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Effect Upon a Lease of a Real Estate Mortgage Foreclosure

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EFFECT UPON A LEASE OF A REAL ESTATE MORTGAGE FORECLOSURE

This discussion will be confined to those jurisdictions adopting the lien theory of mortgages. Many of the questions involved are regulated wholly or partly by statute, so there will be no attempt to make a critical comparison of the rules in the various states. To determine what rule will be followed in any particular state, its statutes should be compared with those existing in the states in which decisions have been reported.

I. When the Lease is Prior to the Mortgage

When the lease is executed prior to the mortgage, and is duly recorded, the mortgage is subject to the lease. Foreclosure will not affect the lease in any way, and the lessee is entitled to possession even after the period of redemption has expired.[1] The purchaser at foreclosure sale is entitled to the rents as against the lessor or his assignee.[2] But if the mortgagee had notice prior to the execution of the mortgage that the mortgagor had assigned the rents, he takes subject to the assignment[3] for the reason that the mort-

[1] *Enos v. Cook*, 65 Cal. 175, 3 Pac. 632 (1884) *Heaton v. Grant Lodge*, 55 Ind. App. 100, 103 N. E. 488 (1913)

[2] *Fahrenbraker v. E. Clemens Horst Co.*, 209 Cal. 7, 284 Pac. 905 (1930).

[3] *Groos & Co. v. Chittim*, 100 S. W 1006 (Tex. 1907) *Fahrenbraker v. E. Clemens Horst Co.*, note 2, *supra*, *contra*.

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the mortgage debtor, his heirs or assigns, as a home. * * * 3. That as to any action suspended by this act the statute of limitations of this state for the commencement of actions shall be extended accordingly. 4. That an emergency exists and this act shall take effect immediately."

Senate Bill No. 4, Extraordinary Session, Legislature of the State of Washington, 1933: "* * * 1. In any action heretofore brought or which may be brought hereafter to foreclose real estate mortgages, the court may, upon application of defendant upon such terms as may be just to all parties stay such proceedings for such period or periods finally ending not later than April 1, 1935 as to court shall deem just and equitable in view of the circumstances of the particular case. * * * 3. In every case where a mortgage foreclosure sale upon execution * * * the period of redemption may be extended for a period of not more than two years from the date of such sale, but in no case shall the period of redemption be extended beyond April 1, 1935, and then only upon such terms and conditions as will be just to all parties. * * * 7. The Governor of the State of Washington shall have power on or after the first day of April, 1934, by proclamation, to suspend the operations of this act or any section thereof * * *"

It is interesting to speculate as to what would have been the fate of these statutes had they been adopted. The form suggested in House Bill No. 150 would have undoubtedly have been declared unconstitutional. It has merit in that it declared the emergency to exist, that it should be of definite duration, and that its application should be to mortgaged property occupied as a home. It would have been open to attack because it failed to protect the mortgagee during the period of extension, because it was an impairment of the obligation of contract, and because it was a deprivation of property without due process of law Senate Bill No. 4, while not so obviously unconstitutional as House Bill No. 150, is objectionable because it was not limited in application to farm or home property because it made no provision for the protection of the mortgagee during the period of extension, although it did make the period of extension discretionary with the court. The attempt in section 6 to have the statute apply to cases already pending is especially bad. The Washington proposals wisely provided for revocation of the court's order of suspension of the usual statutory proceedings as to foreclosure on a showing that the suspension order was not adequately dealing with the situation and for the suspension of the operation of the entire statute upon the proclamation of the Governor that the emergency had passed

gagee acquires only the rights of the mortgagor. This rule is followed in Washington.[4] The recent case of *Security Savings & Loan Society v. Dudley*[5] purports to overrule the *Griffiths* case, but can readily be distinguished on its facts. There the lease was not recorded, and the assignment of rents was made after the mortgage was executed. Hence the court held that the assignee took subject to the mortgage. While the *Griffith* case involves an execution sale rather than a mortgage foreclosure, the same rules apply

If the lease is not recorded, it becomes subject to the mortgage and is destroyed by foreclosure.[6]

II. When the Lease is Executed After the Mortgage but Prior to the Commencement of Foreclosure

A. Rights between the filing of the *Lis Pendens* and the Sale.

The mere filing of a foreclosure action does not terminate a lease, even though the lease may be subject to the mortgage.[7] The early New York rule that the tenancy was terminated has been changed by several recent cases.[8]

Hence the principal problem which arises is the right to the rent *pendente lite*. The general rule is that the mortgagor is entitled to the rent earned during that period. If it does not become due until some later date, it will be apportioned between the mortgagor and the purchaser at the foreclosure sale, according to when it was earned.[9] This conflicts with the general rule that rent will not be apportioned, but rests upon the construction placed upon the statutes relating to mortgage foreclosures. If a receiver is appointed, he has a right to the rent superior to that of the mortgagor. The receiver is bound by the terms of the lease, and cannot collect any more rent than that agreed upon between the lessee and lessor.[10] If the lessee paid the rent in advance, before default by the mortgagor, he may remain in possession without paying any further rent to the receiver.[11] He is treated as having purchased a leasehold interest in the property But it is held in some states that a lessee subject to a mortgage pays rent in advance at his peril, and is liable to the receiver for the reasonable value of the use and occupation.[12] In view of the recent decisions in New York,

[4] *Griffith v. Burlingame*, 18 Wash. 429, 51 Pac. 1059 (1898)

[5] 75 Wash. Dec. 42, 26 Pac. (2d) 384 (1933).

[6] *Tropical Investment Co. v. Brown*, 45 Cal. App. 205, 187 Pac. 133 (1919)

[7] *Blodgett Loan Co. v. Hansen*, 86 Mont. 406, 284 Pac. 140 (1930).

[8] *Metropolitan Life Ins. Co. v. Childs Co.*, 230 N. Y. 285, 130 N. E. 295, 14 A. L. R. 658 (1921) *Prudence Co. v.* 160 *West Seventy-Third St. Corp.*, 260 N. Y. 205, 183 N. E. 365 (1932) *Bank of Manhattan Trust Co. v.* 2166 *Broadway Corp.*, 237 App. Div. 734, 262 N. Y. S. 730 (1933).

[9] *Blodgett Loan Co. v. Hansen*, note 7, *supra*, *Clarke v. Cobb*, 121 Cal. 595, 54 Pac. 74 (1898) *Dolin v. Wachter* 87 Mont. 466, 288 Pac. 616 1930) *Roberts v. State*, 75 Wash. Dec. 131, 26 Pac. (2d) 903 (1933).

[10] *Prudence Co. v.* 160 *West Seventy-Third St. Corp.*, note 8, *supra*, *Bank of Manhattan Trust Co. v.* 2166 *Broadway Corp.*, note 8, *supra*. Nor can the receiver agree with the lessee that he should pay less than the rent stipulated in the lease. *Markantonis v. Madlan Realty Corp.*, 262 N. Y. 354, 186 N. E. 862 (1933).

[11] *Smith v. Cushatt*, 199 Iowa 690, 202 N. W 548 (1925) *Ottman v. Cheney*, 204 Wis. 56, 234 N. W 325 (1931) *Grether v. Nick*, 193 Wis. 503, 213 N. W 304 (1927).

[12] *State ex rel Coker v. District Court*, 159 Okla. 10, 11 Pac. (2d) 495 (1932), *Fletcher v. McKeon*, 71 App. Div. 278, 75 N. Y. S. 817 (1902).

it is doubtful whether that state would now adhere to that rule. The only reason for this latter rule is that it prevents the mortgagor from fraudulently depriving the mortgagee of the rents by taking a payment in advance.

If the mortgage contains a valid pledge of the rents and profits, the mortgagor loses his right to the rent when foreclosure begins.[13] Here again it is a simple matter for the mortgagor to defeat the rights of the mortgagee. If he assigns the rents to a third party before the foreclosure action is begun, the assignee is entitled thereto as against the mortgagee.[14] But an assignment after foreclosure has commenced is too late, since then the rights of the mortgagee have attached and any transfer is subject to his lien.[15] The mortgagee has a lien on all rent in the hands of the mortgagor when suit is started, which extends to rental notes transferred thereafter to a purchaser with notice.[16]

B. Rights during period of redemption.

The rights of the parties during the period of redemption are almost wholly regulated by statute. The statutory provisions differ in nearly every state, but there is enough similarity so that decisions from other jurisdictions are often valuable.

Although there is a conflict of authority, the best rule is that a lease is not affected by the foreclosure sale.[17] The reason for this rule is that if it were held that the lease was terminated by the sale a mortgagor who redeemed would discover that he had lost his lease.[18] Clearly such a result would be unjust.

The general rule, in the absence of statute, is that the mortgagor is entitled to the rents during the period of redemption.[19] By statute in Arizona, California, Montana and Washington the purchaser is given the right to rents during this period.[20] A similar statute existed in North Dakota, but was repealed in 1919.[21] However, he is not entitled to all rents then falling due, but only that earned since the sale. It will be apportioned.[22] If the lessee has paid rent in advance, the purchaser can require him to pay it again.[23] If the mortgagor subsequently redeems from the sale, the statutes provide that the purchaser must account to him for the rents collected.

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[13] *Hakes v. North*, 199 Iowa 995, 203 N. W 238 (1925) *Grether v. Nick*, note 11, *supra*.

[14] *Hakes v. North*, note 13, *supra*.

[15] *Ferguson v. White*, 213 Iowa 1053, 240 N. W 700 (1932)

[16] *Ferguson v. White*, note 15, *supra*; *John Hancock Mutual Life Ins. Co. v. Stowe*, 215 Iowa 324, 245 N. W 295 (1932).

[17] *Reynolds v. Lathrop*, 7 Cal. 43 (1857) *Chadbourn v. Rahilly*, 34 *Minn.* 346, 25 N. W 633 (1885) *Dolin v. Wachter* note 9, *supra*, *Williard v. Campbell*, 91 Mont. 493, 11 Pac. (2d) 782 (1932) *Virges v. Gregory Co.*, 97 Wash. 333, 166 Pac. 610 (1917) *Contra*: *Miller v. Laing*, 212 Iowa 437, 236 N. W 378 (1931) *Tyler v. Hamilton*, 62 Fed. 187 (C. C. Ore.) (1894) 14 A. L. R. 664, note.

[18] *Virges v. Gregory Co.*, note 17, *supra*.

[19] JONES ON MORTGAGES, sec. 2127 *Farm Mortgage Loan Co. v. Pettet*, 51 N. D. 491, 200 N. W 497 (1924)

[20] R. S. A. 1913, Civil Code, Par. 1383; Code of Civ. Proc., sec. 707 Revised Codes 1921, sec. 9448; Wash. Rem. Rev Stat. Ann., sec 600, 602.

[21] *Farm Mortgage Loan Co. v. Pettet*, note 19, *supra*.

[22] Note 9, *supra*.

[23] *McDevitt v. Sullivan*, 8 Cal. 593 (1857).

This right to the rents is purely statutory, so a prior assignment by the mortgagor will not defeat the rights of the purchaser.[24] It is interesting to note that the North Dakota case disapproves the reasoning of the Washington case of *Griffith v. Burlingame*, which was recently repudiated by the Washington court itself.[25]

C. Rights after the period of redemption has expired.

The general rule is that a lease subject to a mortgage is terminated when the purchaser at the foreclosure sale gets the deed, if the lessee was joind in the foreclosure action.[26] The lessee may sue the lessor for breach of the covenant of quiet enjoyment.[27] This cause of action accrues as soon as the lessee is joined in the foreclosure action, and if possible the lessee should claim his damages from the surplus left after the foreclosure sale.[28]

If the lessee is not joined in the foreclosure action, the lease is not affected by it or by the deed to the purchaser.[29] The lessee must pay the rent stipulated in the lease to the purchaser from the date he is given notice that the deed has been delivered.[30] But the purchaser has no greater rights than the lessor, and is not entitled to any rent if the lessee paid it to the lessor in advance.[31]

A few jurisdictions held that the lease is terminated by foreclosure even though the lessee is not joined in the foreclosure action.[32] The only effect of failure to join the lessee is in the remedy to be pursued by the purchaser to gain possession of the property [33] It follows naturally that in these jurisdictions the lessee can sue the lessor for breach of the covenant of quiet enjoyment when the mortgage is foreclosed.[34]

III. When the Lease is Executed Between the Filing of the Foreclosure Action and the Foreclosure Sale.

When a lease is executed *pendente lite*, the lessee takes subject

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[24] *Shintaffer v. Bank of Italy*, 216 Cal. 243, 13 Pac. (2d) 668 (1932) *Patrick & Co. v. Knapp*, 27 N. D. 100, 145 N. W 598 (1914) *Security Savings & Loan Society v. Dudley*, note 5, *supra*, *Roberts v. State*, note 9, *supra*.

[25] *Security Savings & Loan Society v. Dudley*, note 5, *supra*.

[26] *Sullivan v. Superior Court*, 185 Cal. 133, 195 Pac. 1061 (1921) 14 A. L. R. 664, note; *Munday v. O'Neil*, 44 Neb. 724, 63 N. W 32 (1895). *Contra*: *First Trust Joint Stock Land Bank v. Ingels*, 251 N. W 630 (Iowa 1933).

[27] *Standard Livestock Co. v. Bank of California, N. A.*, 67 Cal. App. 381, 227 Pac. 962 (1924)

[28] *Standard Livestock Co. v. Bank of California, N. A.*, note 27, *supra*.

[29] *Title Ins. & Trust Co. v. Pfenning-Hausen*, 57 Cal. App 655, 207 Pac. 927 (1922) *Dundee Naval Stores Co. v. McDowell*, 65 Fla. 15, 61 So. 108, Ann. Cas. 1915A, 387 (1913) *Wheat v. Brown*, 3 Kan. App. 431, 43 Pac. 807 (1896) *Metropolitan Life Ins. Co. v. Childs Co.*, note 8, *supra*, *Markantonis v. Madlan Realty Corp.*, note 10, *supra*, 14 A. L. R. 664, note.

[30] *Title Ins. & Trust Co. v. Pfenning-Hausen*, 57 Cal. App. 655, 207 *v. Brown*, note 29, *supra*, *Metropolitan Life Ins. Co. v. Childs Co.*, note 8, *supra*, *Markantonis v. Madlan Realty Corp.*, note 10, *supra*.

[31] *Stellar Holding Corp. v. Berns*, 143 Misc. 781, 257 N. Y. S. 369 (1932).

[32] *Dolese v. Bellows-Claude Neon Co.*, 261 Mich. 57, 245 N. W 569 (1932) *B. F Avery & Sons' Plow Co. v. Kennerly*, 12 S. W (2d) 140 (Tex. 1929).

[33] *Dolese v. Bellows-Claude Neon Co.*, note 32, *supra*.

[34] *B. F Avery & Sons' Plow Co. v. Kennerly*, note 32, *supra*.

to any order which may be entered in the foreclosure action. He must pay rent to the receiver, even though he has paid the rent in advance.[35] Of course, the purchaser at the sale is entitled to the rent in the same manner as if the lease were executed before foreclosure began.[36] A lease of this sort is terminated when the purchaser at the foreclosure sale gets the deed, even though the lessee was not made a party to the foreclosure.[37]

There are several cases involving leases executed between the foreclosure decree and the sale. If the decree provided that the purchaser should have possession during the period of redemption the lessee cannot attack it collaterally and is liable to the purchaser for the value of the use and occupation of the land if he remains in possession.[38] The lease is not terminated by the sale, and the purchaser is entitled to the rent earned thereafter.[39] It is no defense that the lessee had paid in advance for the whole term.[40]

IV When the Lease is Executed During the Period of Redemption

There are very few cases in which this situation has arisen, and the decisions are not entirely harmonious. If a lessee plants crops the assurance that the lessor will redeem, he does so at his peril and has no rights thereto if they do not mature before the purchaser gets his deed.[41] But if the crop is harvested, the purchaser is entitled to that portion which was payable to the lessor as rent, even as against an innocent purchaser.[42] In Montana the purchaser is entitled to possessoin unless the mortgagor occupies the premises as a home, and may bring ejectment against the lessee.[43]

If the property is leased by the purchaser at the sale, a mortgagor who redeems is entitled to the benefit of the lease.[44]

Conclusion.

Generally, it may be said that a lease is not affected until the deed passes to the purchaser at the foreclosure sale. If the lessee is not joined, the proceedings do not affect the lease in any way

When the right to the rent during the period of redemption is conferred on the purchaser at the foreclosure sale, the mortgagor cannot defeat that right by an assignment of the rents or by accepting a payment in advance. Nor can he defeat the right of a receiver by executing a lease during foreclosure and collecting rent in advance.

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[35] *Gaynor v. Blewett*, 82 Wis. 313, 52 N. W 313 (1892) See *Flynn v. Lowrance*, 110 Okla. 150, 236 Pac. 594 (1925).

[36] *Whithed v. St. Anthony etc. Co.*, 9 N. D. 224, 83 N. W 238 (1899).

[37] *McDermott v. Burke*, 16 Cal. 580 (1860).

[38] *Kester v. Amon*, 81 Mont. 1, 261 Pac. 288 (1927)

[39] *First National Bank v. Maxey*, 34 Ariz. 438, 272 Pac. 641 (1928). See *Millingar v. Foster* 293 S. W 249 (Tex. 1927) 8 S. W (2d) 514, *Condon v. Marley*, 7 Kan. App. 383, 51 Pac. 924 (1898) *contra.*

[40] *Harris v. Foster* 97 Cal. 292, 32 Pac. 246 (1893).

[41] *Hendricks v. Stewart*, 53 N. D. 513, 206 N. W 790 (1926)

[42] *Kuiper v. Miller* 53 N. D. 711, 207 N. W 489 (1926)

[43] *Dyer v. Schmidt*, 67 Mont. 6, 213 Pac. 1117 (1923).

[44] *People's Savings Bank v. McCarthy*, 209 Iowa 1283, 228 N. W 7 (1929)