A seller and a buyer signed a contract of sale for improved real property. The contract contained a financing contingency for a certain percentage of the purchase price. The buyer obtained the requisite financing from a bank.

At the closing, the buyer executed a note to the seller for a portion of the purchase price, which note was not secured by a mortgage. The buyer then executed a second note, secured by a mortgage to the bank, applying the bank loan proceeds to the purchase price of the property. The bank had actual knowledge of the prior note to the seller. The bank promptly recorded its mortgage.

The buyer is now in default on both notes.

There is no applicable statute.

Which party has priority?

A. The bank, because its loan satisfied the financing contingency in the contract of sale.

B. The bank, because its note is secured by a purchase-money mortgage.

C. The seller, because he retained a vendor's lien that was first in time.

D. The seller, because the bank had actual knowledge of the seller's note.

Explanation:

The seller received a promissory note—ie, a legal document that creates or memorializes a debt—but did not take a mortgage or other lien to secure the debt. However, when a **seller transfers title** to a buyer and any portion of the **purchase price remains unpaid** (as seen here), an **equitable vendor's lien** is implied by law.

Subsequently, 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 other liens (whether the PMM or those liens are recorded or not). Therefore, the bank's mortgage has priority. This is true regardless of whether it knew of the seller's lien **(Choices C & D)**.

(Choice A) The fact that the bank's loan satisfied the financing contingency in the contract of sale between the seller and buyer does *not* give the bank priority. Instead, it has priority because its note is secured by a PMM.

Educational objective:

Equitable vendor's liens are implied by law when a seller transfers title to a buyer and any portion of the purchase price remains unpaid. Purchase-money mortgages are created when a mortgage is given to secure the purchase price of the mortgaged property, thereby giving them 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