

Article - Revisiting Mortgage Assignments - Real Property Law Section 275

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The recently enacted revision of Article 14 of New York State's Real Property Actions and Proceedings Law sets forth an entirely new procedure for foreclosure of a mortgage by power of sale. New Article 14 includes a right for a borrower to compel an assignment of a mortgage when it exercises its right of redemption prior to bidding at the auction sale. There has also been under consideration in Albany legislation which would enable a property owner refinancing its mortgage to compel an assignment.

The ability to assign a mortgage can be an important right for both the homeowner and the commercial property owner. Under Article 11 of New York State's Tax Law mortgage recording tax must be paid on the principal amount secured by a mortgage on real property, and tax is required to be paid when funds secured by a mortgage other than a credit line mortgage under Tax Law Section 253-b are readvanced. A refinancing owner or a purchaser of real estate obtaining a new mortgage loan can maintain pre-existing indebtedness without paying mortgage recording tax on the amount remaining outstanding (1) if the original note and mortgage are retained by the existing mortgagee, as part of the new loan, or assigned to the new lender. (2)

As real estate counsel will recall, the New York State Legislature, in a 1989 amendment to Section 275 of the Real Property Law (hereafter "Section 275"), closed what was perceived to be an abuse of the ability to keep alive the benefit of mortgage recording tax previously paid. In doing so, however, issues arose as to when a mortgage could be assigned and whether the existing mortgagee could be required to execute an assignment on demand of the mortgagor.

This article sets forth the background of the Section 275 issues, sets forth examples of how taxing authorities apply Section 275, and provides an update on legislative efforts to enable a borrower to compel a mortgage assignment.

BACKGROUND

Former Real Property Law Section 275, captioned "Assignment of mortgage required in lieu of certificate or discharge", was originally enacted by Chapter 408 of the Laws of 1914. Under that statute, "whenever a mortgage upon real property shall be due and payable", the holder of the mortgage, on payment to it of all sums due, was required to deliver an assignment of the mortgage without recourse to any person on demand of the owner-mortgagor. Former Section 275 was



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thereafter amended to provide that a junior lienor, the state comptroller as trustee for the New York State Employees' Retirement System, and the holder of an FHA insured mortgage were not required to execute an assignment in lieu of a discharge. (3)

The legislature presumably intended in 1914 to override cases which had generally held that there was no common-law right to an assignment of a mortgage in lieu of a discharge. Only a junior lienor of the same property or a person acting as surety for payment of the indebtedness secured were, on payment of the debt, entitled (on the theory of subrogation) to an assignment of the debt and mortgage. (4) Section 275 as enacted in 1914 put this issue to rest until it was resurrected by the 1989 revision of Section 275.

The ability of a refinancing borrower or the purchaser of real estate to take advantage of mortgage recording tax paid on the outstanding principal indebtedness secured by an existing mortgage can, of course, be very valuable. In a county with a one percent rate of mortgage tax, \$1,500 can be saved by the borrower on a \$150,000 loan. In the City of New York the savings would be \$3,000 on a two percent rate of tax. Savings on a commercial mortgage in New York City where the maximum rate of tax is two and three - quarters percent can be significant. Further, there would appear to be no inequity in allowing for an assignment and enabling a borrower to avoid paying mortgage recording tax twice on the same indebtedness.

However, to remedy the perceived abuse of certain commercial property owners “parking” a mortgage by assignment to them or their nominees for later assignment to a bona fide lender on other property, the legislature enacted Chapter 241 of the Laws of 1989 effective July 1, 1989. Section 275 was amended to remove the option to require a lender to execute an assignment on demand of the mortgagor. The amendment stated that when a mortgage is “due and payable, and the full amount of principal and interest due on the mortgage is paid, a certificate of discharge of mortgage shall be given to the mortgagor or person designated by him”. The execution of an assignment, if allowed at all, became permissive instead of mandatory.

On July 14, 1989, the Technical Services Bureau (Bureau) of the Taxpayer Services Division of the New York State Department of Taxation and Finance (Department) issued its informational bulletin TSB-M-89-(6)-R (Bulletin 1). After noting the practice of “parking” mortgages to avoid tax, it opined that “new section 275 terminates the past practice of mortgagors demanding an assignment of a fully paid mortgage and then 'selling' that mortgage to another mortgagee for 'new' money on the 'old' mortgage - without payment of the mortgage recording tax. Clearly falling within this category would be a mortgage paid in full according to its terms... or upon the mortgagor's right of prepayment...”.

According to Bulletin 1, mortgages were not “due and payable” when being transacted in the “secondary market” or when the lender did not exercise its rights under a due on sale clause.

Following enactment of revised Section 275, and issuance of Bulletin 1, the pace of commercial mortgage lending slowed significantly. Lenders were concerned that execution of an assignment could be outside their authority, and commercial borrowers were reluctant to pay mortgage



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recording tax anew on outstanding indebtedness. Stories were told about certain private mortgagees assigning mortgages in return for receiving part of the mortgage tax savings.

Responding to calls for clarification, the Bureau issued its informational bulletin TSB-M-89- (6.1)-R (“Bulletin 2”) on August 3, 1989 which superseded Bulletin 1 noting it “should be destroyed”. The new bulletin stated that Section 275 was revised to prevent the reuse of “parked” mortgages without payment of mortgage recording tax. It termed such mortgages “dormant” since they ceased on assignment to secure any bona fide obligation.

Bulletin 2 set forth a number of situations in which a mortgage, when assigned, would be deemed to continue to secure a bona fide indebtedness and could be further transacted without the payment of additional mortgage tax. These included: assignments in the secondary mortgage market; the assignment of a construction loan to a permanent lender; refinancing with the same borrower or in connection with a sale; and workouts of defaulted mortgages. Required to be submitted to the recorder with the assignment was what has come to be known as the Section 275 affidavit. In this, the affiant states, on knowledge, that the assignee is not acting as nominee of the mortgagor and that the mortgage continues to secure a bona fide obligation. (5)

Chapter 748 of the Laws of 1990 effective July 1, 1989 amended Section 275 to incorporate the position of the Department in Bulletin 2. Section 275 now provides that “the full amount of principal and interest due on a mortgage shall not be considered to be paid whenever such mortgage continues to secure a bona fide debt and an enforceable lien continues to exist”.

With issuance of Bulletin 2 and following enactment of Chapter 748, lenders again assigned their mortgages in the usual course of real estate transactions. However, in transactions other than those specified in Section 275, it must still be determined if a mortgage will be deemed by the State and New York City to continue to secure a bona fide obligation. There is also a question of whether a mortgagor has a right to compel an assignment of the existing mortgage.

“DORMANT” MORTGAGES

Since Section 275 is part of the Real Property Law and not the Tax Law, it has been the position of the Department that it does not have the authority to render formal opinions on the subject. The Department thus affords only informal advice on Section 275. Regulations issued with respect to Mortgage Recording Taxes published in the Official compilation of Codes, Rules and Regulations of the State of New York (6) do not reference Section 275. The proposed revision of Article 11 of the Tax Law (7) does not deal with Section 275. The Department's position, and that of local recorders accepting assignments for record, as to when a mortgage is deemed “dormant” has, therefore, been informally obtained on a case-by-case basis.

A mortgage assigned to an affiliate of the borrower prior to July 1, 1989, the effective date of new Section 275, may be assigned to a new lender without the imposition of additional mortgage recording tax. Such a mortgage is deemed to continue to secure a bona fide obligation so long as the assignment is accompanied by an affidavit that the assignor received its assignment prior to



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July 1, 1989. The changes to Section 275 by Chapter 241 of the Laws of 1989, as amended by Chapter 748 of the Laws of 1990, are prospective only.

A mortgage may continue to secure a bona fide obligation when assigned to an affiliate of the borrower if the obligation is regularly paid in accordance with its terms, and the books and records of the borrower and the assignee treat the obligation as a true indebtedness. This will, however, be reviewed on a case by case basis.

A deed in lieu of foreclosure to the mortgagee's nominee will not itself trigger mortgage recording tax, but any further transaction of the mortgage, be it an assignment or a modification, will require payment of mortgage recording tax. This is also the Department's position when a deed in lieu of foreclosure is delivered to the mortgagee's nominee pursuant to a Bankruptcy Court order. The Department contends that even such an order does not impact enforcement of the mortgage recording tax.

The New York City Department of Finance has refused to accept an assignment of a pre-existing mortgage to the seller of real property as part of the buyer's purchase money financing without payment of mortgage recording tax on the prior but still outstanding indebtedness. It asserts that, under Section 275, the mortgage as assigned to the seller secures a new obligation on which mortgage tax is due.

The borrower's purchase of participation interests in a mortgage loan has been determined by the Department, in correspondence to a major lender's counsel in 1983, not to be a mortgage taxable event. The sale of participations enables a lender to secure a credit facility without the payment of mortgage recording taxes on readvances. The borrower makes payments by purchasing participation interest in the loan, and the lender makes readvances by purchasing back those participations. For the purchase of participation interests in a mortgage loan now, under Section 275, it will most likely be held that there is no bona fide obligation secured to the extent of the participation interests purchased.

Section 5-334 of the General Obligations Law provides that the lender's exercise of an option to purchase an ownership interest in the borrowing entity not triggered by an event of default is enforceable for mortgage loans of \$2,500,000 or more. This section was enacted in 1985 (8) to address the concern that such a right would constitute a clog on a borrower's equity of redemption. A lender's exercise of the right to purchase equity interests in the owning entity, where it holds both a beneficial interest in the borrower and the mortgage, should not cause the mortgage to be deemed "dormant".

COMPELLING AN ASSIGNMENT

The 1989 amendment to Section 275 removed from the statute the requirement that the holder of mortgage, on payment to it of the full amount of principal and interest due, deliver an assignment of the mortgage, without recourse, at the borrower's direction. Case law since that time suggests



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that an assignment may be compelled as a matter of equity, in the limited situation of a mortgage foreclosure to benefit a redeeming defendant other than the mortgagor.

The Supreme Court, Kings County, in the 1993 case of *Goldstein v. Soledad Place Corp.* (9) held that a tenant which was a party defendant in a foreclosure was entitled to an order directing the mortgagee to assign on payment of all sums due. According to Justice Stanley L. Sklar, “(w)hile the current version of Real Property Law Section 275 does not expressly provide that a party in the instant case is entitled to an assignment in lieu of a discharge, such relief can be inferred from the amended statute and the reason for its amendment”.

The Nassau County District in the 1994 case of *Harris v. Crossland Mortgage Corp.*, (10) emphasized that the *Goldstein* case dealt with the redemption of premises by a tenant in a foreclosure proceeding and not a voluntary refinancing of a mortgage loan. The Appellate Division, First Department (11) has agreed that the foreclosing mortgagee can be compelled to execute an assignment, since an action to foreclose a mortgage is an equitable proceeding on full payment of the indebtedness by and at the direction of a person who redeemed.

It is clear that the 1989 amendment to Section 275 has made the mortgagee's execution of an assignment permissive rather than mandatory, and the courts will compel an assignment only in a mortgage foreclosure to protect the interest of a redeeming third party.

Two statutes enacted since 1989 can be invoked to require execution of an assignment. Section 1921 of the Real Property Actions and Proceedings Law (Discharge of mortgage), as amended effective June 16, 1994 (12), requires that a mortgagee deliver a satisfaction of mortgage for recording within forty-five days of its receipt of payment “unless otherwise requested in writing by the mortgagor or the assignee of such mortgage” (emphasis added). This applies to all mortgages. Reference to an “assignee” should, however, be held to compel execution of an assignment when it is contractually provided for in the mortgage or other loan documents.

The other change in law is the enactment effective July 7, 1998 of the new Article 14 to the Real Property Actions and Proceedings Law providing (except in certain circumstances) for foreclosure of a mortgage by power of sale. Section 1410 of the RPAPL allows the mortgagor, the record owner or the holder of any other interest on the mortgaged premises subordinate to the lien being foreclosed, to prevent the sale by payment of all sums due to the mortgagee prior to commencement of bidding at the auction sale.

Upon such redemption, the redeeming party, which may be the mortgagor, may require the foreclosing mortgagee to assign the debt and the mortgage to any person or entity other than the mortgagor or its nominee. The assignment so directed to be made is deemed the assignment of a bona fide obligation under Section 275. A Section 275 affidavit is required to be submitted to the recorder.

While it is possible to have a situation in which mortgage tax savings are sufficiently attractive that the mortgagor, with the indulgence of its new lender, will precipitate a power of sale foreclosure to



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enable it to exercise the statutory right to redeem and direct an assignment, it is certainly not an alternative which will often be employed by design of the borrower-mortgagor. The right to compel an assignment of mortgage in the normal course of commercial and residential real estate transactions still requires action by the state legislature.

State Assemblyman Daniel Feldman, a Democrat from Brooklyn, and State Senator James Lack, a Republican from Suffolk County, continue to introduce legislation (13) to amend Section 275 to enable a borrower refinancing its existing mortgage loan with a new lender to demand an assignment to the new lender. According to the memorandum in support of the Assembly Bill, many banks still take the position that they are not required to deliver an assignment in connection with a refinancing. This “causes existing mortgagors ... to have to pay a part of their mortgage tax twice... on the 'original' mortgage debt”.

Promoted and supported by a numerous homeowner associations, title companies, mortgage brokers and the New York Association of Realtors as consumer protection legislation to prevent the double taxation of refinancing homeowners, this bill passed both houses of the legislature in 1996. It was, however, vetoed by then Governor Cuomo who was concerned that enabling a borrower to require an assignment instead of again paying mortgage tax on the same indebtedness could have a severe fiscal impact on state revenues. In 1997 the bill passed the State Assembly with one dissenting vote. Due to Governor Pataki's opposition (for the same reasons as his predecessor), however, the bill has not succeeded in the State Senate.

This bill is the best protection, for the homeowner refinancing a mortgage, against being subject to double taxation on the same principal indebtedness. For commercial property owners, loan documents should require the mortgagee to execute an assignment on demand. We also await the first instance of an assignment being demanded by a commercial mortgagor in a foreclosure brought under a power of sale.

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1. *City of New York v. State Tax Commission*, 516 N.Y.S. 2d 132 (3rd Dept. 1987). Additional mortgage recording tax will, however, be payable if the mortgage is “spread” to become a lien on property in a county having a higher rate of tax under Tax Law Section 255 (1)(b).
 2. The lender to which the mortgage is assigned can even complete the advances under the original recorded mortgage. TSB-A-95 (16)-R, 12/22/95.
 3. See Chapter 228 of the Laws of 1940, Chapter 831 of the Laws of 1940 and Chapter 751 of the Laws of 1947.
 4. *Ellsworth v. Lockwood*, 42 N.Y. 89 (1870); *Twombly v. Cassidy*, 82 N.Y. 155 (1980).
 5. The mortgage can when applicable recite that is not subject to Section 275 of the Real Property Law as it is an assignment within the secondary mortgage market.



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6. Subchapter E of Chapter III of Title 20.
7. Senate Bill S05213/Assembly Bill A08077.
8. Chapter 177 of the Laws of 1985.
9. 599 N.Y.S. 2d 213.
10. 610 N.Y.S. 103, 105.
11. River Bank America v. Stabile, 628 N.Y.S. 2d 103 (1995).
12. Chapter 132 of the Laws of 1993.
13. Assembly Bill 73/Senate Bill 2787.



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