

My Lender Would Not Proceed with My Loan and I Just Lost My Downpayment!

By John Dolgetta, Esq.

In a recent decision, *Sanjana v. King* (*see* <https://bit.ly/2kDGf5K>), the Appellate Division, First Department, affirmed the Supreme Court's decision (*see* <https://bit.ly/2Mw924T>) which held that a seller could retain the purchasers' downpayment of \$110,000 as liquidated damages where the purchasers failed to timely cancel the contract of sale in accordance with its terms when the purchasers obtained a conditional mortgage commitment and the lender refused to move forward with the loan.

The Relevant Mortgage Contingency Provisions in *Sanjana*

The parties entered into a contract for the sale of a condominium unit in New York City. The standard language in the contract provided as follows: "The obligations of Purchaser hereunder are conditioned upon issuance, on or before thirty (30) days from the date hereof (the "Commitment Date") of a written commitment from an Institutional Lender pursuant to which such Institutional Lender agrees to make a loan other than a VA, FHA or other governmentally insured loan to Purchaser, at Purchaser's sole cost and expense, of \$800,000 or such lesser sum as Purchaser shall be willing to accept." This is customary language and is similar to language included in many of the various forms of contract (see below).

Additionally, the contract provided that if the purchaser is unable to obtain a mortgage commitment or a commitment is not "...issued on or before the Commitment Date,...Purchaser may cancel this Contract by giving Notice to the Seller within 5 business days after the Commitment Date..." and receive a refund of the downpayment. The contract, however, further provided that "[i]f the Purchaser fails to give Notice of cancellation...then Purchaser shall be deemed to have waived Purchaser's right to cancel this Contract and to receive a refund of the Downpayment by reason of the contingency contained in this [paragraph] [emphasis added]." The Court relied on these provisions in arriving at its decision.

The Issuance of the Mortgage Commitment or Letter of Approval

In *Sanjana*, the purchasers received a conditional letter of approval (i.e., conditional mortgage commitment) from their lender on February 15, 2017. The Court explained that the "approval identified numerous conditions that had to be satisfied before the mortgage would be approved...." Among other conditions, the letter of approval required that the purchaser provide certain information (such as organizational and financial information) relating to the condominium.

Nearly a month after the conditional approval was issued (i.e., on March 10, 2017), "after the time to cancel the contract had passed", as the Court points out, the lender notified the purchasers that it was revoking their conditional approval "...because the condo's HOA did not contribute at least 10% of its monthly dues to a reserve account." While the decision indicates that the purchasers claimed they had informed the sellers on March 14, 2017 of the lender's revocation,

the seller's attorney was only formally notified of lender's revocation, in writing, by the purchasers' attorney on March 29, 2017. In that letter, the attorney stated that his clients "...never received a commitment. They received a conditional commitment which was revoked' and demand[ed] a return of the downpayment."

On April 3, 2017, the seller's attorney sent a letter to the purchasers' attorney refusing to return the downpayment "...because plaintiffs failed to give notice of cancellation within 5 days of February 25, 2017 (the Commitment Date)." The seller's attorney also included a "TIME OF THE ESSENCE" ("TOE") notice in the letter and demanded that the purchasers proceed with the closing on April 10, 2017. It could be argued that the TOE notice did not provide a "reasonable time" for the purchasers to close, but that is the subject of another article ([see https://bit.ly/2FbnHPN](https://bit.ly/2FbnHPN)). The purchaser did not close and commenced an action to recover the downpayment.

The purchasers' attorney moved for summary judgment on the grounds that the mortgage contingency clause was a condition precedent to a closing and if the commitment is revoked then the purchaser should be entitled to the return of the downpayment. The seller's attorney cross-moved for summary judgment seeking a dismissal of purchasers' action to recover their downpayment on the grounds that the purchasers failed to terminate the contract in a timely manner, thereby waiving their right to cancel the contract and forfeiting the downpayment. The Supreme Court found in favor of the seller and awarded the seller the right to retain the downpayment. The purchasers appealed the decision and the Appellate Division affirmed the Supreme Court's decision in favor of the seller.

The Courts' Rationale in *Sanjana*

The Supreme Court, quoting *Blair v. O'Donnell* ([see https://bit.ly/2INafwo](https://bit.ly/2INafwo)), explains that "[a] mortgage contingency clause is construed to create a condition precedent to the contract of sale. The purchaser is entitled to return of the down payment where the mortgage contingency clause unequivocally provides for its return upon the purchaser's inability to obtain a mortgage commitment within the contingency period." The Court goes on to explain that "...when the lender revokes a mortgage commitment that has been issued after the contingency period has elapsed, the contractual provision relating to failure to obtain an initial commitment is inoperable, and the question becomes whether the lender's revocation was attributable to bad faith on the part of the purchaser."

In *Sanjana*, the Supreme Court explains that since there was never a formal, firm commitment issued, because the commitment was "conditional" in nature, the lender could not revoke a commitment. The Court, therefore, was not required to determine whether the revocation was due to purchasers' bad faith. Here, the commitment was conditional and as the Court explains, the purchasers had two options, they could either cancel the contract within 5 days of the Commitment Date or ask for an extension of the Commitment Date. The purchasers did neither and, ultimately, the court held that a strict review and interpretation of the "four corners" of the contract must result in one outcome, that the seller be allowed to retain the downpayment due to the purchasers' non-compliance with the clear contract terms.

The Court states that “[w]hile losing the entire downpayment might be a harsh outcome, this Court cannot rewrite a term of a contract signed by the parties. The parties agreed that plaintiffs would not be obligated to purchase and would get their downpayment back if they failed to get a mortgage commitment as long as they gave the sellers notice within five days of the commitment date.” Here the Court, adhering to the “four corners” doctrine, opined that if the rights and duties of the parties are clearly enumerated in the agreement, courts will customarily interpret and apply those provisions strictly.

The Mortgage Contingency Clause

The decisions in *Sanjana* highlight several important issues and risks involving the mortgage commitment and mortgage contingency clause, which is one of the most commonly negotiated and revised provisions in a real estate contract. It is also one of the least understood clauses. The decision in *Sanjana*, while in some instances clarifies some of the ambiguities relating to same, also creates more questions.

For example, the standard forms of Residential Contract of Sale (2000) and Condominium Contract (2000), which are commonly utilized in downstate New York real estate transactions, contain similar mortgage contingency provisions. It is important to note that both of these forms are nearly 20 years old and have not been updated. Times have certainly changed, especially after the economic crisis and major changes in the financing parameters of lenders. It is imperative that revisions be made to these forms and to the “standard” language.

Unfortunately, sellers’ attorneys generally push back on any changes to the standard forms, especially the mortgage contingency provisions. However, any attorney representing a purchaser should and **must** push back as well, especially in light of the ruling in *Sanjana*, and demand that certain changes be made to the standard provisions. Below is a common mortgage contingency clause, which is contained in subparagraph 8(a) of the Residential Contract of Sale (2000) (*see* <https://bit.ly/2AVzGCW>):

“To the extent a Commitment is conditioned on the sale of Purchaser’s current home, payment of any outstanding debt, no material adverse change in Purchaser’s financial condition **or any other customary conditions** [emphasis added], Purchaser **accepts** [emphasis added] the risk that such conditions may not be met; however, a commitment conditioned on the Institutional Lender’s approval of an appraisal shall not be deemed a “Commitment” hereunder until an appraisal is approved (and if that does not occur before the Commitment Date, Purchaser may cancel under subparagraph 8(e) unless the Commitment Date is extended). Purchaser’s obligations hereunder are conditioned only on issuance of a Commitment. Once a Commitment is issued, Purchaser is bound under this contract even if the lender fails or refuses to fund the loan for any reason.”

Following the rationale laid out in *Sanjana*, if the above highlighted provisions are allowed to remain in the contract, the “four corners” doctrine would dictate that any other **customary conditions** would be at the risk of the Purchaser. The contract does not define “customary conditions” and, most commitment letters contain numerous conditions, some of which are not in

purchasers' control. It is strongly recommended that language be added to the contract or rider defining "customary conditions" and/or that would allow a purchaser to cancel a contract in the event a conditional commitment issued, or if a commitment, whether conditional or firm, is revoked by Lender through no fault or bad faith of purchaser.

The decision in *Sanjana* seems to make a blanket statement that if a commitment is issued that contains any outstanding conditions, the purchaser would be permitted to cancel the contract provided notice is timely given. However, a strict reading of the above provision contradicts that conclusion. Typically, a satisfactory appraisal is the only condition that is included in the contract that would seemingly allow a purchaser to cancel the contract, even where a conditional commitment is issued.

A conditional commitment or approval issued by a lender that includes conditions not specifically carved out in the contract, would customarily be considered a "firm" commitment, and contrary to the holding in *Sanjana*, the contract would not afford the purchaser the right to cancel even if the purchaser did so within the time frame provided for in the agreement. However, following the reasoning in *Sanjana*, if a commitment is deemed to be "firm", it would then permit a court to consider whether the lender's revocation was due to Purchaser's bad faith, and could potentially result in a determination that allows the purchaser to receive the downpayment back.

There are many additional changes that should be made to the mortgage contingency clause, as well as changes to other provisions contained in the "standard" forms, but the important lesson is that real estate professionals should be aware of these court decisions so that they can alert both buyers and sellers to risks before they enter into contracts. As in *Sanjana*, the courts will customarily adhere to the "four corners" doctrine in contract disputes. If the rights and duties of the parties are clearly and unambiguously enumerated in the "four corners" of the agreement, courts will customarily interpret and apply those provisions strictly.

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