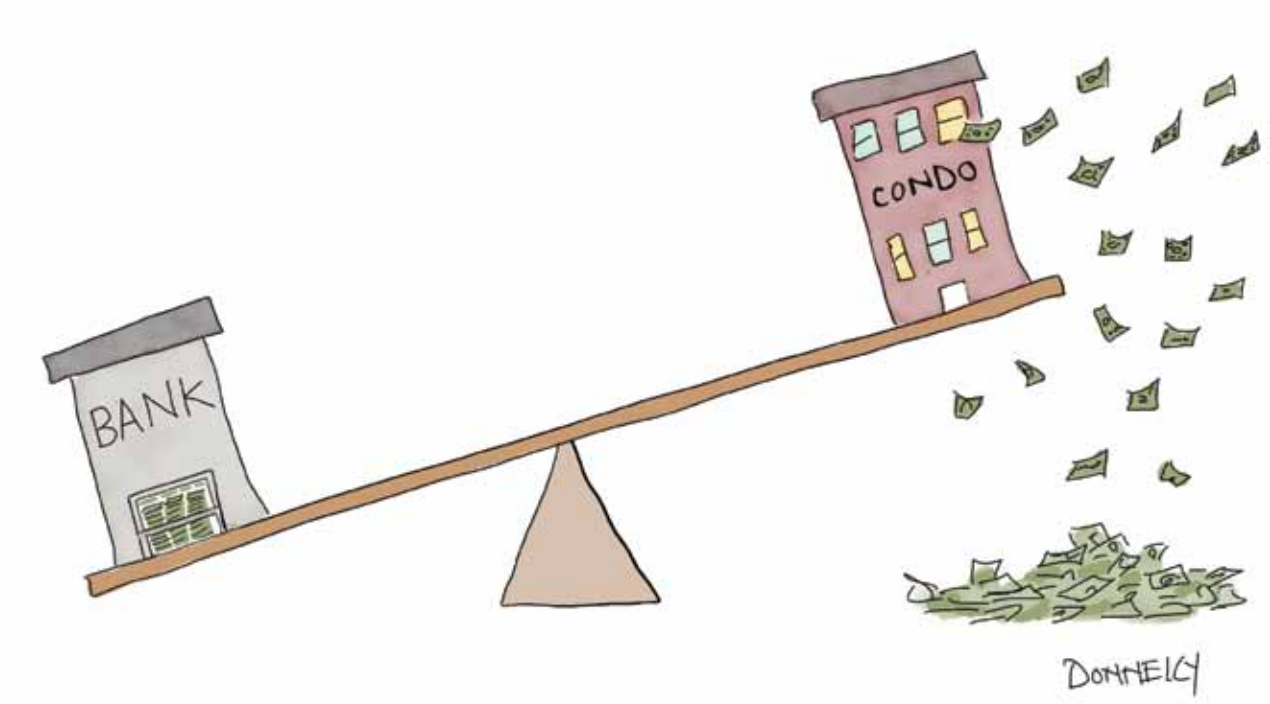
By Richard Siegler and Dale J. Degenshein

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# The Seesaw World of Condo Foreclosures

Cooperatives and condominiums are very different animals. Consider the handling of foreclosures.

When a co-op apartment owner fails to pay maintenance, and that owner has a loan secured by her shares, the cooperative is often protected because it has a first lien on the apartment. In practice, very often a lender will pay the maintenance (or at least portions of it) to the cooperative to preserve the asset. If the apartment is sold at a non-judicial foreclosure auction, the cooperative will receive the balance of monies due and, thereafter, the lender will be permitted to receive what is owed on the loan.

Condominiums are not so lucky. When a condo unit-owner defaults in the payment of common charges, and also defaults in the payment of his mortgage, the condominium can seek to foreclose. But unlike a cooperative, its lien is second to what's known as the "first mortgage of record against the premises." Here is what typically happens: the bank sends notices as required by law and begins a foreclosure proceeding against the unit-owner. Maybe the unit-owner answers the complaint, maybe not. The bank may diligently pursue the proceeding, but sometimes it does not. After all, the collateral will still be there. And – here's the rub – the loan is accruing interest, often at some inflated default rate.

The condominium, in the meantime, cannot collect its common charges. The lender won't pay them – it gets paid first and has no incentive to make the condominium whole. No, everyone waits until the judicial foreclosure is completed, which, under the best circumstances, can take more than a year. And the condominium recovers its common charges only if there are "surplus funds" – that is, money above what the lender is owed.

It's unlikely that there are "surplus funds." Most loans are for 70 to 80 percent of the value of the apartment, in which case there is often no money left for the condo. And even if the condo is paid, it may have to wait years to see a penny. Many times, by the way, the unit-owner remains in residence.

What exactly is the "first mortgage of record against the premises"? When a unit-owner takes out a loan for $70,000, and another loan for $100,000, and they are combined, is the "first mortgage" $70,000 or $170,000? This is another factor that determines whether a condominium will receive surplus funds.

Here are two recent cases that address these questions:

### *Citimortgage Inc. v. Abdou Salam Gueye*

Adbou Salam Gueye owned a condominium apartment at 725 Riverside Drive in Manhattan. Citimortgage sought to foreclose and began an action in 2009. When the lender sought a judgment of foreclosure seven years later, the condominium asserted that the amount of the interest which had accrued – and which the bank sought to collect – should be reduced or extinguished because the bank had delayed its prosecution of the case for seven years.

After she was served with the complaint in 2009, the borrower/unit-owner defaulted. Then she did nothing. Even so, the plaintiff/bank did not file a "request for judicial intervention" until 2012, meaning that no judge was assigned to the case for three years. Nothing happened during that period. When the bank sought a judgment of foreclosure, the condominium argued that the bank's seven-year delay in prosecuting the action should prevent it from recovering interest, particularly as it would also prevent the condominium from recovering any of its outstanding common charges.

The court discussed whether the delay was an inadvertent failure by the bank's counsel, or a purposeful delay designed to increase the interest owed to the bank at the time of the foreclosure sale. The bank never provided a reason for its delay. It argued, instead, that the condominium could have recovered common charges had it started its own foreclosure proceeding. But the court noted that this alternative would have been an expensive and difficult choice. Even if the condominium were the plaintiff, the bank would still receive monies before the condominium in the event of a sale. Basically, the court acknowledged a lose/lose for the condominium.

The court did state that there was no time period within which a plaintiff had to pursue a foreclosure proceeding. However, the seven years between the start of the proceeding and the bank's motion for a judgment of foreclosure was too long. The court then determined that almost $100,000 of interest accrued "almost entirely due to plaintiff's failure to prosecute its case in a timely fashion." Accordingly, the bank was not permitted to collect.

### *Plotch v. Citibank*

In this case, the Court of Appeals, New York's highest court, addressed the question of what constitutes a "first mortgage of record." Under the Condominium Act, the board of managers has a lien on each unit prior to all other liens *except* (i) liens for taxes and (ii) all sums unpaid on a first mortgage of record. The question in this case was whether two mortgages that were consolidated into a single mortgage lien years before the condominium board filed its common-charge lien constituted a first mortgage of record.

**WHAT EXACTLY IS "THE FIRST MORTGAGE OF RECORD"?**

Typically, a condominium claims that a consolidated first mortgage should not be treated as a first. Here, the plaintiff purchased the condominium unit in a foreclosure auction in 2010, subject to the first mortgage of record. He subsequently commenced this action, arguing that the original second mortgage ($38,000) was subordinate to the common-charge lien filed by the condominium. The reason it made a difference, according to the plaintiff, was that the $38,000 "second mortgage" should have been extinguished by the condominium's successful foreclosure action.

The court noted that the priority of liens is normally determined by the chronology of recording, but for the provision of the Condominium Act discussed above. The plaintiff maintained that, in order to identify the first mortgage, a consolidated mortgage must be broken down into its component mortgages. The bank argued that the consolidation agreement constituted the first mortgage and that the plaintiff, therefore, purchased subject to the full amount due.

The Court of Appeals explained that "for purposes of determining priority when there is an intervening lien, the mortgages retain their separate-lien status." In that scenario, the consolidation agreement would not be considered "the first mortgage of record."

But in this case, the condominium's lien was filed *after* the loans were consolidated. Accordingly, the court found that the consolidation agreement did not "interfere with any rights of the condominium board," and that the entire consolidated mortgage was a "first mortgage."

### The Takeaway

The first of these cases is very important for condominiums. Most of the cases we have seen that preclude a lender from collecting interest (or a portion of interest) are because the court found the lender was acting in bad faith. In this case, however, the court was very clear that the lender's failure to diligently pursue the case warranted a reduction of interest.

As to the second case, the Court of Appeals has now clarified that consolidated mortgages, at least so long as they are consolidated prior to the filing of a common-charge lien, become a first mortgage so that the condominium's lien is behind the total loan. Until the Condominium Act is changed, we suspect that condominiums will continue to have problems collecting their common charges during foreclosures. ■

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