

# Bankruptcy Blog

## A Blog on Illinois Bankruptcy Cases and Related Topics | Attorney Jeana K. Reinbold

### What Constitutes a “Mortgage” Under Illinois Law?

August 31, 2012 · by Jeana · in Avoidance Powers, Mortgages, Trustees ·

A ruling by a Bankruptcy Court in Illinois that a bankruptcy trustee could avoid two mortgages which utilized a standard form used by the lending industry could constitute a precedent opening the door to avoidance of thousands of mortgages in Illinois.

Gifford State Bank (“Bank”) granted two mortgage loans in 2004 and 2009 with regard to two parcels of real estate located in Rantoul, Illinois. Both mortgages were recorded.

The forms of the mortgages utilized by the Bank in these loans were consistent with the Fannie Mae/Freddie Mac form in Illinois, which merely identified the principal amount of the underlying promissory notes.

Subsequently the borrowers filed chapter 7 bankruptcy. The chapter 7 trustee (“Trustee”) then brought an adversary proceeding against the Bank seeking to avoid the two mortgage loans, on the grounds that they were defective because the face of the mortgages failed to include the interest rate or maturity date.

The Bankruptcy Court found in favor of the Trustee, and the case is presently on appeal before the District Court. [FN1]

The problem for the Bank is two-fold.

First, the Bank and the Trustee disagree as to the proper interpretation of Section 11 of the Illinois Conveyances Act . [FN2] The Bank argues that language of the statute referencing the interest rate and maturity date is permissive not mandatory. The Trustee cites to several Illinois Supreme Court cases indicating that it would be likely to rule that the information in the statute is required.

Second, a bankruptcy trustee is given the status of a bona fide purchaser of real property under the Bankruptcy Code. [FN3] In these circumstances, this means that a trustee will not be charged with actual knowledge of a prior encumbrance. The question in this case therefore is whether the Trustee can be charged with having constructive knowledge of the mortgages.

Logic might dictate that the answer is yes, as it would seem that a properly recorded mortgage provides notice to the world of its existence. There was no issue in the case as to whether the mortgages were properly recorded. Any party searching the registry would therefore be on constructive notice as to the existence of these mortgage liens.

However, the case may be a closer call. A case cited by the Bank in support of its position has recently been reversed by the District Court. [FN4] The Jones case involved a priority dispute between two competing mortgagees, where the later in time mortgagee claimed that the first-recorded mortgage was defective because a third party could not determine the amount, interest rate or maturity date from the face of the document. The Jones case might be distinguishable as it concerned the sufficiency of a cross-collateralization clause in addition to the requirements of Section 11, but the District Court cites Illinois cases which indicate that a mortgage missing certain of these terms fails to provide constructive notice. [FN5]

Stay tuned.

[FN1] *Richardson v. The Gifford State Bank (In re Crane)*, 2012 WL 669595, Bankr. No. 11-90592, Adv. Pro. 11-9067 (Bankr. C.D. Ill.), *appeal pending*, 2:12-cv-2146 (C.D. Ill.)

[FN2] Section 11 of the Illinois Conveyances Act, 765 ILCS 5/11, provides:

Mortgages of lands may be substantially in the following form:

The Mortgagor (here insert name or names), mortgages and warrants to (here insert name or names of mortgagee or mortgagees), to secure the payment of (here recite the nature and amount of indebtedness, showing when due and the rate of interest, and whether secured by note or otherwise), the following described real estate (here insert description thereof), situated in the County of ...., in the State of Illinois.

Dated (insert date).

(signature of mortgagor or mortgagors)

The names of the parties shall be typed or printed below the signatures. Such form shall have a blank space of 3 1/2 inches by 3 1/2 inches for use by the recorder. However, the failure to comply with the requirement that the names of the parties be typed or printed below the signatures and that the form have a blank space of 3 1/2 inches by 3 1/2 inches for use by the recorder shall not affect the validity and effect of such form.

Such mortgage, when otherwise properly executed, shall be deemed and held a good and sufficient mortgage in fee to secure the payment of the moneys therein specified; and if the same contains the words "and warrants," the same shall be construed the same as if full covenants of ownership, good right to convey against incumbrances of quiet enjoyment and general warranty, as expressed in Section 9 of this Act were fully written therein; but if the words "and warrants" are omitted, no such covenants shall be implied. When the grantor or grantors in such deed or mortgage for the conveyance of any real estate desires to release or waive his, her or their homestead rights therein, they or either of them may release or waive the same by inserting in the form of deed or mortgage (as the case may be), provided in Sections 9, 10 and 11, after the words "State of Illinois," in substance the following words, "hereby releasing and waiving all rights under and by virtue of the homestead exemption laws of this State."

Mortgages securing "reverse mortgage" loans shall be subject to this Section except where requirements concerning the definiteness of the term and amount of indebtedness provisions of a mortgage would be inconsistent with the Acts authorizing "reverse mortgage" loans, or rules and regulations promulgated under those Acts.

Mortgages securing "revolving credit" loans shall be subject to this Section.

[FN3] 11 U.S.C. § 544(a).

[FN4] *Peoples National Bank v. Jones and Banterra Bank*, No. 12-45, Bankr. No. 10-41897, Adv. Pro. 11-4050 (S.D. Ill.).

[FN5] *Id.* pp. 9-10.

Tags: [bankruptcy trustees](#), [constructive notice](#), [illinois mortgage requirements](#), [section 544](#)

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