

A woman acquired title to a four-acre lot. Several years later, she executed a mortgage on the lot to a bank to secure repayment of a \$100,000 loan. Subsequently, the woman executed a mortgage on the same four-acre lot to a finance company to secure repayment of a \$50,000 loan. Both mortgages were promptly recorded.

The woman recently defaulted on both loans. The bank promptly initiated foreclosure proceedings and sent proper notice to all necessary parties. The current fair market value of the four-acre lot is \$250,000.

The finance company has filed a timely motion in the foreclosure proceeding asking the court to require the bank to first foreclose on two of the four acres in the four-acre lot. The bank opposes this motion and insists that it has the right to subject the entire four-acre lot to the foreclosure sale.

Will the court grant the finance company's motion?

- A. No, because the bank holds a purchase-money mortgage.
- B. No, because the entire four-acre lot is subject to the bank's senior mortgage.
- C. Yes, because a pro rata foreclosure of the lot will not prejudice the rights of the bank.
- D. Yes, because of the "two funds" rule of marshalling.

Explanation:

The **priority of mortgages** and other liens in the foreclosure process is generally determined by their **recording dates**. However, a different rule applies to **purchase-money mortgages** (PMMs)—ie, mortgages granted to **secure the purchase price** of the mortgaged property. PMMs have **super-priority** over all other mortgages or liens, whether or not recorded.

Here, both the bank and the finance company have mortgages on the entire four-acre lot. The woman already owned the lot when she executed the mortgages, so neither mortgage is a PMM (**Choice A**). Therefore, the order of recording determines priority. And since the bank received its mortgage first and promptly recorded it, the bank has the senior mortgage and is entitled to foreclose on the entire four-acre lot.

(Choice C) Mortgagees are entitled to foreclose on the *entire* property subject to the mortgage unless otherwise provided by law. Therefore, the bank has no obligation to foreclose on a smaller two-acre parcel. Additionally, such a pro rata foreclosure *could* prejudice the bank's rights since there is no guarantee that two acres would sell for an amount sufficient to satisfy the bank's interest.

(Choice D) The "two funds" rule of marshalling applies when a senior creditor has two funds available to satisfy a debt (eg, a mortgage on multiple properties), and a junior creditor also has an interest in one of those funds. It requires the senior creditor to first look for satisfaction from the fund that is not shared so as to preserve the junior creditor's interest in the shared fund. But here, both mortgages are secured by a single fund—the four-acre lot.

Educational objective:

Priority of mortgages and other liens is generally based on the order in which they were recorded. Purchase-money mortgages, however, have super-priority over all other mortgages or liens, whether or not recorded.

References

Restatement (Third) of Property: Mortgages § 7.2 (Am. Law Inst. 1997) (priority of purchase-money mortgages).

Copyright © 2011 by the National Conference of Bar Examiners. All rights reserved.

Copyright © UWorld. All rights reserved.

Lien priority on real property

Purchase-money mortgages
(super priority)



First recorded liens
(senior priority)



All other recorded liens
(junior priority)



Unrecorded liens
(lowest priority)

