Sills Cummis & Gross P.C.

As Seen In Law360 July 13, 2017

# Avoid Becoming A Dreaded Mortgagee-In-Possession In NJ

Lenders in New Jersey beware. Although taking possession of a property and the cash flow therefrom after a borrower defaults might be tantalizing, being deemed a mortgagee-in-possession has costly implications that lenders should avoid.

There is minimal case law in New Jersey providing guidance regarding when a lender is determined to be a mortgagee-in-possession. But the few cases, read together, provide a guide on how to avoid unintentionally becoming a mortgagee-in-possession. This article summarizes that guidance, and elaborates on the duties attached to becoming a mortgagee-in-possession.

## Duties and Liabilities of a Mortgagee-in-Possession

Courts in New Jersey have long recognized that "[a] mortgagee, by taking possession, assumes the duty of treating the property as a provident owner would treat it, and of using the same diligence to make it productive that a provident owner would use."[1] While that might sound straightforward, a lender taking possession can also raise questions regarding liability to third parties.[2] Common examples of the duties assumed when taking possession include collecting rents, paying property taxes, making repairs, and paying condominium association fees.[3] Additionally, mortgagees-in-possession can be liable for injuries suffered by third parties on the mortgaged property.[4]

In Woodview Condominium Association Inc. v. Shanahan, the New Jersey Superior Court, Appellate Division, summarized the liabilities as follows:

> Indeed, a mortgagee in possession is liable both for damages to the property while in possession, and in tort for injuries arising

**Joshua N. Howley, Esq.**

*Joshua N. Howley is a member of the litigation department at Sills Cummis & Gross PC. His practice focuses on representing lenders, servicers and funds in asset recovery and mortgage foreclosure litigation.*

*Brent McDonough, a summer law clerk at the firm, assisted with the preparation of this article.*

> from "his actionable fault in utilizing the property or ... his failure to perform duties imposed by law upon the owner of the land." Furthermore, "[a] mortgagee in possession may also be subject to prosecution by local governmental authorities for the failure of the mortgaged property to conform to housing codes, health and safety ordinances and other similar regulations." And, mortgagees in possession have been required to "pay taxes as they accrue on the property." Significant for present purposes, "a mortgagee in possession may be liable for services rendered to him in connection with the property during his occupancy thereof on the basis of an express or implied contract. (citations omitted)."[5]

The list of responsibilities that attach to being deemed a mortgagee-in-possession is exhaustive, thus mortgagees should be cognizant of the behavior that could convert them into a mortgagee-in-possession.

## Becoming a Mortgagee-in-Possession

Lenders do not automatically become mortgagees-in-possession upon a borrower's default or the commencement of a mortgage foreclosure action.[6] Rather, lenders have a right to possession, which they may or may not act upon.[7] If a lender does not explicitly assert its right to possession, courts determine whether to classify a lender as a mortgagee-in-possession on a case-by-case basis.[8] Most lenders prefer never to take possession because of the risks going along with it. Thus, lenders should understand the actions that could convert them into a mortgagee-in-possession.

The leading New Jersey case is Scott v. Hoboken Bank for Savings.[9] There, after the borrower defaulted on his property taxes and interest payments on his mortgage, he entered into an agreement with the lender whereby the mortgagee was given complete authority to collect rents and evict tenants for nonpayment. Additionally, the agreement provided that the mortgagee would take over the payment of the property's "running expenses," which included paying for repairs, improvements and insurance premiums.[10] The lender argued that it was merely acting as the borrower's agent in performing those duties, but the New Jersey Supreme Court held that the lender had completely taken over the management and control of the mortgaged property. That was sufficient to convert the mortgagee into a mortgagee-in-possession and render it liable for the injuries suffered by a third-party on the premises.[11] It was irrelevant that the lender never physically possessed the property.[12]

The New Jersey Appellate Division's decision in Woodview Condominium Association Inc. v. Shanahan provides another example of conduct that will convert a lender into a mortgagee-in-possession.[13] There, the court held that, even though the lender did not hold legal title, physically retaking the estate and renting out its two condominium units after the borrower defaulted was sufficient.[14] Significantly, this was one of the first cases in which the court found that a mortgage-in-possession was liable for the payment of condominium assessments and maintenance. The court reasoned that, for equitable reasons, a mortgagee-in-possession is "liable for goods and services furnished to him during his occupancy" by third parties and held that the lender was responsible for the condominium association fees because he benefited from the maintenance work covered by those fees.[15]

A few cases decided after Scott exemplify actions that courts will allow a lender to take without unintentionally converting itself into a mortgagee-in-possession. One such recent case is Woodlands Community Association v.

Mitchell. In Mitchell, the New Jersey Appellate Division found that winterizing and changing the locks of a condo after the borrower defaulted on the mortgage and vacated the premises was not sufficient to convert the lender into a mortgagee-in-possession.[16] The court found that those actions were too "discrete" and concluded that "the minimal actions taken by defendant here in winterizing the unit and changing the locks d[id] not serve to deem it a mortgagee in possession and d[id] not render defendant responsible for the unpaid condominium fees and assessments."[17] Although not at issue in this case, the court further found that "[i]f a mortgagee is dilatory after the entry of a final judgment of foreclosure in proceeding to sale or has refused to go to sale on the unit, that conduct might result in the imposition of responsibility for the Association fees."[18]

McRoy v. Eskander is another case where a lender took certain measures with respect to the mortgaged property that did not constitute taking possession.[19] There, the plaintiff injured himself when he slipped and fell on an icy sidewalk abutting an apartment complex.[20] The owner had previously defaulted on his mortgage payments to the lender, and vacated the premises.[21] Although final judgment was entered in the foreclosure in the lender's favor, the sheriff's sale was still pending.[22] The plaintiff argued that the lender should be considered a mortgagee-in-possession, liable for the plaintiff's injuries, but the court disagreed, finding that "[a]lthough [lender] paid the property taxes and water bill and occasionally drove by the property to determine if the building was inhabited, these actions were undertaken to protect its collateral and not to exert any control over the management of the property, and did not convert [lender] into a mortgagee in possession."[23] This case shows that lenders can protect their interest in the mortgaged property without becoming a mortgagee-in-possession as long as they do not take over the management and control of the property.

Similarly, the court in Rojas v. Rubenstein found that the lender's actions were directed at protecting his collateral, not managing and controlling the property.[24] In Rojas, a tenant of an apartment building fell after leaning on a faulty banister while walking down the staircase, and broke his leg.[25] The building's owner had previously defaulted on his mortgage payments and, in a separate action, the court had assigned a rent receiver to carry out the duties of the property owner until the sheriff sale.[26] At the time of the injury, the building was in violation of numerous housing codes, but the rent receiver did not have enough funds to make the necessary repairs.[27] Prior to the injury, the rent receiver had asked the lender to address some of the building's issues and the bank agreed to pay off one water bill, "obtain forced-placed insurance on the property to protect against hazards, and redeem a tax sale certificate because 'it was a tax lien on the property which would have impaired [its] first priority position[.]'"[28] Similar to McRoy, the court held that in taking these measures, the bank was merely protecting its collateral interest, not controlling the building.[29]

## Conclusion

The cases summarized above should give lenders a sense not only of what actions can convert them into a mortgagee-in-possession, but also of the breadth of duties that attach to taking possession. While lenders may be tempted to take control of a property to control the revenue, there are alternatives that lenders should consider before taking possession if they want to avoid becoming liable. Lenders should always consider the appointment of a rent receiver during the pendency of the foreclosure. The rent receiver would be responsible for collecting rents from tenants and

evicting them if they do not pay as well as maintaining the mortgaged property.[30] Additionally, if lenders opt to have a rent receiver appointed, they will not be responsible for repairing the property or paying its taxes and assessments.[31]

However, if a lender prefers to avoid using a rent receiver, the lender should familiarize itself with the actions listed above implicating legal possession. For example, although a lender in New Jersey after Mitchell can winterize a mortgaged property and change the locks in order to protect its collateral, taking more substantial steps like collecting rents, making repairs, and paying insurance premiums can convert that lender into a mortgagee-in-possession. When in doubt, lenders should always return to Scott and decide whether a court would view its actions as taking over the management and control of the mortgaged property.

---

[1] Shaeffer v. Chambers, 6 N.J. Eq. 548, 557 (Ch. 1847).

[2] George E. Osborne, Handbook on the Law of Mortgages, § 283 (2d ed. 1970).

[3] Id.

[4] Id.

[5] Woodview Condo. Ass'n, Inc. v. Shanahan, 391 N.J. Super. 170, 176-77 (App. Div. 2007).

[6] 12B-36 Karl B. Holtzschue, Purchase and Sale of Real Property § 36.04 (2017).

[7] Id.

[8] Woodlands Cmty. Ass'n v. Mitchell, No. A-4176-15T2, 2017 WL 2437036 (App. Div. June 6, 2017).

[9] Scott v. Hoboken Bank for Sav., 126 N.J.L. 294, 298 (Sup. Ct. 1941).

[10] Id. at 295. The agreement assigned the rents due and to become due and conferred certain rights to the mortgagee. Those rights included "complete authority to collect rents and to sue for the same, if unpaid, in the name of the corporate owner for the use of the mortgagee or in its own name as assignee; and to dispossess tenants for non-payment of rent. It further provided that the mortgagee might reduce the existing rents . . . as agent of the owner." The agreement also stated that rents should be used "to pay the necessary running expenses of said premises, including necessary repairs and decorations, insurance premiums, water rents and commissions for renting of said premises, and for collecting the rents thereof for the alterations, repairs, or improvements to said premises as herein provided; to pay to the mortgagee the interest due on the bond and mortgage to pay the taxes." Id.

[11] See id. at 299.

[12] See 30 New Jersey Practice, Mortgages § 21.10, at 132-33 (Myron C. Weinstein) (2d ed. 2000) (arguing that "management and control are the important tests").

[13] Woodview, supra, 391 N.J. Super. at 174.

[14] Id. at 174-75.

[15] Id. at 177 (citing Osborne, Law of Mortgages, § 283 (2d ed. 1970)).

[16] Mitchell, supra, at 2-3. “Winterizing” means draining the pipes, turning off the water, and setting the thermostat at a temperature that will protect the pipes in winter. Id. at 3

[17] Id. at 2.

[18] Id. at 9.

[19] McRoy v. Eskander, No. A-3558-13T3, 2015 N.J. Super. Unpub. LEXIS 909 (App. Div. Apr. 21, 2015)

[20] Id. at 1.

[21] Id.

[22] Id. at 1-2.

[23] Id. at 5.

[24] Rojas v. Rubenstein, No. A-5755-10T2, 2012 N.J. Super. Unpub. LEXIS 2359 (App. Div. Oct. 18, 2012).

[25] Id. at 10.

[26] Id. at 4.

[27] Id. at 5.

[28] Id. at 6-7.

[29] Id. at 29.

[30] Weinstein, supra, at 144.

[31] Id.