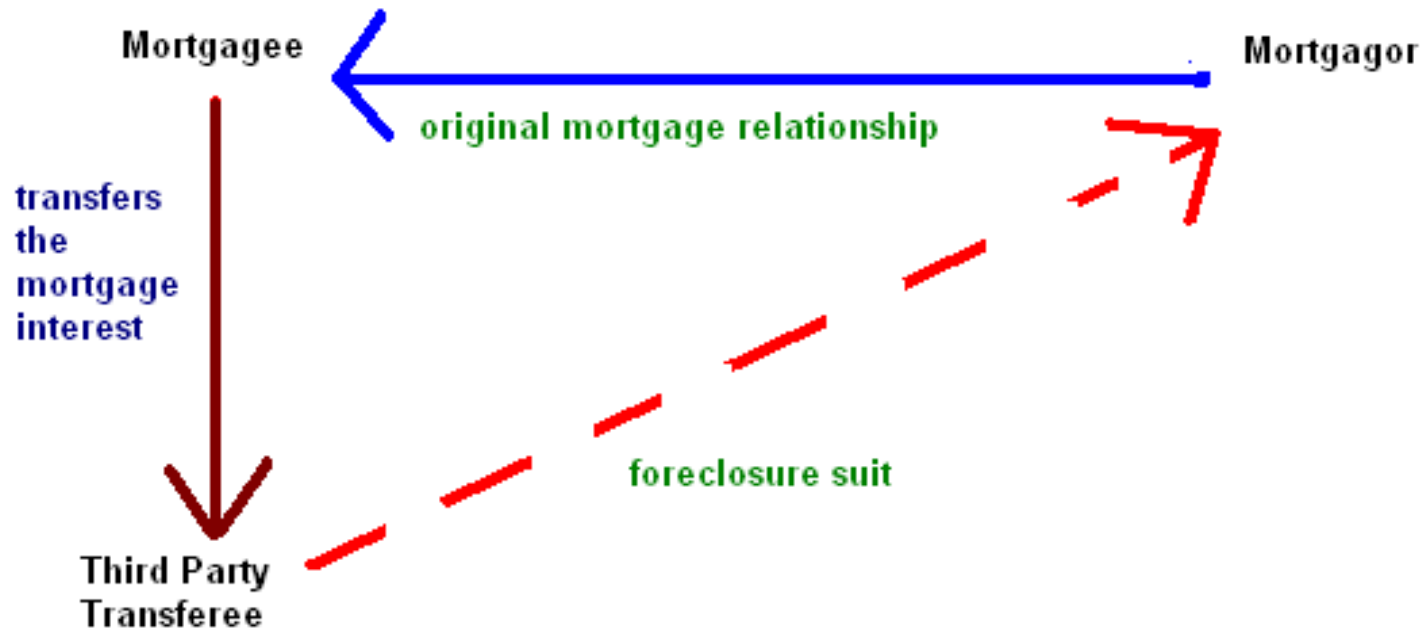


Mortgage Theory

- **Lien Theory:**
 - A mortgage is not an ownership interest;
 - So, one tenant taking out a mortgage does not break up a joint tenancy
- **Title Theory:**
 - mortgage not an ownership interest;
 - So, one tenant taking out a mortgage does break up a joint tenancy (it breaks up the unity of time by giving the mortgagee an interest in the property)
- **Either way, one spouse taking out a mortgage, where allowable, does not break up the tenancy by the entirety.**
- **But, foreclosure does break up a tenancy by the entirety.**

The Use of Defenses against Transferees of a Mortgage



The Use of Defenses (cont.)

■ Rules:

- If Third Party Transferee is not a “holder in due course,” Mortgagor can use any defenses against Third Party Transferee that she could have used against Mortgagee
- If Third Party Transferee is a “holder in due course,” Mortgagor can use “real” defenses against Third Party Transferee, but not defenses that were personal to the Mortgagor.

■ What is a holder in due course?

- The transferee must have taken the mortgage in **good faith** (without knowledge of the defense against its enforcement)
- The transferee must have **paid fair value** for the mortgage

“Real” Defenses vs. “Personal” Defenses

■ What are “real” defenses?

- Defenses that go to the heart of the mortgage’s existence; the mortgage was never validly executed

- Examples:

Forgery

Incapacity

Illegality

Duress

■ What are “personal” defenses?

- Defenses that are based on the conduct of the mortgagee during the negotiations for the mortgage; the mortgage was validly executed

- Examples:

Lack of consideration

Unconscionability

Fraud in the Inducement

Foreclosure

■ Priority:

- Purchase money mortgage has first priority
- Otherwise, it's "first in time, first in right"

■ Mortgage Transfers:

- Generally, a transfer of the mortgaged property does not extinguish a mortgage.
- As to question of whether transferee takes subject to the mortgage, same rules apply as with the subsequent purchasers

■ Effects of Foreclosure when there are multiple mortgages on the property:

- Foreclosing party's mortgage gets paid off first
- If there is any money left, it goes to the inferior mortgages
- If there is still any money left, it goes to the mortgagee
- Inferior mortgages are extinguished
- Superior mortgages are not paid off, but are not extinguished

Short Sales

- Mortgage documents almost always allow the mortgagee (usually a bank) to veto any sale for less than the full value of the mortgage.
- A short sale occurs when the mortgagee agrees to take less money than the full value of the mortgage with the understanding that the buyer will not take the property subject to the mortgage.
- **Why would a mortgagee agree to this?**
 - It's sometimes better for a bank to lose some money on the short sale than to have the property sitting with no payments or go through the expensive foreclosure proceeding, only to be unable to later sell it.

Is the Mortgagor Responsible for the Difference in a Foreclosure or Short Sale?

- “Recourse” states (most states)
 - The bank can successfully sue the mortgagor for the remainder after the short sale or foreclosure.
 - As a practical matter, this is often not done since people who can't pay their mortgage usually don't have money to pay a judgment.
- “Non-Recourse” States (e.g., AK, AZ, CA, FL, CT, ID, MN, WA, TX, NC, ND, UT)
 - The bank cannot collect the excess from the mortgagor.
- “One action” States (e.g., NY, NV)
 - The bank must *choose* between bringing a foreclosure action and suing the mortgagor personally
 - This is often effectively the same as a non-recourse rule.

Income Tax Consequences of a Short Sale

- If a debt is cancelled or forgiven, the amount cancelled or forgiven is often considered taxable income!
- Non-recourse loans have always been an exception, so in a non-recourse state, a foreclosure or short sale was never a problem.
- For recourse loans:
 - If the debtor is bankrupt or even just “insolvent” other exceptions allow the amount to be excluded.
 - The Mortgage Debt Relief Act of 2007
 - Income from the discharge of debt on their principal residence is *not* taxable income.
 - This also applied to debt reduced through mortgage restructuring and debt forgiven in connection with a foreclosure.
- Thus, this issue is not a major problem nowadays.