A man decided to purchase an apartment building. To finance this purchase, the man borrowed funds from a bank. The man executed a negotiable promissory note and a mortgage to the bank in order to secure repayment of the loan.

Two years later, the bank sold its promissory note to a mortgage company by endorsing and promptly delivering the note to the mortgage company. Shortly thereafter, the man stopped making payments on the mortgage, and the mortgage company initiated judicial foreclosure proceedings against him. The man has moved to dismiss the suit.

Should the motion to dismiss be granted?

A. No, because the mortgage was not assigned and is unenforceable by anyone except the bank.

B. No, because the mortgage will be deemed to have been transferred with the promissory note.

C. Yes, because the promissory note could not be assigned independent of the mortgage.

D. Yes, because the promissory note required a separate document for assignment to the mortgage company.

**Explanation:**

**Transfer of promissory note & mortgage**

| | |
|---|---|
| Transfer of both documents | *Both* documents are transferred unless: |
| Transfer of note without mortgage | expressly prohibited in note/mortgage |
| Transfer of mortgage without note* | forbidden by statute or public policy *or*<br>increases mortgagor's duties, burdens, risks<br>Transfer is void |

*Jurisdictions are split as to effect of transfer.

To **finance the purchase of real property**, a borrower typically executes two documents that serve as evidence of the debt:

**Promissory note** – a formal "IOU" that sets forth the terms of the loan. It is the primary evidence of the debt and is not recorded in the deed records.

**Mortgage** (or deed of trust) – a lien that secures the loan by attaching the debt to a real property interest and providing a means of enforcement (eg, foreclosure). It is recorded in the deed records to provide notice of an outstanding debt attached to the real property.

If a lender decides to sell its security interest, the lender can assign the promissory note independent of the mortgage to an assignee **(Choice C)**. A ***nonnegotiable*** **promissory note** requires a **separate assignment** document to transfer ownership **(Choice D)**. However, a ***negotiable*** **promissory note** can be transferred by merely **endorsing and delivering** the note to the assignee. Once the promissory note is properly transferred, the mortgage automatically transfers with the note (unless the parties agreed otherwise) **(Choice A)**.

Here, the *negotiable* promissory note was properly transferred to the mortgage company upon its endorsement and delivery. The mortgage will be deemed to have automatically transferred to the mortgage company, so the mortgage company can enforce the mortgage through foreclosure. Therefore, the man's motion to dismiss this foreclosure proceeding should be denied.

**Educational objective:**

A nonnegotiable promissory note must be transferred by a separate document, while a negotiable promissory note can be transferred by endorsing and delivering the note. Either note can be transferred independent of the mortgage, and the mortgage will automatically transfer with the note (unless otherwise agreed).

**References**

Restatement (Third) of Property: Mortgages § 5.4 (Am. Law Inst. 1997) (transfer of mortgages).