Mortgage Subordination

A Rule Not to be Ignored

If a conservation easement is recorded on a property that is subject to a previously existing mortgage, the rights of the holder of the mortgage come before the rights of the conservation easement holder. That is, unless the holder of the mortgage (the "Mortgage Holder") agrees to change the *first in time, first in right* rule.

The consequences of not securing such agreement can be severe:

- If the owner fails to make mortgage payments, the Mortgage Holder has the power to order the county sheriff to sell the property at a public sale to recoup the debt owing to it. If the Mortgage Holder has not agreed to allow the conservation easement to survive such action, the sale will be ordered free and clear of the conservation easement.
- If the owner used the donation of the conservation easement as a charitable deduction for federal tax purposes, the Internal Revenue Service could successfully disallow the deduction and subject the owner to interest and penalties. (Treasury Regulations Section 1.170A-14(g) states that: "[N]o deduction will be permitted under this section for an interest in property which is subject to a mortgage unless the mortgagee subordinates its rights in the property to the right of the qualified organization to enforce the conservation purposes of the gift in perpetuity.")

To guard against such outcomes, an owner could pay off the mortgage prior to entering into the conservation easement or refinance in conjunction with the easement. However, if this is not financially feasible, the owner will have to secure agreement from the Mortgage Holder to place some of its rights in a subordinate position to those of the prospective holder of the conservation easement.

Incentive to Subordinate

The Mortgage Holder can voluntarily agree to step into a subordinate position by signing and recording a document called a subordination agreement. Why would it do so? Often it is because the Mortgage Holder sees an economic advantage in accommodating the other interest. In the case of a proposed second mortgage, the new mortgage may fund improvements increasing the value of the property. (For example, a power line or sanitary sewer facilities to be installed will increase the value of this and other real property in the community.) Sometimes the Mortgage Holder agrees to subordinate to avoid the loan being paid off or refinanced. The loan secured by the mortgage may bear a higher interest rate than the Mortgage Holder could obtain currently and is being paid down regularly without a problem. Thus, the Mortgage Holder has an incentive to keep this asset on its books.

Hurdles in Obtaining a Mortgage Subordination

Credit: Conservationtools.org,
Acknowledgements: Patricia L. Pregmon, attorney at law, is the primary author, and Andy Loza, the editor and contributing author.

Identifying the Mortgage Holder

The first hurdle to overcome in obtaining mortgage subordination is to find a person who has the capacity to review and approve the request. That may be an easy task if the mortgage is held by a bank or other lender with whom the owners have an ongoing relationship. Direct the request for subordination to a senior level officer or some other person that regularly services the owners as a customer.

In all other cases, and especially when the assignee of the mortgage identified on the public record is MERS (Mortgage Electronic Registration Systems, Inc.), direct the request to the mortgage servicing company that collects monthly payments from the owners. Try to find out which department handles requests for subordination and direct the communication to the head of that department.

The initial communication should come from the owners. Most, if not all, mortgage servicing companies have a policy of not communicating with anyone else about a loan but for the borrowers. If agreeable to the owners, the initial communication should authorize one or more representatives of the future holder of the conservation easement (the "CE Holder") to discuss the subordination arrangements with the Mortgage Holder. The representatives of the CE Holder authorized to contact the Mortgage Holder will need both the loan number and social security numbers of the borrowers.

Initial Communication

The goal of the initial communication is to get past rejection out of hand -- it's always easier to just say no. The following are samples of the kinds of arguments that might be advanced in the initial letter to, or other communication with, the Mortgage Holder requesting subordination.

1. This loan is a valuable asset, which the Mortgage Holder will not want to have paid off or refinanced. The loan bears an advantageous interest rate compared to current market. The customers have an excellent record of regular payment.
2. The Mortgage Holder's security for the loan will not be materially impaired by the conservation easement. The loan to value ratio (the ratio, expressed as a percentage, between the outstanding principal balance of the loan and the value of the property as diminished by the conservation easement) is equal to or less than the loan to value ratio at the time the loan was made.
3. Alternative to 2: The Mortgage Holder's security after taking into account the diminution in value resulting from the conservation easement is ___%, which maintains conformity with the maximum 80% loan to value ratio required by industry standards.
4. The conservation easement will not materially impair marketability of the property. There is a robust market for lands protected by conservation easement in the vicinity.
5. The CE Holder will, if the Mortgage Holder has no objection, publicly acknowledge the Mortgage Holder's cooperative role in advancing the protection of natural and scenic resources in the community.

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