

The Massachusetts Appeals Court Reaches A Practical Conclusion Concerning Lender's Rights After Developer Defaults.

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On May 15, 2019, the Massachusetts Appeals Court held in *Trustees of the Beechwood Village Condominium Trust v. USAlliance Federal Credit Union* (“*Beechwood*”) that where the holder of a mortgage partially releases its construction mortgage on individual condominium units, the release acts as a discharge of the unit and the common areas of the condominium. As such, the lender’s partial release of the developer mortgage prevented the lender from exercising its rights to develop the remaining unbuilt condominium units.



The question presented in *Beechwood* was what right does a lender retain when the developer defaults on a mortgage where the lender issued partial releases on the individual sold units. In *Beechwood*, USAlliance Federal Credit Union (“Lender”) granted a mortgage in the amount of \$4.7 million. The developer constructed the infrastructure, created a master deed and sold 54 of the 79 of the age restricted single family detached condominium units for this association located in Rockland, Massachusetts.

The developer sold the first unit in 2007 and by 2011 all development ceased despite the remaining 25 unsold units. Since the infrastructure is substantially complete, the right to develop the remaining units remained a very valuable asset. The condominium association filed suit in the Massachusetts Land Court for the purpose of determining whether it or the lender had the right to develop the remaining condominium units. The Land Court determined that the lender had the right to construct the remaining units. The Land Court reasoned that the Lender’s partial discharge of the mortgages released only the individual stand-alone lots (units) where the houses were located, but not the associated common areas where the future lots (units) would be built. The Beechwood Condominium Association appealed the Land Court decision and the Massachusetts Appeals Court reversed.

The *Beechwood* case raises interesting legal issues with potentially serious consequences for purchasers of new condominium units, builders and lenders. In this case, if the condominium association obtains the required votes, it will be able to complete the development and sale of the remaining units.

By way of background, in Massachusetts, the superiority of recorded documents follows a first in time priority regime. As such, a first mortgage will have priority rights over all other subsequently recorded documents. Often times priority rights focus on payment obligations of the respective mortgage holders. However, this is not always the case. For example, where a landowner grants its neighbor an easement to access property, if a lender's mortgage is recorded prior to the recording of the easement and the lender forecloses, the easement would be eliminated.

In *Beechwood*, the Lender granted the developer a mortgage, the developer built the infrastructure, constructed some of the units, recorded the master deed, and sold 54 units. After the sale of each of the individual units, the Lender issued a partial release of its mortgage. The Lender argued that since the mortgage was recorded prior in time to the master deed, the Lender had the right to foreclose. In addition, the Lender argued that its partial releases acted to discharge only the individual unit and not the associated common areas.

The Association argued that if the Appeals Court were to rule for the Lender, that the after recorded master deed would be eliminated. Had the Appeals Court ruled in favor of the Lender, the rights of all of the unit owners would be placed in doubt, including the mortgages granted on those units to the individual purchasers.

The Beechwood Condominium Trust argued that the lender's release acted as a release of all its mortgage interest in the common areas. It based its position on the fact that all of the unit deeds included an undivided interest in the common areas and the lender granted a partial discharge of its mortgage on the units which, by definition in the master deed, included an interest in the common areas. The Appeals Court agreed with Beechwood.

The situation presented in *Beechwood* is generally avoidable through the creation of what is called a "subordination agreement." A subordination agreement is a document signed by the lender and the developer which acknowledges that the lender's mortgage does not have priority over the subsequently recorded master deed. In essence, the subordination agreement acts to alter the traditional recording priority system as discussed above. With a subordination agreement, a foreclosure of the developer's mortgage does not eliminate the master deed.

At Perkins & Anctil, we have represented countless developers and lenders to new-construction condominium associations. Whether representing a developer or a lender, we always insist on subordination agreements. It is our opinion that subordination agreements protect the interests of the developer, unit owners and all lenders providing financing. As to developers, a subordination agreement allows

buyers to purchase units without fear that a foreclosure will eliminate the master deed. As to the lenders, P&A is careful to ensure that the lender's interest includes property rights and very broad development rights. Proper drafting of the documents places all parties on notice of their respective rights.

The consequences of the *Beechwood* decision are significant. If the Appeals Court were to decide in favor of the Lender, all financing for individual units may have stopped. Simply put - a lender cannot risk financing a unit where the master deed could be eliminated through foreclosure. In addition, lenders for developers are put on notice of the importance of drafting proper provisions to protect their rights should the developer default.

P&A would like to acknowledge the efforts of fellow Community Association Institute affiliated Attorneys Ellen Shapiro and Thomas Moriarty for their well-earned victory on behalf of Beechwood.