A seller conveyed residential land to a buyer by a warranty deed that contained no exceptions and recited that the full consideration had been paid. To finance the purchase, the buyer borrowed 80% of the necessary funds from a bank. The seller agreed to finance 15% of the purchase price, and the buyer agreed to provide cash for the remaining 5%.

At the closing, the buyer signed a promissory note to the seller for 15% of the purchase price but did not execute a mortgage. The bank knew of the loan made by the seller and of the promissory note executed by the buyer to the seller. The buyer also signed a note to the bank, secured by a mortgage, for the 80% advanced by the bank.

The buyer has now defaulted on both loans. There are no applicable statutes.

Which loan has priority?

A. The bank's loan, because it was secured by a purchase-money mortgage.

B. The bank's loan, because the seller can finance a part of the purchase price only by use of an installment land contract.

C. The seller's loan, because a promissory note to a seller has priority over a bank loan for residential property.

D. The seller's loan, because the bank knew that the seller had an equitable vendor's lien.

Explanation:

The seller received a promissory note—ie, a legal document that creates or memorializes a debt—but no lien or mortgage to secure the debt. But when a **seller transfers title** to a buyer and any portion of the **purchase price remains unpaid**, an **equitable vendor's lien** may be **implied** by law. Therefore, the seller *may* have an equitable vendor's lien, but the deed recites that the full consideration was paid.

The bank received a promissory note secured by a mortgage—ie, a lien against real property given to secure a debt. Since the **mortgage** was given to **secure the purchase price** of the mortgaged property, it is a **purchase-money mortgage** (PMM). PMMs have **super priority** over all prior liens regardless of whether the PMM or those liens are recorded. Therefore, the bank's loan has priority—regardless of whether it knew of the seller's lien **(Choices C & D)**.

(Choice B) A seller can finance the purchase of land through *several* means—including a PMM, equitable vendor's lien, and installment land contract. An installment land contract is an agreement where the debtor promises to make regular installment payments until the full contract price is paid (not seen here).

Educational objective:

An equitable vendor's lien is implied by law when a seller transfers title to a buyer and any portion of the purchase price remains unpaid. In contrast, a purchase-money mortgage is created when a mortgage is given to secure the purchase price of the mortgaged property, thereby giving it super priority over all other mortgages and liens.

References

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

Lien priority on real property