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A Halfway Improvement In The Ancient Law Of Mortgages

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Updating archaic mortgage laws has rarely been a priority for the justice system, however a new proposal might just bring about some long overdue change. [-] GETTY

Owners of commercial real estate and their mortgage lenders often agree to amend the terms of their loan, in minor and sometimes major ways. The traditional law of mortgages complicates all those amendments for no good reason. Those complications are driven by blind adherence to ancient principles of mortgage law that should play no role in modern real estate finance transactions.

More specifically, after the borrower and lender close their original loan and record their mortgage, someone else might theoretically record another mortgage or some other lien or claim against the same real property (any of those, a "junior-priority lien"). If the borrower and the first lender amend their loan, the first mortgage might lose its first priority and become a second-priority mortgage, with lower priority than the junior-priority lien – a very bad result for the first lender. That could happen if the loan amendment somehow made the loan more burdensome, such as by increasing the loan amount or the interest rate. This would, according to the law of mortgages, unfairly hurt whoever holds a junior-priority lien. Therefore, the first lender should lose priority as punishment.

None of that makes any sense in the real world, of course. Commercial mortgages typically prohibit the borrower from creating any form of junior-priority lien. Future lenders rarely accept junior-priority liens, although other types of claims might get recorded involuntarily.

In the rare case where a second lender wants to (and can) record a junior-priority lien, the first thing it will ask for is a certificate from the first lender, confirming the status of its mortgage and disclosing any amendments to date. The second lender isn't going to assume anything about the previously recorded first mortgage. Any requirement to record mortgage amendments doesn't add much.

Given the treatment of mortgage amendments under traditional mortgage law, whenever a mortgage lender agrees to any loan amendment, they often take two extra steps. First, they check for junior-priority liens. Then they record a mortgage amendment just to avoid any possible risk that their mortgage might become subordinated to future junior-priority liens. That recordation triggers a discussion of whether the mortgage lender should obtain new title insurance, which can trigger significant premiums. Even if the first mortgage expressly states that it might be amended later without

loss of priority, a conservative first lender and its conservative counsel will still worry about potential loss of priority to junior-priority liens.

Any state legislature could easily eliminate this entire issue and the resulting headaches. They could simply pass a law confirming that if a recorded mortgage says it secures all future amendments, then the recorded mortgage secures all future amendments, even major ones, with no risk of lost priority (a "priority protection law"). Such a law would allow the holders of first mortgages to stop worrying. Virginia enacted a law along those lines. This issue is not, however, of great concern for most state legislatures.

The Uniform Law Commission recently proposed a law that would solve part of the mortgage amendment problem in any state that enacts the ULC's proposed law. That law lists ten common ways loans get amended, and confirms that each such amendment doesn't jeopardize the priority of the lender's mortgage and doesn't require the lender to record anything. The ULC's list includes extensions of the maturity date, reductions of the interest

rate, benign changes in the interest rate index, forgiveness or forbearance, changes in escrow accounts or insurance requirements, and a few others.

Unfortunately, the list of protected amendments doesn't mention more substantial amendments of the type that might, in fact, make the lender's mortgage more burdensome and hence hurt hypothetical junior-priority lien holders. For those types of changes, the first lender must still worry about ancient principles of mortgage law.

The ULC could have solved that problem, too, by recommending that the states adopt a priority protection law – hardly a controversial or unreasonable proposition. The ULC skipped that opportunity to simplify and improve upon the ancient law of mortgages. Lenders will just have to live with the problem until someone cares enough to solve it and help bring the law of mortgages a bit further into the 21st Century.

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I help buyers, sellers, borrowers, lenders, tenants, property owners, and other commercial real estate market participants identify and achieve their business goals. To do that, I need to understand risk, security, numbers, value, financeability, flexibility, and exit strategy. Some legal issues matter a lot and many don't. It's important to know the difference. I write extensively on commercial real estate law and practice – over 400 articles and five books so far, including the 2024 three-volume New Guide to Ground Leases (www.groundleasebook.com). I occasionally serve as an arbitrator or expert witness in complex real estate disputes.