A developer financed the purchase of a tract of vacant land with a mortgage loan from the seller. Two years later, at a time when the land remained vacant, the developer took out a second mortgage loan from an investor to construct self-storage units on the land. Both mortgages were promptly recorded in the order in which they were executed.

The developer made all payments on both mortgage loans for several years but eventually defaulted on the loan from the seller, who threatened to initiate foreclosure proceedings. To avoid the foreclosure, the developer executed a deed in lieu of foreclosure conveying the land back to the seller. But before the developer delivered the deed to the seller, it notified the investor of the proposed conveyance and gave her the option to cure the developer's default on the seller's loan. The investor declined to do so, and the developer delivered the deed to the seller.

If nothing else has happened since the conveyance to the seller, is the investor's mortgage still valid?

A. No, because the investor declined to cure the developer's default on the seller's loan.

B. No, because the seller's mortgage was a purchase money mortgage.

C. Yes, because a deed in lieu of foreclosure does not eliminate junior mortgages.

D. Yes, because the investor's mortgage secures improvements made to vacant land.

Correct

Collecting Statistics

02 mins, 58 secsTime Spent

2023Version

Explanation:

Ways to avoid foreclosure

Equitable redemption*	Mortgagor pays full amount of outstanding debt (as increased by acceleration clause) plus any accrued interest
Deed in lieu of foreclosure	Mortgagor conveys all interest in mortgaged property to mortgagee
Renegotiating debt	Parties renegotiate terms of promissory note & mortgage

*Many states also recognize a statutory right of redemption that permits a mortgagor to reclaim the property *after* a foreclosure sale.

A mortgagor (the developer) may convey all interest in the mortgaged property to the mortgagee (the seller) in lieu of foreclosure so long as both parties agree—as seen here. This "**deed in lieu of foreclosure**" allows the mortgagee to **take immediate possession** of the property **without** the formalities of a **foreclosure sale**. However, a deed in lieu of foreclosure **does not eliminate** any **junior mortgages** attached to the property (the investor's mortgage). Therefore, the investor's mortgage on the land is still valid.

(Choice A) The investor's status as a junior lienholder is not affected by her failure to cure the developer's default on the seller's senior loan.

(Choice B) The seller's mortgage was a purchase-money mortgage (PMM) because it was granted to the seller of real property as part of the same transaction in which title was acquired. This gave the seller's mortgage priority over any mortgages and liens that arose *before* the developer purchased the property with the seller's loan. But the fact that the seller had a PMM has no impact on the investor's junior mortgage.

(Choice D) The reason for obtaining a junior mortgage is irrelevant. It is not extinguished by the deed in lieu of foreclosure.

Educational objective:

A deed conveying a mortgagor's interest in the mortgaged property to a mortgagee in lieu of foreclosure allows the mortgagee to take immediate possession of the property without the formalities of a foreclosure sale. However, any junior interests remain attached to the property.

References

Restatement (Third) of Prop.: Mortgages § 8.5 cmt. b (Am. Law Inst. 1997) (deed in lieu of foreclosure).