Y. Gen. Oblig. Law § 5-1501(1) (McKinney 1999).

27. This "negative option" was enacted by New York L. 1996, ch. 499, § 1 (January 1997). It was thought to be an improvement over the previous mechanism, where the attorney-in-fact's authority automatically extended to every category listed unless the principal expressly provided otherwise. In practice, the new requirement may create yet another counterintuitive pitfall in New York real estate practice, familiar to anyone who has ever forgotten to return the "negative option" form sent out every month by any book or CD club.

28. *See* N.Y. Real Prop. Law § 294(1) (McKinney 1999).

29. *See* N.Y. Gen. Oblig. Law § 5-703 (McKinney 1999); *Ochoa v. Estate of Sarria*, 468 N.Y.S.2d 44, 45 (App. Div. 1983) (holding that, without written authorization from lessee empowering attorney to exercise purchase option clause in lease, attorney's exercise of such clause for lessee was ineffective); *Raoul v. Olde Village Hall, Inc.*, 430 N.Y.S.2d 214, 217 (App. Div. 1980) (requiring a showing that attorney was authorized in writing to act as agent for vendor and, when attorney sent purchasers a realty sales contract not signed by vendor, vendor could have asserted attorney's lack of authorization as defense in purchasers' action for specific performance); *Singer v. Klebanow*, 168 N.Y.S.2d 487, 489 (Sup. Ct. 1957) (letter from defendant's attorney did not satisfy statute of frauds, absent showing of written authority for defendant's attorney to act as defendant's agent in signing contract).

30. *See* N.Y. Real Prop. Law §§ 292-a, 309(1). The statute contains no comparable provisions validating powers of attorney issued by limited liability companies. *But see* N.Y. Limited Liability Corp. Law § 202(h) (empowering limited liability companies to "appoint . . . agents").

31. *Reboul, MacMurray, Hewitt, Maynard & Kristol v. Quasha*, 455 N.Y.S.2d 86, 87 (App. Div. 1982). This case involved an affidavit on a contested issue in a litigation where the court seemed generally very unsympathetic to the party whose affidavit was being ignored. Perhaps the case is limited to its own facts or simply does not apply to real estate closings.

32. N.Y. Real Prop. Law § 309-a(1) (McKinney 1999).

33. These recording offices are believed to include the City Register of New York County.

34. The recording offices that impose these new requirements can surely rationalize them, as they can any other contemplated new requirements. The concern may relate to proper indexing and cross-indexing of documents, but there are probably easier ways to address this particular concern. If all other rationalizations fail, these new requirements may be said to prevent fraud, which is a great fallback argument for almost everything. But that argument fails too, because anyone who creates a fraudulent document will be perfectly happy to continue to commit fraud when they sign and acknowledge their fraudulent document.

35. *Arthur v. Burkich*, 520 N.Y.S.2d 638 (App. Div. 1987) (observing that "it has been settled law since the early 19th century that a mortgagor has no right to pay off his obligation prior to its stated maturity date in the absence of a prepayment clause in the mortgage or contrary statutory authority." *Id.* at 639. The court recognized that "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, 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." Today those anxious creditors would include every fixed-rate securitization trust. The *Arthur v. Burkich* court declined to apply the Pennsylvania rule, in which silence regarding prepayment implies a right to prepay. The court emphasized the commercial nature of the transaction and concluded, "in any event, reform of the radical and adventuresome extent petitioners conceive is for the Legislature, not the courts, to bring to pass." *Id.* at 640. *But see* Restatement (Third) of Property § 6.1 (1996) (rejecting the established majority rule, the same rule as New York's, and providing, instead, "in the absence of an agreement restricting or prohibiting payment of the mortgage obligation prior to maturity, the mortgagor has a right to make such payment in whole or in part"). The net effect of the Restatement's change in the law will be to make it all the more important for lender's counsel to remember to include a paragraph to ban prepayment except as expressly negotiated in the documents.

36. *See, e.g.*, *Poughkeepsie Galleria Co. v. Aetna Life Insurance Co.*, 680 N.Y.S.2d 420 (Sup. Ct. 1998). This litigation involved a sophisticated borrower, a loan of $112 million and a prepayment formula that had been so heavily negotiated that some last-minute changes in the clause were interlineated by hand. As the court explained, the borrower "essentially argues that the portion of the prepayment clause which requires it to pay a prepayment premium, though negotiated by [borrower] and its counsel and agreed to by [borrower], is void and enforceable. However, prepayment premiums in nonresidential commercial mortgages are both valid and enforceable." *Id.* at 421. Faced with some other set of facts and a less sophisticated borrower, a New York court might conceivably stretch to invalidate a prepayment premium, but it seems unlikely. A bankruptcy court may have a different view.

37. *See, e.g.*, *George H. Nutman, Inc. v. Aetna Business Credit, Inc.*, 453 N.Y.S.2d 586, 587 (Sup. Ct. 1982) ("The election by the mortgagee herein to accelerate the mortgage and to treat the mortgage debt as due was not a voluntary act by the mortgagor sufficient to bring the prepayment penalty into operation."); *3C Associates v. I.C. & L.P. Realty Co.*, 524 N.Y.S.2d 701, 702 (App. Div. 1988) ("Given that the accelerated payment here is the result of plaintiffs-mortgagees having elected to bring this foreclosure action, they may not exact a prepayment penalty."). *But see* Bruce J. Bergman, *Bergman on New York Mortgage Foreclosures*, Vol. 1, 1-30, (Matthew Bender 1999 & Supp. 2000) ("The traditional view that a prepayment penalty is waived upon acceleration or default may be waning").

38. N.Y. Gen. Oblig. Law § 7-105 (McKinney 1999).

39. N.Y. Gen. Oblig. Law §§ 7-107, 7-108 (McKinney 1999).

40. For more on nondisturbance agreements, see Joshua Stein (subcomm. chair), *Report on Nondisturbance Agreements, with Model Agreement*, 22 NYSBA *Real Property Law Section Newsletter*, Spring 1994.

41. *See* Michael J. Feinman and William Zeena Jr., *Election of Remedies Statute's Effect on Holders of Mortgage Loan Guarantees*, N.Y.L.J., March 11, 1992, at 1.

42. The concept of multiple notes for a single financing is hardly unusual in New York real estate finance. Any construction loan will typically require at least two notes. Routine refinancings often require the lender to accept an assignment of a pile of old notes, which are then usually consolidated into one, but do not necessarily need to be.

43. Because mortgagees often lose original promissory notes, they may start to move away from notes and instead make "noteless loans." And if a mortgagee chooses to use multiple notes to evidence a loan that will refinance an existing loan, the parties may need to "sever" the existing mortgage—break it into pieces—to avoid mortgage recording tax. This creates additional paper, expense, and utterly gratuitous complexity, but should create no substantive problems if done right.

44. N.Y. Real Prop. Law § 254-d (McKinney 1999). This prohibition applies to residential and commercial mortgage loans.

Joshua Stein is a real estate and finance partner in the New York office of Latham & Watkins, a member of the American College of Real Estate Lawyers, chair of the Practising Law Institute's annual seminar on commercial real estate finance (New York and San Francisco), and author of over 60 articles on real estate legal and business issues. Some of those articles will be the basis for a book to be published in 2001 by American Law Institute / American Bar Association, tentatively entitled "Practical Guide to Real Estate Practice." **Mr. Stein acknowledges with thanks the helpful comments received on this article from numerous New York practitioners—too many to list here—who will all be identified and acknowledged when the author's complete summary of New York mortgage law and practice (described in the text of this article) is published. Any opinions or errors in this article are solely those of the author, not any organization with which the author is affiliated.**

Award for Attorney Professionalism on Tap

Do you know an attorney who is the consummate professional? Share his or her example with others—nominate that person for the second annual New York State Bar Association (NYSBA) Attorney Professionalism Award.

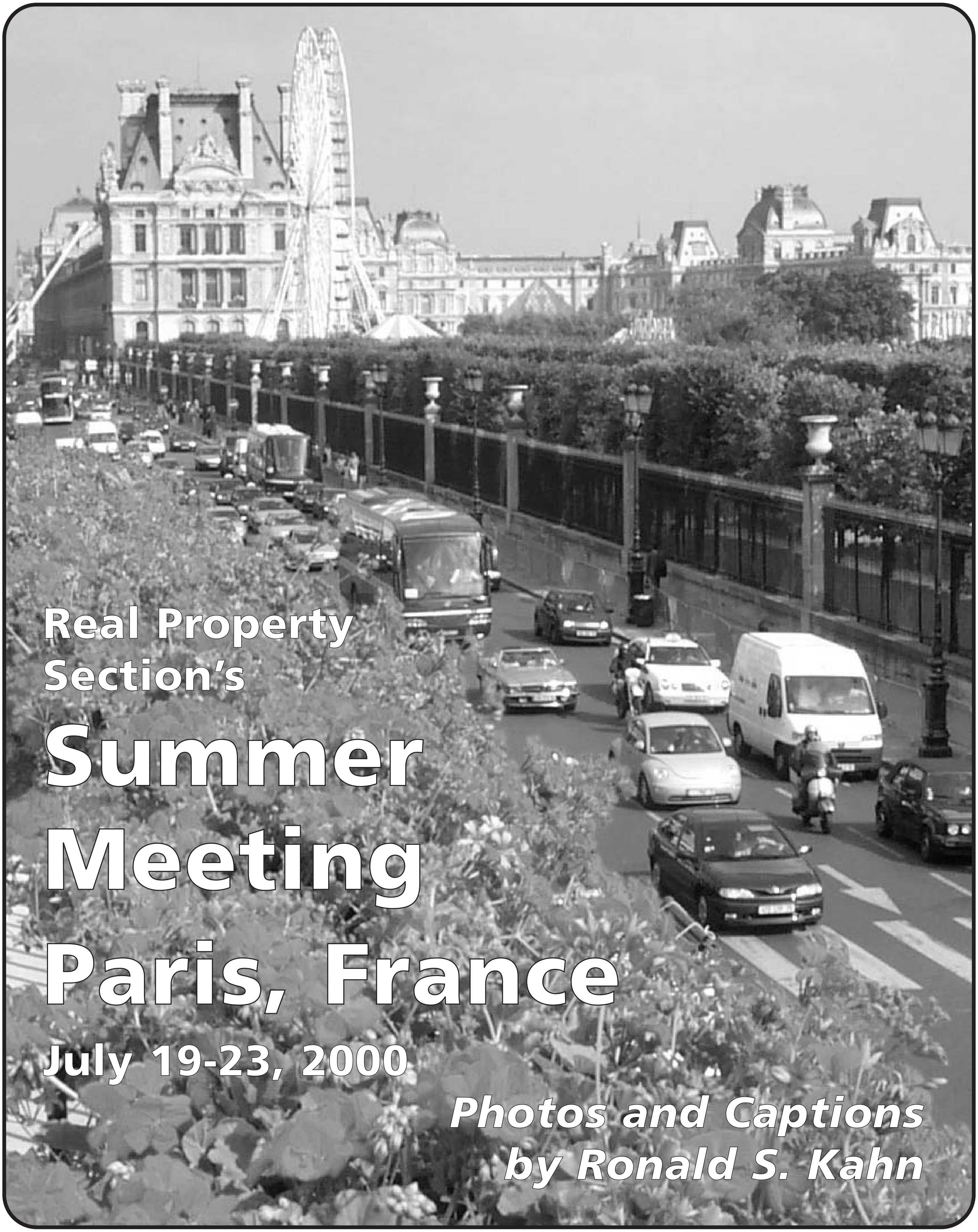
The Committee on Attorney Professionalism is seeking nominations for the award, which will be presented during the Annual Meeting to be held January 2001. Barry Kamins, of Brooklyn, was the first recipient of the award, presented during the January 2000 Annual Meeting.

The Committee's definition of attorney professionalism is ". . . a dedication to service to clients and a commitment to promoting respect for the legal system in pursuit of justice and the public good, characterized by exemplary ethical conduct, competence, good judgment, integrity and civility."

Nominees should demonstrate the following attributes:

- Dedication to service to clients and always acting in the best interests of the client;
- Promotion of the public good;
- Exemplary ethical conduct: endeavoring at all times to fulfill the spirit, and not just the requirements, of the Code of Professional Responsibility;
- Competence: keeping abreast of the latest developments in his or her area of practice through continuing legal education programs and self-study;
- Service to the profession: mentoring newer attorneys, educating and informing other attorneys through direct contact, participation in seminars, lectures and panels, and publishing written works of professional interest;
- Good judgment: providing client service consisting of discerning opinions and advice based upon knowledge, experience, and moral as well as legal considerations;
- Integrity: always exhibiting soundness of character, fidelity, honesty and fairness;
- Civility: behaving to all with courtesy, consideration and respect.

Nomination forms can be obtained by calling (518) 463-3200 or writing: New York State Bar Association, One Elk Street, Albany, NY 12207, Attn: Terry Brooks. Nominations must be received by October 7.



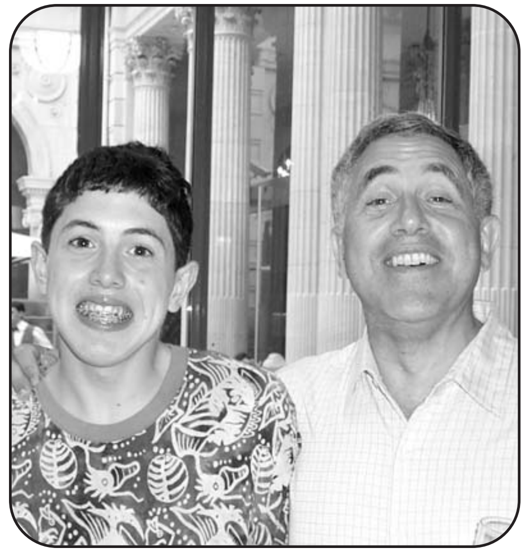
Real Property Section's Summer Meeting Paris, France

July 19-23, 2000

Photos and Captions by Ronald S. Kahn

Musee du Louvre taken from the Intercontinental Hotel.

The City from the Montmartre Center.



Jim Grossman and son.

Mort and Rosalind Rosen.

Matt Leeds, Jeff Chancas and Ron Kahn in Goldenberger's Deli.

Rube Goldberg's water fountains outside of the Pompidou Center.

Jeff Chancas inside the catacombs.

Cruising the Seine from the Batoux Mouche.

Chancas and I ate a lot. Here in Angelina's for a little hot chocolate.

Lester Bliwise and Jim Messenger at Musee D'Orsay.

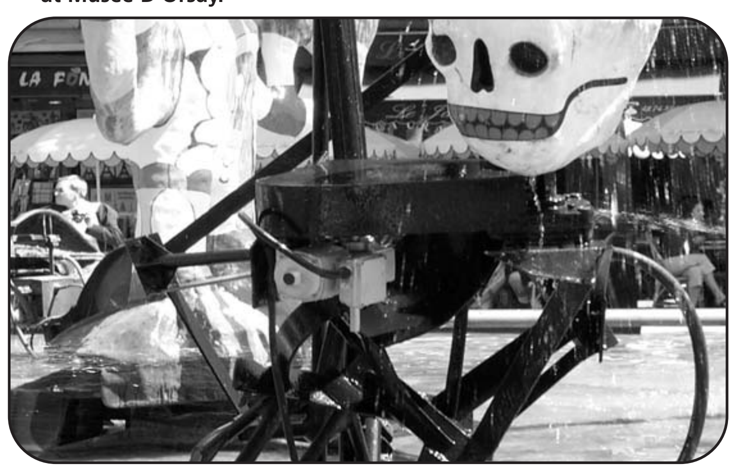
Drayton Grant and Roslyne Hahn.

Ronni Arougheti and Jim Grossman on dinner cruise.

Lew Taishoff, Mel Mitzner and Harold Lubell at Musee D'Orsay.

The shop associated w
Looks like a good

The City from the Pompidou Center looking to the NW at the Eiffel Tower.



Rube Goldberg's water fountains outside of the Pompidou Center.

Sari Leeds, Matt Leeds and Jeff Chancas.

The City from the Pompidou Center while looking at the Picasso Statues.

with the Hotel DeVille.
condo conversion.

Rosanna Ziff, Ronni Arougheti and Suki Grossman.

Joel and Roslyn Sachs.

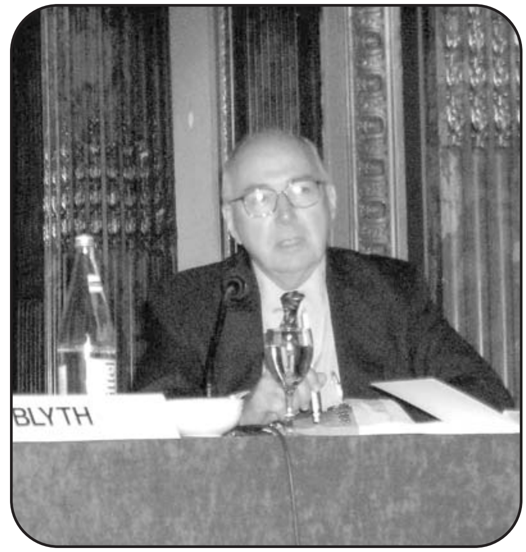
Roslyne Hahn and Jasmine Hahn.

Jeff Chancas alongside the graves of Simone De Beauvoir and Jean Paul Sartre.

The end of the Tour de France. So I am a little early in the morning!

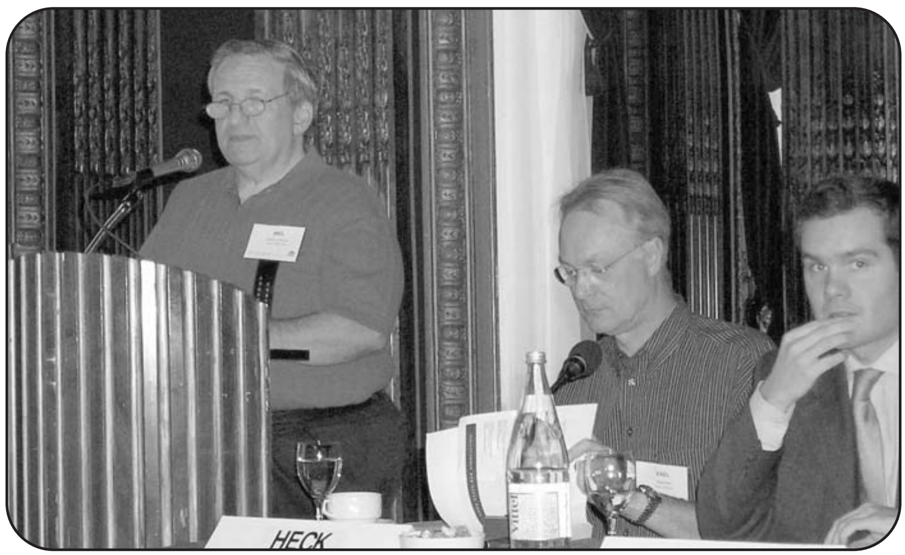
Paris ain't alone!

Edmund Rosenkrantz and Jeffrey Chancas.



John Blyth.

Lorraine Power Tharp.



Mel Mitzner introducing the second session. Axel Heck and Francois Herpe.

Kathy Heider and John Blyth.

Dorothy Ferguson and Edmund Rosenkrantz.

Real Estate Transfer Taxes: The Mere Change Exemption and Controlling Interest Transfers

By Michael J. Berey

At its October 27, 1999 Tax Representatives and Practitioners Program (TAXRAPP) the New York City Department of Finance made known certain Amendments issued to the Rules Relating to the Real Property Transfer Tax (RPTT), codified at § 23, Title 19 of the Rules and Regulations of the City of New York, on application of the mere change of identity exemption to the transfer of controlling economic interests. The Amendments, effective May 28, 1999, can be found on the Internet at http://www.titlelaw-newyork.com under "Transfer Taxes."

The transfer or acquisition of a controlling economic interest in an entity owning real property has been a RPTT taxable event since Local Law 71 of 1986 became effective retroactive to July 13, 1986. § 1201 of the New York State Tax Law (the "Tax Law") and Title 11, Chapter 21 of the City's Administrative Code deal with the RPTT. Controlling interest transfers have, since July 1, 1989, been subject to tax under New York State's Real Estate Transfer Tax (RETT) at Article 31 of the Tax Law.

The RETT and RPTT are primarily payable by the transferor of the taxable interest, with the transferee secondarily liable for the tax in the event of nonpayment. The RETT rate is $2 for each $500 of consideration. The RPTT rate for commercial property is 1.425% when the consideration paid or imputed is less than $500,000 and 2.625% when the consideration is at least that amount.

For controlling interest transfers, the RETT and RPTT are generally computed based on the fair market value of the real property interest held by the owning entity apportioned based on the percentage of the economic interest in the entity being transferred or acquired.

To be taxable within a three-year period (or longer, if the transfers are being made pursuant to a plan to avoid payment of tax), there must be either the transfer of an economic interest in the entity by a transferor or the acquisition of an economic interest by a transferee (or by transferors or transferees "acting in concert" or "in one or several related transfers") of at least 50% of the total voting power or fair market value of all classes of stock in the case of an interest in a corporation, or of at least 50% of the capital, profits or beneficial interests in the case of an interest in a partnership, trust or other unincorporated association.

Controlling interest taxes have been broadly applied by the New York State and City taxing authorities. The transfer of a controlling interest in an entity which directly, or through its controlling economic interest in a different entity, has an interest in real property is subject to tax. The transfer of a controlling interest in an entity owning a leasehold is considered a taxable event irrespective of the remaining term of the lease, a factor usually applied in applying the RETT to leasehold grants. The transfer of a controlling interest in a contract vendee or in the holder of a foreclosure bid are considered taxable, as is the gift transfer of a controlling interest to the extent of outstanding mortgage indebtedness apportioned to the interest being transferred. Interests acquired at, and within three years of, the formation of the real property interest owning entity by an original shareholder, partner, or member, will be aggregated. If the total of the interests so "acquired" constitutes at least a 50% aggregate economic interest, the interests obtained after formation will be taxed.

It is also the State's informal position that the taxation of controlling economic interest transfers applies to the "Additional Tax" under Tax Law § 1402-a, popularly known as the "Mansion Tax," The Mansion Tax is a grantee tax of 1% of consideration applicable, in general, to the conveyance of a one-to-three family residence where the consideration is $1 million or more.

However, both the RETT and RPTT also provide for an exclusion from consideration to the extent that an otherwise taxable transfer constitutes a mere change in identity or form of ownership or organization, what is generally known as the "mere change" exemption.

Section 11-2106 of the City's Administrative Code was amended by Chapter 170 of the Laws of 1994 to provide an exemption from the RPTT for transfers made on and after June 9, 1994 that effect a mere change of identity or form of ownership or organization to the extent the beneficial or other ownership interest being transferred or conveyed remains the same. The mere change exemption has, by enactment of Chapter 61 of the Laws of 1989, been applicable to the RETT since July 1, 1989. RETT exemptions are at Tax Law § 1405.

The Amendments made known at TAXRAPP include two significant, "new" positions on application of the mere change exemption to controlling interest transfers. The examples set forth below have been extracted from illustrations in the Amendments.

First, for transfers or transactions occurring *on and after January 1, 1999*, the determination of the RPTT rate to be applied to a controlling interest transfer will be determined based on the amount of consideration prior to application of the exemption. This is a change from the Department's prior position, which remains applicable to transfers occurring before January 1, 1999.

For example, X Corporation, having two shareholders, A and B, each owning 50% of the corporation's stock, owns 100% of the stock of Y Corporation, which owns unencumbered real property in the City of New York having a fair market value of $1 million. X Corporation distributes in liquidation 25% of the Y Corporation stock to A and 75% of the Y Corporation stock to B. The transfer of Y Corporation stock is exempt as a mere change of identity or form of ownership or organization *except* to the extent of the additional 25% stock interest distributed to B. The RPTT due is $6,562.50 determined by multiplying $250,000 (25% of the fair market value of the real property) by the tax rate of 2.625%. The higher tax rate applies since the "measure of tax" for the distribution of the Y Corporation stock is $1 million, which is greater than the $500,000 threshold for application of the increased rate.

This issue does not apply to the RETT since its tax rate does not change with the amount of consideration.

Second, for transactions involving economic interests, a determination of whether a controlling interest has been transferred is to be made prior to application of the exemption. Interests that are not exempt will be subject to tax even if they represent less than 50% of the capital, profits or other beneficial interests in the entity owning the interest in real property if the total of the interests being transferred, without consideration of the no change exemption, is 50% or more.

For example, Limited Partnership X has four limited partners and one general partner. A, B, C, and D, limited partners, have, respectively, 29%, 29%, 24% and 14% interests in the partnership. E, the general partner, has a 4% interest in the partnership. X owns a parcel of unencumbered real property in the City of New York with a fair market value of $1 million. Limited Partnership X merges into Limited Partnership Y in which A, B and C each have a 24% interest, D has a 14% interest, and E has a 4% interest, for an aggregate interest in Partnership Y amongst these partners of 90%. The merger is exempt as a mere change of identity or form of ownership or organization to the extent of 90%. RPTT is imposed on the 10% interest that is not a mere change. The tax due is $2,625 determined by multiplying $100,000 (the fair market value of the real property apportioned to the 10% interest in Partnership Y not covered by the mere change exemption) by the tax rate of 2.625%. The applicable rate of tax is determined by the full value of the consideration prior to application of the exemption, which in this example is $1 million, greater than the $500,000 threshold for application of the higher tax rate.

The Amendments state that this second position does not reflect a change in the policy of the Department of Finance. According to the "Basis and Purpose of Amendments" section of the Notice of Rulemaking, "(s)ince June 4, 1994, Department policy has been that for all transactions occurring on or after [June 9, 1994], the determination of whether a transaction constitutes a transfer of a controlling economic interest is made prior to the application of the mere change exemption."

The RETT statute and regulations do not specifically deal with this issue. It is, however, the State's informal position that the determination of whether a transfer is a controlling interest transfer is to be made prior to application of the mere change exemption, with the non-exempt part of the transfer being subject to tax even if less than a 50% interest.

The State's position is consistent with its prior position on the now repealed "Tax on Gains Derived From Certain Real Property Transfers" which applied to transfers of $1 million or more and can be found at former Tax Law, Article 31-B. § 590.51, of Subchapter L, Chapter III, Title 20 of the Official Compilation of Codes, Rules, and Regulations of the State of New York recited that

> [T]he million dollar exemption is applied to consideration first and then the mere change exemption is applied. A transfer in which the consideration is greater than $1 million will remain taxable, the mere change exemption only defers payment of tax on the portion of gain determined to be attributed to a mere change in form or ownership.

It is also consistent with the State's regulations on application of the Mansion Tax. Section 575.3 of Part 575, Subchapter K, of the above regulations indicates that if the overall consideration for a transfer of real property that has both residential and commercial portions is $1 million or more, the residential portion will be taxable even if it is, of itself, less than the threshold amount.

The Amendments indicate that the application of the mere change exemption to transfers to and from trusts will be dealt with at a later date.

Michael J. Berey is Senior Underwriting Counsel and Senior Vice-President of the First American Title Insurance Company of New York. Additionally, he is Co-Chair of this Section's Task Force on Computerization and Technology and is the publisher of an Internet site for New York real estate counsel found at *http://www.titlelaw-newyork.com.*

This article was previously published in Vol. 6, No. 3 of *Metes & Bounds.*

When Does Coverage Continue Under an Existing Title Insurance Policy?

By Marvin N. Bagwell

Divorces raise a whole host of contentious issues, which have become all too familiar both to the legal community and to society in general. Child custody, spousal support and ownership of the marital residence are issues that come immediately to mind. To this brief list, we can now add a new concern: the care, custody and control of the title insurance policy. Whenever the soon-to-be ex-spouses own (or soon-to-be "owned") a marital residence, there is likely to be a title insurance policy insuring their ownership interest somewhere in someone's safe deposit box. Now that the spouses are no longer recognized by the law as being one, or unitary, who gets the benefit of the title coverage?

"[W]hat is one person's meat is another's poison. What to the insured is properly viewed as the policy's continuation of coverage is considered by the underwriter to be its continuation of liability."

This question is not limited to divorces although the emotions tend to be more raw and language tends to be more colorful when those which "let no man pull asunder" split on their own accord. The same question arises on the death of a tenant (whether joint or in common), the dissolution of a partnership or the transfer of real property by individuals to their wholly owned limited liability company (LLC) or partnership (LLP). This article will consider the rules determining when coverage continues under a title insurance policy. Of course, what is one person's meat is another's poison. What to the insured is properly viewed as the policy's continuation of coverage is considered by the underwriter to be its continuation of liability. Where one stands depends upon whose ox is being gored, but far be it for us to mix our metaphors.

Time, the editors, as well as the ingenuity of the human imagination will not permit us to consider every possible permutation involving a succession of rights in and to the coverage provided by a title insurance policy. The usual situations that a title practitioner may expect to encounter are: the divorce of a married couple (tenants by the entirety becoming a tenancy in common); the natural demise (hopefully, not as a result of the tearing asunder of the unity) of one or both tenants whether joint, in common or by the entirety and the conveyance to or from a partnership, corporation, LLP or LLC to or from its constituent stockholders, partners or members. Being lawyers, the first place where we would look for an answer to the continuation of coverage question is the written contract between the parties, which is, within the title policy itself. In that regard and for the purposes of this article, we will also restrict our attention to the 1992 American Land Title Association (ALTA) form of owners and mortgage policies. Conveniently, under existing state Insurance Department regulations, and with few very minor exceptions, these are the only policy forms used currently in New York State.[1]

In order to determine whether coverage continues to a successor-in-title, we must turn our attention to two sections of the fee or owner's—the terms are used interchangably—title policy, the definition of the word "insured" and the section entitled, "Continuation of Insurance After Conveyance of Title." "Insured" is defined to include those who succeed to the interest of the named insured by operation of law as distinguished from purchase including, but not limited to heirs, distributees, devisees, survivors, personal representatives, next of kin, or corporate or fiduciary successors."[2] The operative terms within the definition are "by operation of law as distinguished from purchase." Most underwriters take the position that in order for a titleholder subsequent to the named insured to be entitled to continuing coverage under the policy, the successor-in-interest must come into title automatically purely through the passivity of a succession-in-interest sanctioned by the common law or by statute and not through an active conveyance. In the examples given above, the heirs of the deceased named insured would certainly succeed to the policy interests of the named insured. This means that the heirs of a tenant in common, a surviving joint tenant with right of survivorship as well as the surviving spouse of a deceased tenant by the entirety would continue to have coverage under the original fee or owner's title insurance policy. A corporate successor by merger or a substitute trustee would also receive the benefits of a continuation of coverage. However, continuation of coverage after a divorce and the conveyance of the marital property is not as self-evident.

Upon a divorce, or upon the judicial annulment or voiding of a marriage, tenants by the entirety become tenants in common.[3] Therefore, when the divorce decree becomes effective, both tenants would hold an undivided one-half interest in the title policy as well as in the real property. That is well and good so long as the ex-spouses remain in title. Suppose as a part of the settlement agreement or just for peace and quiet, one tenant conveys his or her undivided one-half interest to the other tenant? Since the conveyance is not automatic nor by operation of law, the title coverage for the conveying ex-spouse would cease, terminate and determine (whatever that means). Further, in a normal situation the conveyance would have been made for consideration (if not monetary consideration then in consideration of the divorce, i.e., a release from the bonds of matrimony). Therefore, the transfer from one ex-spouse to the other fails to meet both the no conveyance and no consideration tests. As a result, the ex-spouse remaining in title leaves the divorce with the entire title to the marital home but only one-half of the original title policy coverage. The other half, which belonged to the departing spouse, terminated when the departing spouse came out of title.

The situation is not much better for the conversion of an individual or group interest to a corporate or partnership interest. It is certainly not unheard of for a group of individuals to form a corporation or a partnership and to contribute real property which is owned in their individual or group name as their capital contribution to the partnership or corporation or partnership. Under the definition of "insured," since the transfer is not by operation of law and can only occur through a deed conveyance, the succeeding legal entity would have no coverage under the original title policy. In order to have fee coverage, the new entity in title must purchase a new title policy. In the case of a conveyance to a LLC or LLP, the parties to the conveyance can ameliorate this result by purchasing (for $25) an endorsement to the original policy extending coverage to the new property owner. However, the somewhat absurd and definitely consumer-unfriendly situation remains to a degree in the divorce situation. As we shall see shortly, there is salvation, but as Dante, Ulysses and other travelers discovered, it is incomplete and can only be gained through grace.

Even when coverage continues, there are limitations. First and significantly, the fact that there is now a successor to the named insured does not change the date of the policy. Therefore, no events which have occurred in the chain of title subsequent to the policy's original date (usually, the date the named insured came into title) would be covered. It also goes without saying that sans a Market Value Rider[4] the policy's original face amount is not changed by the new successor coming into title. Therefore, to cover the possibility of intervening claims and to account for the inflation in value of the property, most title underwriters and agents recommend that the successor at least consider purchasing a new policy.

The successor to the original named insured also takes the policy coverage subject to any rights that the underwriter would have against the named insured. In other words, if the named insured has given the title underwriter any reason to deny a claim, such as an act of the insured, the underwriter retains that defense against the successor to the named insured. An example of such a defense would be the original insured's participation in a fraud.[5]

Under certain circumstances, the coverage provided by a title policy will continue to a named insured even after the named insured has conveyed title. The circumstances which lead to coverage continuation are set forth in paragraph 2 of the Conditions and Stipulations of the policy which, by happenstance, is titled "Continuation of Insurance After Conveyance of Title." If the insured (1) retains an interest in the land such as would occur if the insured conveyed a fractional interest but retained the remaining share in the property; (2) holds an indebtedness secured by the property such as a purchase money mortgage; or (3) has liability under the covenants provided in the deed of conveyance to the new purchaser, coverage continues. However, coverage does not continue for anyone who purchases the insured's remaining interest in the property or who takes an assignment of the purchase money mortgage.

Recognizing that the definition of "insured" under the policy created various gaps in the continuation of coverage which were somewhat illogical and which coincidentally did not adversely affect the initial risk, the New York title industry petitioned the State Insurance Department for an amendment to the Rate Manual which expanded the situations in which coverage would continue to a successor in title. The title industry made the request through the Title Insurance Rate Service Association (TIRSA), its rate service organization duly licensed by the New York Insurance Department.[6] The State Insurance Department approved the expansions as contained in the amendments to the TIRSA Rate Manual on January 26, 1999.[7]

Under the Rate Manual, the title underwriter's "continuing liability" has been expanded to include transfers within the same corporate family,[8] among corporate stockholders pursuant to a plan of liquidation,[9] from a partnership to its constituent partners,[10] from a LLC to its members,[11] among the members of the insured's immediate family,[12] and to the insured's trust where the beneficiaries are either the insured or members of the insured's immediate family.[13] However, certain requirements must be met for the coverage to continue. For corporations, partnerships and LLCs, there can be no change in the beneficial ownership of the entity. This means that if A and B each own a 50% interest in a partnership, A and B must each also hold a 50% interest in the successor LLP. For all expanded categories, the transfers must be for no consideration, excluding the value of a mortgage or lien remaining on the land after the transfer occurs. The date of the policy also remains unchanged, so defects in title that may have arisen between the original date of the policy and the date of the transfer are not covered.[14]

Unfortunately, the TIRSA expansions do not resolve the divorce problem. A "transfer to a member of the insured's immediate family as a gift, for no consideration" entitles the successor-in-interest to a continuation in policy coverage. However, is an ex-spouse still "a member of the insured's immediate family"? If the transfer is in consideration of the divorce, is the conveyance a "gift"? There is no official guidance to which one could turn for an answer. Much will depend literally, upon the interpretive kindness of strangers, that is, of underwriters who are willing to stretch the traditional definition of family to encompass the realities of the 21st century. Hence, the appeal to grace. When posing the question, just hope that your favorite title underwriter is not having a bad hair day.

The 1992 mortgage, mortgagee or loan policy—all of which are interchangeable names for the same document—insured the validity, enforceability and lien priority of the mortgage which the lender has placed on the borrower's property to secure the borrower's payment of the mortgage note. Consequently, the lender wants to be assured that it is covered at possibly three different points in time: when it holds the loan, when it assigns the loan, and when it comes into title to the real property, usually through a foreclosure action. Here is how the policy accomplishes these goals.

The first thing that the loan policy does in its Conditions and Stipulations, is to define the term "insured." An "insured" is not only the initial owner of the indebtedness but also any successor in ownership of the indebtedness. Therefore, the initial lender's assignee of the mortgage is covered by the original title policy. The lender's assignment carries the policy coverage with it. In addition, any governmental agency or instrumentality that either insures or guarantees the mortgage indebtedness is also covered. This means that Fannie Mae, Freddie Mac, SONYMA and other assorted governmental agencies known primarily through their acronyms are assured of coverage if because of their insurance, they find themselves holding the mortgage. The coverage is as of the original date of the policy and in the policy's original amount. However, the obligor under the indebtedness, i.e., the borrower or mortgagor, is not covered if it comes into title to the mortgage. This could occur for example if a child gives a mortgage to a parent, and then because of the parent's death, the child also inherits the mortgage. The mortgage would in this case merge into the fee interest and would be extinguished.[15] The policy limitation follows the common law and simultaneously prevents a fee owner from having a double recovery under a claim if the fee owner comes into title to the mortgage.

"[I]t is a common misconception to believe that when a lender comes into title to the property usually because of a foreclosure action, the lender policy converts to a fee policy. This is untrue."

The policy, by its terms, also provides that the lender's coverage continues if the original lender or its assignee acquires title to the property by foreclosure, by deed in lieu of foreclosure or by any other means that discharges the lien of the insured mortgage. Not only is the lender covered, but also the lender's parent or subsidiary corporations by operation of law are covered. This provision expands coverage to those foreclosing lenders who choose to take title from the referee in the name of an entity other than that of the original lender. Finally, the governmental agency which acquires the indebtedness, presumably because it insured that the borrower would pay the lender, retains coverage as well.[16]

However, it is a common misconception to believe that when a lender comes into title to the property usually because of a foreclosure action, the lender policy converts to a fee policy. This is untrue. The mortgage policy remains as a mortgage policy and does not convert to a fee policy. Therefore, upon coming into title to the property, the lender does not gain the expanded coverages provided by the owner's or fee policy, but retains the indemnity against loss of the mortgage or loan policy.

An insured lender, after it comes into fee title to the real property, usually hopes to convey the property as quickly as possible. The lender's title insurance coverage will continue after the conveyance to a third-party buyer, so long as the insured lender holds an interest in the land, holds an indebtedness secured by the land (i.e., a purchase money mortgage, or has liability by reason of the warranty covenants (such as, "the said party of the first part is seized of said premises in fee simple, and has good right to convey the same") contained in its deed of conveyance. However, coverage does not continue to anyone who purchases the land or the indebtedness from the lender in possession of the real property.[17] This prevents cost-conscious lenders from saving money (and not so coincidentally thereby depriving the title underwriter of a premium) through an assignment of the title policy along with the deed of conveyance.

Presumably, absent fraud, mortgages do not go into foreclosure immediately after closing. We can expect usually that the borrowers would have made some payments that have the effect of reducing the amount due on the loan. The title policy provides that the underwriter obtains the benefit of the decreasing amount due under the loan in that the amount of coverage provided by the policy decreases as the mortgage is paid off. Therefore, the amount of insurance coverage provided to a successor lender by assignment or to a lender in possession of the real property cannot exceed the least of the face amount of the policy or of the principal amount of the indebtedness plus the fees and expenses incurred by the lender and associated with the foreclosure action, less the amount of the payments made on the mortgage by the borrower.[18] Hence, in the event of a foreclosure, the title underwriter shares in any decrease in the mortgage liability or in the increasing equity in the property as enjoyed by the lender.

"[B]ecause of inflation and to cover the gap in time between the date of the original policy and the new assumption of title, the wise counsel should obtain a new policy for his or her client."

Now that we have described how coverage continues, one question remains. Given that title underwriters derive their income and hence, can only survive through the receipt of premiums, why would they want coverage to continue at all? After all, when coverage continues, no new premium is generated. The answer has to do with risk. Under all of the situations where coverage continues, the later risk is virtually identical to the liability assumed by the title underwriter upon the issuance of the original policy. This is the case because in all situations, the continuation of liability does not change the policy's face amount nor its original date. Hence the title underwriter's original liability or risk has not changed either. However, when the insured property has been conveyed for consideration, by definition a sale has occurred and to the extent of the sale, the original insured is now out of title. The intervening sale or conveyance creates a new risk for which the title underwriter should be compensated if it is to provide coverage.

This is also the case in corporate conversions from individuals to a corporation, corporations to LLCs, individuals to partnerships, corporate mergers or partnerships to LLPs. The original parties remain the same and therefore the originally assumed risk does not change. When the composition of the new entity changes from that of its original formulation, a new risk factor enters into the original equation. The title underwriter deserves to be compensated for the assumption of the new risk. On the mortgage side, the same analysis is at work. By far, the most continuations of coverage situations occur when mortgages are assigned. The title underwriter's coverage of the assignment relates back to the original loan in its original amount. Also, the legal correctness of the assignment itself is not insured. Hence, the coverage can continue because the assignment does not change the title underwriter's original risk. In general, when a change in title occurs through the operation of law as opposed to an actual conveyance or sale, when the transfer is for no consideration, and in change of entity situations, where the new entity is composed of the same parties as the original entity, coverage can continue because the title underwriter's original risk has not been altered.

Although the divorce situation posed at the beginning of this article remains unsettled, as we have seen there are many situations in which the coverage provided by a title insurance policy will continue to a successor-in-interest, providing that certain conditions are met. The coverage remains in the same amount as, and is as of the date of the original policy. Therefore, because of inflation and to cover the gap in time between the date of the original policy and the new assumption of title, the wise counsel should obtain a new policy for his or her client. That way, especially in the more and more common divorce situations, the existence and amount of coverage would not be left to the vagaries of your underwriter's mood on a particular day. And besides, the underwriter would certainly not object to the payment of a new premium though far be it from us to suggest that a title underwriter would have any mercenary intentions or derive any benefit from confusion. Res ipsa loquitor.

Endnotes

1. The State Insurance Department approved the use of the ALTA 1990 form of policy until December 31, 1993. After that date, title underwriters could only legally issue the 1992 ALTA, Short Form Residential Loan, Junior Loan, Short Form Junior Loan and the United States policy forms.
2. 1992 ALTA Owner's Policy, Definition of Terms, paragraph 1(a).
3. 13 Warren's Weed, New York Real Property § 6.01 (4th ed. 2000).
4. Pursuant to § 6409c of the Insurance Law, title insurance underwriters are required to offer for an additional premium to the purchaser of a one-to-four family residential property an endorsement to the original policy, which increases the face amount of the policy to the property's market value when the claim occurs. Hence a fee insured would be covered for the inflation in the value of the insured property.
5. For example, see the fact situation discussed by the Court in *Ghaly v. First American Title Insurance*, 93 N.Y.2d 814 (1997); *see* N.Y.L.J., Dec. 29, 1997, at 21.
6. *See* N.Y. Ins. Law art. 23 § 2313 (McKinney 1985).
7. *See Rate Manual*, § 32 (Title Insurance Rate Service Association, Inc. 1999).
8. *Id*. " . . . from a parent corporation to a wholly–owned subsidiary; from a wholly-owned subsidiary company to its parent company; from one company to another, each of which are wholly-owned subsidiaries within one corporate group, or each of which have identical stockholders, partners or members in

identical proportion."

9. *Id*. " . . . by a corporation to its stockholders pursuant to a plan of liquidation; by the named insured individual or individuals in exchange for all of the capital stock of a corporation."

10. *Id*. " . . . from a partnership to its partners upon the dissolution of the partnership; by the named insured individuals or individuals to a partnership as part of the named insured's capital contribution to the partnership."

11. *Id.* at I-13." . . . from a limited liability company to its members upon the dissolution of the limited liability company; or by the named insured individual or individuals to a limited liability company; or by the named insured individual or individuals to a limited liability company, as part of the named insured's capital contribution to the limited liability company."

12. *Id.* ". . . to a member of the named insured's immediate family as a gift, for no consideration. For the purpose of this section, immediate family is limited to the spouse, issue as that term is defined in the New York Estate, Powers and Trust Law, parents, brothers and sisters (but not the issue of brothers and sisters) of the named insured."

13. *Id.* " . . . to a trust created by the named insured in which all of the beneficiaries, lifetime and remainder, are either the insured or members of the insured's immediate family."

14. Until 1982, the terms and conditions of the title insurance policy were supplemented by the Rate Manual of the New York Board of Title Underwriters (the "NYBTU Rate Manual"). The NYBTU Rate Manual expanded the title policy's coverage provisions by setting forth specific instances where coverage would continue after a new entity succeeds to the original insured's interest in the property. For example, under the NYBTU Rate Manual, corporations having the same shareholders could transfer property among themselves and member of the same family could make intrafamily no-consideration gifts among themselves and not lose the benefit of a title insurance policy. However, the NYBTU disbanded in 1982. For guidance as to coverage issues for policies issued between 1982 and January 29, 1999, the terms and conditions of the policy itself must be consulted, which admittedly, is not always the most pleasant of chores.

15. *See* 8 Warren's Weed, § 5.01 (4th ed. 2000).

16. 1992 ALTA loan policy, "Conditions and Stipulations," ¶ 2a.

17. *Id.* at ¶ 2b.

18. *Id.* at ¶ 2c.

Marvin N. Bagwell is Vice-President and Chief Counsel for the New York Division of United General Title. He is currently the Vice-Chair of the Title Section of the New York State Land Title Association; Vice-President of the Title Insurance Rate Service Association; and the author of several articles published in the *New York Law Journal* and the *New York Real Estate Law Reporter.*

The Nassau County Fiscal Problems—Sui Generis?

By Jon N. Santemma

Nassau County consistently ranks among the most desirable areas in the state in terms of the personal wealth of its residents, the income generated by those residents, and the value of its real property. How has this excellent suburban county now reached the point at which its municipal bonds approach the status of junk bonds? Can similar circumstances cause major financial problems in other counties and municipalities in the state? What role do real estate taxes play in this situation?

Nassau County's fiscal health is dependent upon the amount of money it spends and the amount of money it takes in. For at least a decade, Nassau County has simply taken in less than it pays out. Rather than raising the County portion of the tax rate (about 15% of the total real estate tax burden), Nassau floated bonds to pay the difference.

While many reasons have been advanced for the high level of expenditures, it seems generally agreed that the problem has been exacerbated by extraordinary awards in binding arbitration with the police, a proliferation of County employees whose seniority has reached substantial levels of compensation, and payment of real estate tax refunds.

Nassau County and Tompkins County are the only two counties in the state in which the county is the assessing jurisdiction, and not the individual towns that comprise the county. That uniqueness in and of itself does not create a fiscal problem. However, the difficulty in Nassau County stems from the fact that, since 1948, the towns, school districts, and special districts in Nassau County that comprise hundreds of taxing entities are each guaranteed by the full amount of the taxing entities' real estate tax revenue as required by their respective budgets without having any exposure to paying refunds.

Nassau receives its real estate tax income under the same mechanism by which counties throughout the state obtain their real estate tax revenues. Payments of real estate taxes for all government (except villages and cities) are made to the Town Receiver of Taxes, who then distributes the payment among the appropriate school districts, towns, special districts (fire, water, park, library, lighting, sanitation, etc.). After all other municipalities have been paid, the town remits the balance collected to the county on account of the county budget. The county absorbs whatever loses are represented by the difference between collections and budgeted income for local real estate taxes. Thus, everyone except the County is virtually guaranteed their necessary and budgeted cash flow.

When assessed valuations are then reduced by court order as a result of successful certiorari proceedings, most counties make the refund to the taxpayer on behalf of the county itself and all other municipalities, school districts, and other districts in its territory. Generally, the counties then charge back the town, school district, or special district with the amounts paid by them on the district or town's behalf.

In Nassau County, however, the process stops before the charge-back. The law is such that Nassau County may not charge the refunds back to the municipalities or districts within its borders for the amount refunded due to over-assessed property, probably on the theory that, since Nassau is the entity fixing the assessed values, Nassau ought to stand behind its assessments. This process, by which Nassau County absorbs those refunds, has cost Nassau County over $800 million in the past ten years.

Nassau County is unusual in that it guarantees the payments to the local towns and districts; other counties cannot be put in the position of incurring a recurring expenditure for the refund of real estate tax payments for tax or money spent by some other taxing jurisdiction. Other counties are ultimately responsible for their own percentages of the refunds (in Nassau County's case, say 15% or "only" $100 million as opposed to a figure eight times that amount).

"How has this excellent suburban county [Nassau] now reached the point at which its municipal bonds approach the status of junk bonds?"

How is Nassau County modifying its procedures to cope with the magnitude of the refunds? It has adjusted its methodology for reviewing assessed valuations, thus providing for more active attention to cases as they first enter the system. Essentially, if the assessment is reduced before the tax is paid, there are no refunds involved. Each municipality must raise its respective tax rate to collect the amount budgeted. A year-round assessment review commission has been established by the County through state legislation, an effort which had been advocated by the County Executive for some time and which became effective within the past grievance period (January 1 - February 29). Their results, announced for the final assessment rolls (April 1), are encouraging because of significant adjustments in prospective assessments. This eliminates the wait for case resolution, which could follow the initial challenges by several years.

This year-round commission is an invaluable tool in establishing an equitable assessment review process, provided that unsuccessful or unsatisfied petitioners continue to have access to court when cases cannot be promptly resolved through administrative review. The County Attorney's Office has also implemented a voluntary mediation process which, although in its infancy, has great promise of enabling the case resolution sooner and faster.

The cost of operating a government, which includes a police force, parks and recreations, roads, maintenance, housing, etc., will continue to be an expense that must be met. This is true for every other county in the state that enjoys the same level of services as Nassau County.

Somewhat unique is the extensive county police force that is the backbone of police protection on Long Island, including both Nassau and Suffolk counties. These services are provided in other less densely populated areas by Town Police and State Police. As a result, the demands on the county government alone are quantitatively higher in Nassau than the rest of the state. Furthermore, the high population density also affects a qualitative difference.

Suffolk County also enjoys a large County Police Department, yet it charges back to the local municipalities for tax refunds made by the county. Its major issues in tax certiorari, such as those involved in the dismantling of the Shoreham Nuclear Plant, may approach the magnitude of those charged in Nassau County, but are not automatically the ultimate responsibility of the County. This is because the assessed values are fixed and defended by each of the nine towns in Suffolk County.

Regardless of whether a county is simply a guarantor of payment, as in Suffolk, or a sole payer of refunds, as in Nassau, the impact of tax certiorari proceedings on local municipalities cannot be overstated. Each year the cost of government rises. Then, as the municipalities' need for money rises and the assessment roll remains static, tax rates must rise or a deficit is built into the municipality budget. Each year that taxes go up, however, the value of the real estate that must pay those taxes decreases because a property with a stabilized cash flow will suffer a reduced market value as a result of the diversion of a greater portion of that cash flow to real estate taxes and away from returns on investment.

"Local towns and districts in Nassau County are justifiably nervous about what a revaluation will do for them or to them."

Maintenance of a reasonably accurate assessment roll is in the best interest of every municipality. The magic word is "maintenance," not "revaluation." For example, the City of New York has not revalued the entire city in recent memory. However, every year the assessor in the City of New York makes adjustments in various communities and property types upwards or downwards depending upon the trends of values in those communities. While the real estate tax review process in the city has other problems, at least from the standpoint of maintaining an assessment roll, it constantly does make changes so as to reflect, over the greater period of a number of years, a reasonable approximation of what trends are going on in the various component parts of the city.

Nassau County has not reassessed the 400,000 parcels of real property that comprise the County of Nassau since 1938. It revalued the 26,000 to 30,000 commercial and industrial properties 14 years ago, and the current (perhaps unanimous) belief on the part of the local elected officials and practitioners is that a revaluation of the entire county should take place within the next two or three years.

A revaluation, with continued growth of the Assessment Review Commission and speedy access to the courts (when cases are not resolved by the Commission) would enable the County, as an entity, to increase its responsiveness to the taxpayers and decrease its responsibility for the payment of refunds. The machinery is in place, and such refinements are in the best interests of the County. Unfortunately, a revaluation, and to a far lesser extent, staffing of the review commission, involves very substantial cash outlays at a financially difficult time.

There are all kinds of estimates as to whether taxpayers' bills will rise or fall after a revaluation, not to mention the impact on this town or that town, or its effect on residents, commercial properties and other aspects of Nassau County life. Again, real estate taxes are a function of two components, the assessed valuation and the tax rate. Assuming that the amount of money needed to operate government, whether for a special district, school district, or town, remains constant, the tax rate must decrease if the assessed valuation rises, and vice versa. There will be some shifts somewhere, but no one knows just where.

Local towns and districts in Nassau County are justifiably nervous about what a revaluation will do for them or to them. There is no scientific answer to that question, nor will there be until a revalued assessment roll is created that reflects a revalued analysis of the entire county. At that point, projections can be made as to what the tax rates would be in the various sub-municipalities in the county based upon the amounts of their budgets.

Unlike towns in the rest of the state, the fact that the County is required to stand behind its assessed valuations and guarantee that any shortfall in revenues as a result of erroneous valuations will not harm the local town or district, the massive revaluation project becomes more palatable. In the long run, there should be a system in place which is more equitable, far simpler to explain and understand, and where the County's exposure for refunds is reduced, yet individual towns have a fixed understanding of where they stand with respect to the impact on their tax rates.

Reviews of assessed valuations, however, will continue to grow because the total tax burden continues to inexorably rise. A mass revaluation approach can never be as accurate as an individual tax parcel analysis by a knowledgeable tax certiorari practitioner because the value in any community shifts, rises and falls unevenly each year, particularly in a single assessing jurisdiction as large and diverse as Nassau County.

However, any system that gives people greater understanding of how government functions is good. Additionally, concepts that tend to stabilize the chaotic process of updating an archaic system are also good.

Accordingly, the revaluation process, coupled with an active and fully staffed commission of assessment review, plus periodic adjustment of the assessment roll, would help to substantially reduce Nassau County's responsibility for real estate tax refunds. No one can reasonably oppose such a program, providing there is swift access to the courts for review of those cases in which the Commission is not responsive. That access is the *sine qua non* necessary for the protection of taxpayers' rights.

"The Certiorari and Condemnation Committee of the New York State Bar Association has urged the creation of a state commission to revise these archaic laws and to create a new method of handling real estate tax assessment problems."

The failure of Nassau County to raise that 15% portion of the real estate tax that pays for its expenses, the high costs of doing business for Nassau County services, and Nassau's primary and sole liability for the payment of real estate tax refunds, are prime components of Nassau County's fiscal problem. In the unlikely event that these three factors exist in any other county or municipality in the state, a problem similar to Nassau County's present crisis is possible. By modifying the real estate tax review process and fixing the assessment roll to reflect accurate figures, Nassau County can move towards the firmer economic footing enjoyed by its sibling counties in the state.

While Nassau County's position is unique, the recent turn of events should serve as a cautionary message to all municipalities that the underlying process of making, fixing and reviewing assessments, magnifies budgetary shortfalls. In fact, the assessment process may need an overhaul statewide in order to prevent a potential disaster in next economic downturn.

We are operating in New York State under a 100-year-old statutory scheme of property tax, assessment, and review procedures. The Certiorari and Condemnation Committee of the New York State Bar Association has urged the creation of a state commission to revise these archaic laws and to create a new method of handling real estate tax assessment problems.

Jon N. Santemma is a partner at Santemma and Deutsch, LLP. He is Co-Chair of this Section's Condemnation, Certiorari, and Real Estate Taxation Committee; author of articles for the New York State Bar *Journal, Real Estate Law Journal*, and *Institute for Property Taxation*; and Past President of the Nassau County Bar Association.

The New York State Low Income Housing Tax Credit: Encouraging Private Investment in Affordable Housing

By Stephen Hicks

Established under the Tax Reform Act of 1986 to promote private sector involvement in the production of affordable rental housing, the Federal Low Income Housing Tax Credit Program utilizes tax incentives to attract substantial private investment in low income housing.

Realizing the need for more affordable housing in New York and building on the success of this Federal Tax Credit Program, Governor Pataki proposed a New York State version. The New York program, passed by the Legislature and signed by the Governor on May 15, 2000 would operate essentially the same as the federal program.[1]

This article will briefly describe the federal program and highlight some of the features of the newly created New York version.

The Federal Program

This tax credit program, existing in § 42 of the Internal Revenue Code,[2] provides a dollar for dollar reduction in federal income tax liability for project owners who develop, rehabilitate and acquire low income rental housing. The objective is to provide investor equity capital to reduce debt service and thereby lower rents. Tax credits are utilized by developers and not-for-profits as a budget "gap filler" in developing these rental projects through the sale of the project to a syndicated pool of investors.

Though the allocated tax credits are used each year for a ten-year period, the project by law must remain affordable in accordance with the income and rental guidelines described below for 15 years plus an additional 15 years pursuant to the terms of a recorded land use agreement.[3] The code provides for a buyout provision after 15 years which, if triggered, could under certain circumstances cause the project to phase out the rent restrictions over a three-year period. To qualify, the rental project must be a "qualified low-income housing project."[4] The building must have either at least 20% of its units rent restricted and occupied by tenants earning not more than 50% of the area median income as set by the United States Department of Housing and Urban Development; or at least 40% of its units must be rent restricted and occupied by tenants earning not more than 60% of the area median income. These restrictions are known as the 20/50 and 40/60 tests. Tax credits are only available for the number of units in the rental project that are both rent restricted and occupied by low income tenants. Rent, including utilities, cannot exceed 30% of the qualifying income.[5]

> *"The objective is to provide investor equity capital to reduce debt service and thereby lower rents."*

There are actually two types of credits in the federal program—the 9% credit and the 4% credit—referred to as the "Applicable Percentage."[6] Both credits are allowable over a ten-year period. Which credit is available depends on the building's characteristics and what, if any, additional federal subsidies are received. The goal is for the credit to yield a present value of either 70% or 30% of the building's qualified basis over a ten-year period. This requires the Treasury Department to recompute each month, based on a statutory interest rate formula, the annual percentage rate for each credit. Therefore, although labeled a "9%" credit and "4%" credit, in reality the actual percentages are not 9 and 4, and they each change monthly. For example, in March 2000 the 9% credit (70% present value) was 8.59%, while the 4% credit (30% present value) was 3.68%.

How Equity Is Raised

After receiving an allocation of tax credits, the awardee generally works with a syndicator to sell interests in the rental project together with the corresponding percentage of credits. Investors today pay approximately 80 cents for each year of every one dollar of tax credit. So that one dollar of credit available each year for ten years would generate $8. It is not known how much equity can be raised with the New York credit. The market will dictate its value and its full potential may not be realized for some time. When the federal program was first commenced, approximately 42 cents was generated for every federal tax credit dollar awarded. Today the market price has nearly doubled.

Each year the New York State Division of Housing and Community Renewal (DHCR), as the lead Housing Credit Agency for New York State, receives an allotment of federal tax credits. These credits are distributed in accordance with a "Qualified Allocation Plan" (QAP).[7] Required by law, the QAP is prepared by the state and adopted after public hearings. This document sets forth the criteria and preferences by which credit will be allocated to projects. Credits are awarded to eligible applicants after a Notice Of Funding Availability (NOFA) is published and DHCR staff score all applications to determine the best projects. Demand for these federal tax credits continually far exceeds the supply.

The New York Initiative

Overall, New York's tax credit program, new Article 2-A of the Public Housing Law, will operate the same as the federal one with a few important differences.

First, the New York tax credit will reduce New York State tax liability—not federal—under Article 9-A, 22, 32 or 33 of the Tax Law.[8] Second, and most important, New York will require at least 40% of the building to be rent restricted and occupied by tenants earning not more than 90% of the area median income. The New York law essentially deletes the 20/50 federal test for the project and amends the 40/60 federal test to be a 40/90 test.[9]

By allowing the project to rent to tenants earning more than 60% of area median income but less than 90% those families currently shut out of federal tax credit projects, but without the financial resources to pay market rent or purchase a home, can enjoy an affordable apartment. For example, in Dutchess County 60% of area median income for a family of four is $35,760, while 90% of area median income is $53,640. To qualify for a federal tax credit rental unit a family of four would need to earn less than $35,760. An income of either $36,000 or $49,000, both below 90% of the area median income, disqualifies the family from the building constructed with federal tax credits, but would allow them to move into one created with state tax credits.

The New York initiative should increase the low income population eligible for affordable housing, strengthen communities by creating affordable housing for other working families, and promote the development of mixed income housing. With the ability to charge higher rents developers can service more debt and should need less public subsidy to operate a financially stable project.

One other difference in the two programs involves the recapture of credits due to an error by the developer in complying with the tenant income eligibility test described above. Unlike the federal law, New York State grants the Commissioner of Taxation and Finance, in consultation with DHCR's Commissioner, the ability to ignore the error upon a determination that such error is de minimis.[10]

". . . New York will require at least 40% of the building to be rent restricted and occupied by tenants earning not more than 90% of the area median income."

Other Features of the N.Y.S. Law

The legislation sets an overall ceiling on the state credit of $2 million and funds the program for the current fiscal year.[11] Although the statute does not sunset, whether or not this program exists next year will hinge on the state's decision to fund it again. Investors, however, have ten years to use awarded credits whether or not the program exists in future years.

A state tax credit program exists in several other states including Massachusetts, Virginia and California. Unlike many other states, New York-based projects would not be required to receive an allocation of federal credits as a condition for qualifying for state tax credits. Therefore, the state credits can be allocated separately from the federal credits.

Under the legislation, DHCR will administer both the federal and state programs and is responsible for determining the amount of the credits to be awarded.

All provisions of § 42 of the Internal Revenue Code not inconsistent with the New York statute shall apply to the New York Tax Credit program.[12] Therefore, federal provisions such as the not-for-profit set aside as well as the boost for Qualified Census Tracts (QCT) and Difficult to Develop Areas (DDA) are part of the New York State Tax Credit initiative.

If any state tax credits exceed the amount of the state tax liability for any tax year, the excess could be carried forward to the following year or years.[13]

In the determination of the Commissioner of DHCR, any award of New York tax credits must be the least amount necessary to ensure a project's financial feasibility.[14]

DHCR will oversee compliance with the State Tax Credit Program and must annually issue eligibility statements to the New York State Department of Taxation and Finance.[15]

What Happens Next?

Working with the New York State Department of Taxation and Finance, DHCR must establish allocation and compliance procedures for the state credit by promulgating rules, regulations and forms necessary to administer the provisions of the act.[16] The regulations may include DHCR's scoring criteria of tax credit applications including what project factors will be rewarded with a higher score.

DHCR will seek input from potential users—developers, attorneys, syndicators and others—before drafting proposed regulations. These proposed regulations will then be delivered to the Governor's Office of

Regulatory Reform for review, followed by publication for a 45-day public comment.

Thereafter, final regulations will be adopted and published. In the event that this process is not completed by the Fall of 2000, DHCR may opt to issue emergency regulations in the interim.

DHCR generally issues a Notice of Funding Availability (NOFA) each fall for most of its capital programs including federal tax credits and Housing Trust Fund money with applications due the following February and awards announced in June. The state tax credits could be processed pursuant to a similar timetable during the upcoming funding round—Unified Funding 2001. Alternatively, DHCR may elect to issue an earlier, separate NOFA for these state credits. Any decision will be influenced by the comments DHCR receives from the pool of potential users.

Endnotes

1. Empire Zones Program Act, ch. 63, 2000 N.Y. Laws.
2. 26 U.S.C.A. § 2 (West 1998).
3. *Id.* at § 2(h)(6).
4. *Id.* at § 42(g)(1).
5. *Id.* at § 42(g)(2).
6. *Id.* at § 42(b).
7. *Id.* at § 42(m)(1)(b).
8. N.Y. Tax Law § 18(a) (McKinney 1998).
9. N.Y. Pub. Hous. Law § 21(5)(B) (West 1989 & Supp. 2000).
10. N.Y. Tax Law § 18(b)(5)(c).
11. N.Y. Pub. Hous. Law § 22(4).
12. *Id.* at § 25(2).
13. N.Y. Tax Law § 210(30)(b).
14. N.Y. Pub. Hous. Law § 22(5).
15. *Id.* at § 21(4).
16. *Id.* at § 25 (1).

Stephen Hicks is currently the First Deputy Commissioner at the New York State Division of Housing and Community Renewal, and a member of the Not-for-Profit subcommittee of the NYSBA Real Property Section.

Bergman on Mortgage Foreclosures:

Effect of an Appeal on a Foreclosure

By Bruce J. Bergman

This sounds like the obscure stuff, but attorneys know it is a real issue. True, heavily litigated foreclosures are a minority of the cases, but they *do* happen, and knowing proper strategy in tough situations is a worthy advantage.

When a mortgage foreclosure action *is* litigated, it is always possible that an aspect of that litigation could be an appeal. Suppose, for example, a judgment of foreclosure and sale is granted (which, of course, authorizes conducting a foreclosure sale), but the borrower files an appeal. Although there is room for some middle ground, it is most often reasonable to assume that the appeals court will either affirm or reverse. Should the foreclosing plaintiff await the result of the appeal, to avoid whatever consequences may emerge from the uncertainty, or should it dodge delay and speed to the presumed resolution of foreclosure sale? And if a foreclosure sale *is* conducted, what would be the effect on the ownership of the property if a reversal puts the foreclosure back to an earlier stage, or worse, dismisses the action?

A case of recent vintage provides some answers.[1] The ruling there was that a good faith purchaser is entitled to retain the ownership evidenced by the referee's deed even though the foreclosure was reversed on appeal. Such a result then confines the foreclosing plaintiff to an action solely upon the monetary obligation.[2] Critically, that the foreclosure sale purchaser may have had actual knowledge of the appeal does not vitiate his position as a bona fide purchaser for value.

"When a mortgage foreclosure action is *litigated, it is always possible that an aspect of that litigation could be an appeal."*

The answer then to the question: if the foreclosing plaintiff is very confident in the result of the appeal, there isn't so much to debate, although these things can never be so certain. To the extent there is some chance of reversal on appeal, if the plaintiff is the purchaser at the sale, danger seems to be eliminated. The only real jeopardy would result upon the confluence of a reversal, a third party bidder at the sale and a remaining debt that couldn't be recouped from the borrower.

Endnotes

1. *Aubrey Equities, Inc. v. Goldberg*, 247 A.D.2d 253, 668 N.Y.S.2d 598 (1st Dep't 1998).
2. *Id.*, citing *DaSilva v. Musso*, 76 N.Y.2d 436, 560 N.Y.S.2d 109, 559 N.E.2d 1268 (1990).

Mr. Bergman, author of the three-volume treatise, *Bergman on New York Mortgage Foreclosures*, Matthew Bender & Co., Inc. (rev. 1999), is a partner with Certilman Balin Adler & Hyman, LLP in East Meadow, New York, outside counsel to a number of major lenders and servicers, and an Adjunct Associate Professor of Real Estate with New York University's Real Estate Institute where he teaches the mortgage foreclosure course. He is also a member of the USFN, the American College of Real Estate Lawyers and is on the faculty of the Mortgage Bankers Association of America School of Mortgage Banking.

Section Committee & Chairs

The Real Property Law Section encourages members to participate in its programs and to volunteer to serve on the Committees listed below. Please contact the Section Officers or Committee Chairs for further information about the Committees.

Committee on Attorney Opinion Letters
David J. Zinberg (Co-Chair)
250 Park Avenue
New York, NY 10177
(212) 907-9601
Fax: (212) 907-9681
E-Mail: dzinberg@ingramllp.com

Jill M. Myers (Co-Chair)
46 Prince Street
Rochester, NY 14607
(716) 697-0041
Fax: (716) 697-0043
E-Mail: myersj@dellmet.com

Task Force on Commercial Foreclosure Reform
Richard S. Fries (Chair)
200 Park Avenue, 15th Floor
New York, NY 10166
(212) 801-9200
E-Mail: rfries@btpm.com

Committee on Commercial Leasing
Dorothy H. Ferguson (Co-Chair)
46 Prince Street
Rochester, NY 14607
(716) 697-0042
Fax: (716) 697-0043
E-Mail:
dorothyferguson@choiceone.net

Joshua Stein (Co-Chair)
885 Third Avenue, Suite 1000
New York, NY 10022
(212) 906-1342
Fax: (212) 751-4864
E-Mail: joshuastein@lw.com

Committee on Computerization & Technology
Michael J. Berey (Co-Chair)
149 Lee Road
Scarsdale, NY 10583
(212) 922-0647
Fax: (212) 331-1511
E-Mail: mberey@firstam.com

Leonard E. Sienko, Jr. (Co-Chair)
12 East Main Steet
Hancock, NY 13783
(607) 637-5400
Fax: (815) 361-2750
E-Mail: lennyesq@hancock.net

Committee on Condemnation, Certiorari & Real Estate Taxation
Jon N. Santemma (Co-Chair)
120 Mineola Boulevard, Suite 240
P.O. Box 1662
Mineola, NY 11501
(516) 294-8081
Fax: (516) 294-8302
E-Mail: sandattys@aol.com

Lawrence A. Zimmerman (Co-Chair)
20 Corporate Woods Boulevard
Albany, NY 12211
(518) 465-7563
Fax: (518) 465-7646
E-Mail:
lzimmerman@helmshapiro.com

Committee on Condominiums & Cooperatives
Matthew J. Leeds (Co-Chair)
1290 Avenue of the Americas
New York, NY 10104
(212) 541-2290
Fax: (212) 541-1390
E-Mail: leeds@rspab.com

Joseph M. Walsh (Co-Chair)
42 Long Alley
Saratoga Springs, NY 12866
(518) 583-0171
Fax: (518) 583-1025
E-Mail: wwllp2@aol.com

Committee on Continuing Legal Education
Terrence M. Gilbride (Co-Chair)
One M&T Plaza, Suite 2000
Buffalo, NY 14203
(716) 848-1236
Fax: (716) 849-0349
E-mail:tgilbrid@hodgsonruss.com

Harold A. Lubell (Co-Chair)
1290 Avenue of the Americas
New York, NY 10104
(212) 541-2130
Fax: (212) 541-4630
E-Mail: lubell@rspab.com

Committee on Environmental Law
Joel H. Sachs (Co-Chair)
1 North Broadway, Suite 700
White Plains, NY 10601
(914) 946-4777
Fax: (914) 946-6868
E-Mail: jsachs@kblaw.com

John M. Wilson, II (Co-Chair)
2400 Chase Square
Rochester, NY 14604
(716) 232-5300
Fax: (716) 232-3528
E-Mail: jwilson@boylanbrown.com

Committee on Land Use & Planning
Karl S. Essler (Co-Chair)
Two State Street, 14th Floor
Rochester, NY 14614
(716) 232-1660
Fax: (716) 232-4791
E-Mail: atty@fixspin.com

Carole S. Slater (Co-Chair)
36 West 44th Street, Suite 712
New York, NY 10036
(212) 391-8045
Fax: (212) 391-8047
E-mail:csslater@msn.com

Committee on Landlord & Tenant Proceedings
Edward G. Baer (Co-Chair)
377 Broadway
New York, NY 10013
(212) 431-1300
Fax: (212) 941-9214
E-Mail: eddy57@aol.com

Hon. Peter M. Wendt (Co-Chair)
111 Centre Street
New York, NY 10013
(212) 374-8402
Fax: (212) 374-0402

Committee on Legislation
Robert W. Hoffman (Co-Chair)
1802 Eastern Parkway
Schenectady, NY 12309
(518) 370-4743
Fax: (518) 370-4870
E-Mail: rwhooplaw@juno.com

Flora Schnall (Co-Chair)
303 East 57th Street, Suite 20-D
New York, NY 10022
(212) 704-6171
E-Mail: flora2050@aol.com

Committee on Low Income & Affordable Housing
Jerrold I. Hirschen (Co-Chair)
36 West 44th Street, Room 712
New York, NY 10036
(212) 819-1130
Fax: (212) 302-8536
E-Mail: jhirschen@counsel.com

Brian E. Lawlor (Co-Chair)
38-40 State Street
Albany, NY 12207
(518) 486-6337
Fax: (518) 473-8206
E-Mail: blawlor@dhcr.state.ny.us

Committee on Not-for-Profit Entities and Concerns
Anne Reynolds Copps (Co-Chair)
126 State Street, 6th Floor
Albany, NY 12207
(518) 436-4170
Fax: (518) 436-1456
E-Mail: arccopps@albany.net

Mindy H. Stern (Co-Chair)
60 East 42nd Street
New York, NY 10165
(212) 661-5030
Fax: (212) 687-2123
E-Mail: mstern@schoeman.com

Committee on Professionalism
Peter V. Coffey (Co-Chair)
224 State Street
P.O. Box 1092
Schenectady, NY 12301
(518) 370-4645
Fax: (518) 370-4979
E-Mail: pcoffey1@worldnet.att.net

Janet Sandra Stern (Co-Chair)
1025 Old Country Road, Suite 205
Westbury, NY 11590
(516) 876-1106
Fax: (516) 997-7876
E-Mail: janet@sawlaw.com

Committee on Publications
William A. Colavito (Co-Chair)
1 Robin Hood Road
Bedford Hills, NY 10507
(914) 666-4606
Fax: (914) 241-1881
E-Mail: wcolavito@yahoo.com

Harry G. Meyer (Co-Chair)
1800 M&T Plaza, Suite 2000
Buffalo, NY 14203
(716) 848-1417
Fax: (716) 849-0349
E-Mail: hmeyer@hodgsonruss.com

Robert M. Zinman (Co-Chair)
St. John's University School of Law
8000 Utopia Parkway
Jamaica, NY 11439
(718) 990-6646
Fax: (718) 990-6649
E-Mail: bob@zinman.com

Committee on Public Relations
Maureen Pilato Lamb (Co-Chair)
510 Wilder Building
One East Main Street
Rochester, NY 14614
(716) 325-6700
Fax: (716) 325-1372
E-Mail: mplamb@frontiernet.net

Harold A. Lubell (Co-Chair)
1290 Avenue of the Americas
New York, NY 10104
(212) 541-2130
Fax: (212) 541-4630
E-Mail: lubell@rspab.com

Committee on Real Estate Financing
Lester M. Bliwise (Co-Chair)
125 West 55th Street
New York, NY 10019
(212) 424-8111
Fax: (212) 424-8500
E-Mail: lbliwise@llgm.com

Leon T. Sawyko (Co-Chair)
130 East Main Street
Rochester, NY 14604
(716) 232-4440, ext. 235
Fax: (716) 232-1054
E-Mail: lsawyko@harrisbeach.com

Committee on Title & Transfer
Karl B. Holtzschue (Co-Chair)
122 East 82nd Street
Apt. 3C
New York, NY 10028
(212) 472-1421
Fax: (212) 472-6712
E-Mail: karl_holt@msn.com

Samuel O. Tilton (Co-Chair)
2 State Street
700 Crossroads Building
Rochester, NY 14614
(716) 987-2841
Fax: (716) 454-3968
E-Mail: stilton@woodsoviatt.com

Committee on Unlawful Practice of Law
Christine M. Kim (Co-Chair)
787 7th Avenue
New York, NY 10019
(212) 728-8611
Fax: (212) 728-8111
E-Mail: ckim@willkie.com

George R. Grasser (Co-Chair)
3400 HSBC Center
Buffalo, NY 14203
(716) 847-5490
Fax; (716) 852-6100
E-Mail: ggrasser@phillipslytle.com

Publication of Articles

The *Journal* welcomes the submission of articles of timely interest to members of the Section in addition to comments and suggestions for future issues. Articles should be submitted to any one of the Co-editors whose names and addresses appear on this page.

For ease of publication, articles should be submitted on a 3½" floppy disk, preferably in Microsoft Word or WordPerfect 5.1 and no longer than 8-10 pages. Please also include one laser-printed copy). The Editors request that all submissions for consideration to be published in this *Journal* use gender neutral terms where appropriate or, alternatively, the masculine and feminine forms may both be used. Please contact the Co-editors regarding further requirements for the submission of articles.

Unless stated to the contrary, all published articles represent the viewpoint of the author and should not be regarded as representing the views of the Editors, Board of Editors or the Section or substantive approval of the contents therein.

Cite as: *N.Y. Real Prop. L.J.*

N.Y. REAL PROPERTY LAW JOURNAL

Co-Editors
William A. Colavito
1 Robin Hood Road
Bedford Hills, NY 10507

Harry G. Meyer
Hodgson Russ et al.
2000 M&T Plaza
Buffalo, NY 14203

Robert M. Zinman
St. John's University
School of Law
8000 Utopia Parkway
Jamaica, NY 11439

This *Journal* is published for members of the Real Property Law Section of the New York State Bar Association.

ISSN 1530-3918

NYSBA

Real Property Law Section
New York State Bar Association
One Elk Street
Albany, NY 12207-1002

ADDRESS SERVICE REQUESTED

NON-PROFIT
U.S. POSTAGE
PAID
ALBANY, N.Y.
PERMIT NO. 155