

So You're Saying There's a Chance: Surpluses in Foreclosure

Article

Amundsen Davis Financial Services Alert

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Commercial lenders often take junior or second mortgages on real estate as additional collateral for loans. Unfortunately, because those junior liens are subordinate to the senior liens, they are subject to being eliminated through the foreclosure process if the primary lienholder files suit to foreclose. Oftentimes the junior lender gives-up on the second mortgage and seeks other ways to recover on its loan and does not bother participating in the foreclosure case filed by the senior mortgagee. The decision to walk away from the junior mortgage, however, should be reconsidered.

In the case of *JP Morgan Chase Bank v. Talaganov*, the junior mortgagee, RBS Citizens, filed an answer to the foreclosure filed by Chase in which it stated that RBS had a mortgage lien, but admitted that Chase had a senior mortgage lien. RBS requested in its answer that it be entitled to any surplus funds. The court eventually entered the judgment of foreclosure and sale, which noted that RBS had a valid junior mortgage in the amount of "TBD." After the property was sold, a surplus of \$66,043.74 existed, which RBS and Talaganov both sought.

Despite the fact that the amount of RBS's junior mortgage was listed as only "TBD" before the sale, the trial court eventually granted RBS's motion for the turnover of the surplus funds. Talaganov appealed on various grounds, but the appellate court affirmed the decision of the trial court and noted that RBS answered the complaint and stated the amount of its junior lien, and also specifically requested that it be entitled to any surplus funds. Had RBS not participated in the foreclosure case filed by Chase, the \$66,043.74 would have been turned-over to the defendant despite the fact that she still owed RBS over \$180,000.00.

It takes minimal effort and fees for a junior mortgagee to answer a foreclosure complaint. While it is true that this effort is often for naught because surplus funds after a forced foreclosure sale are rare, they still occur. They are more like Giant Pandas, which are rare, than unicorns, which do not exist. Even one surplus recovery in the amount of \$66,000.00 would more than cover the costs of participating in dozens of other foreclosure suits as a junior mortgagee. Not participating in the senior mortgagee's foreclosure suit can sometimes be

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characterized as cutting off one's nose to spite one's face.

We regularly counseled lenders, even before the *Talaganov* case, that they should try to “ride the coattails” of the senior mortgagee's foreclosure suit by answering the complaint and seeking any surplus. Failure to participate in the foreclosure will eventually result in the junior lender being proscribed from seeking surplus funds that will exist in some cases.

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