

Developer's lender cannot foreclose on common areas

Partial discharges gave fee interest to unit owners

By Eric T. Berkman
Lawyers Weekly Correspondent

A bank that loaned money to a condominium developer and gave each unit buyer a partial mortgage discharge upon purchase had no remaining mortgage interest in undeveloped common areas, the Appeals Court has found.

The development, Beechwood Village Condominiums in Rockland, was to be built in phases, but the developer ceased operations before all phases had been built and before the mortgage had been paid off. A dispute arose between the lender, defendant USAlliance Federal Credit Union, and the plaintiff condo trust over the lender's right to foreclose on the mortgage and build additional units in the common area.

A Land Court judge had ruled that the lender, which had recorded its mortgage before the recording of the master deed, still held a mortgage interest in the undeveloped common area.

But the Appeals Court reversed, rejecting the lender's argument that the partial releases only released the exclusive-use common area appurtenant to the respective units.

"We conclude that all of the land associated with the condominium development, including the common area, was submitted to the provisions of G.L.c. 183A, the Condominium Act (act or statute), by the master deed, and that the effect of the subsequent mortgage discharges by the relevant lenders upon the sale of each unit was to release the lenders' mortgage interest in all of the common area," Judge Mary T. Sullivan wrote for the Appeals Court. "The unit owners became the fee simple owners of all of the common area as tenants in common, including the undeveloped common area."

The court also found that the lender's interest in the developer's phasing rights remained intact despite the partial releases. Nonetheless, the court found, the developer's easement to access the land to build additional units had expired after seven years under the master deed.

The 30-page decision is *Trustees of the Beechwood Village Condominium Trust v. USAlliance Federal Credit Union, et al.*, Lawyers Weekly No. 11-055-19. The full text of the ruling can be found at masslawyersweekly.com.

'Widely employed device'

Thomas O. Moriarty of Braintree, who represented the condominium trust on appeal, said the partial discharge device has been widely employed for decades, and it would have been potentially devastating for condominium unit owners if the Appeals Court had adopted the lender's argument as to its effect.

"If the partial discharge didn't mean the unit and the unit owner's interest in the common area would survive a foreclosure, it really would have been cataclysmic," he said. "You'd have people believing their units had been partially discharged from the mortgage and then learning that a foreclosure would divest them not only of their ownership in the common area but theoretically wipe out the condominium association itself, which would necessarily undermine the title to the unit."

The lender's mortgage, recorded prior to the master deed, would be in a priority position if the bank was able to foreclose, Moriarty explained. That would allow the bank to take the position that nothing recorded subsequent to its mortgage is valid to dispossess it of any interests pledged to it and the mortgage interest.

"The master deed would be an encumbrance that gets wiped out," he said. "The units themselves would essentially be extinguished and would be a legal nullity since they're created by the master deed."

Ellen A. Shapiro of Dedham, who represented the trust in earlier stages of the litigation and worked with Moriarty on the appeal, said that beyond the foreclosure context, the



A dispute between the lender and Beechwood Village Condominium Trust ends up at the Appeals Court. One of the units is pictured above.



MORIARTY
Represents condo trust on appeal

decision is important because it ensures that condo owners' titles to their units will not have a cloud on them by virtue of a prior unrecorded mortgage.

It also provides the condo owners certainty that the lender cannot sell the undeveloped common area to another developer that puts in another condominium or subdivision.

"That's very important," she said. "Otherwise [another developer] wouldn't need to work with the association on things like architectural integrity."

Edmund A. Allcock, a Boston attorney who practices condominium law, called the case "an excellent refresher" on the nature of development rights in a phased condominium in which the land to be developed in the future is submitted as part of the condominium.

"What a lot of people do not understand is that the submitted land immediately becomes common area, and fee is at that time vested in the units already created," he said. "The reserved development right is in the nature of a quasi-easement, which allows the developer to enter onto common area land and build on that land."

He also said the case is significant because it confirms that a lender's partial release for the sale of units is the equivalent of a subordination to the condo regime.

"This makes sense," Allcock said. "It would be hard for the lender to recognize the existence of the condominium in one instance so that sales could occur and then, at some later date, foreclose on and wipe out the entire condominium."

Michael W. Parker, a condominium lawyer in Boston, said the decision will probably cause lenders to re-examine the practice of granting

Trustees of the Beechwood Village Condominium Trust v. USAlliance Federal Credit Union, et al.

THE ISSUE

Did a bank that loaned money to a condo developer and gave each unit buyer a partial mortgage discharge upon purchase have a remaining mortgage interest in undeveloped common areas?

DECISION

No (Appeals Court)

LAWYERS

Thomas O. Moriarty of Moriarty, Troyer & Malloy, Braintree (plaintiffs)
Charles G. Devine Jr. of Devine Barrows, Wellesley Hills (defense)

partial discharges for units built before all units are completed.

"We can expect that lenders will limit the scope of the discharges to the units only and not to any of the common areas, or shy away from issuing partial discharges altogether," Parker said. "That shift will make condominium projects more difficult to finance, especially in down markets."

Parker added that the decision should serve as a cautionary tale for condo developers to make sure that reserved phasing rights and the construction easement to do the work are completely aligned in time and scope.

"One without the other effectively halts further development," Parker said.

Charles G. Devine Jr. of Wellesley Hills represented the lender. He could not be reached for comment before deadline.

Partial releases

In 2006, developer Beechwood Village Realty Trust bought a 37-acre parcel of land in Rockland to build a condo development. The developer took out a mortgage with USAlliance to help finance its purchase.

On March 9, 2007, after completing the three-unit first phase, the developer recorded the master deed, which provided for up to 79 age-restricted freestanding units to be built in up to 30 phases. The developer reserved phasing and construction rights and reserved construction easements for seven years.

Under the deed, as each unit was sold, the purchaser obtained an undivided ownership in undeveloped common areas.

Over the next four years, multiple phases of the condominium were completed, resulting in 54 units. Each new unit was added by amendment to the master deed and the lender granted a partial discharge of its mortgage for each new unit sold.

The developer ran into financial difficulties during a real estate downturn and no

additional phases were added after 2011. In the meantime, the developer apparently did not meet its mortgage obligations, and the lender sought to foreclose on undeveloped portions.

In 2016, the trust brought an action in Land Court seeking declarations that the mortgage no longer gave the lender an interest in condo land or buildings; that the developer's development, phasing and easement rights expired in 2014; and that the common area could not be developed without consent of 75 percent of unit owners.

The lender, in turn, sought a declaration that it had a mortgage interest in the undeveloped land and in the developer's phasing rights, and that its easement remained enforceable.

Judge Michael D. Vhay found that the partial discharges merely applied to the specific units and not the undeveloped common areas and that, while the developer's phasing rights were largely intact, its easement rights had expired. Both parties appealed.

Subordinate interest

The Appeals Court found that the effect of the lender's partial mortgage discharges when selling each unit was to release its interest in the entire common area.

Accordingly, the panel concluded, the unit owners became fee simple owners of all common areas, including the undeveloped area.

And while the court agreed with the lender that the partial discharges did not release the developer's phasing and easement rights, meaning the lender still had a security interest in those rights, the construction easements had expired in 2014, seven years after the recording of the master deed, as the deed called for.

"[T]he developer (currently) has no easement over the roadways to reach the undeveloped areas ... in order to construct additional phases," Sullivan wrote for the panel. "Were USAlliance to foreclose on its mortgages, it would be similarly limited."