

A land developer executed and delivered a promissory note and a mortgage securing the note to a bank. The bank was named as payee in the note and as mortgagee in the mortgage. The note also included a statement that the indebtedness evidenced by the note was "subject to the terms of a contract between the maker and the payee of the note executed on the same day" and that the note was "secured by a mortgage of even date." The mortgage was promptly and properly recorded.

Subsequently, the bank sold the land developer's note and mortgage to an investor and delivered to the investor a written assignment of the land developer's note and mortgage. The assignment was promptly and properly recorded. The bank retained possession of both the note and the mortgage in order to act as collecting agent.

Later, being short of funds, the bank sold the note and mortgage to an asset management company at a substantial discount. The bank executed a written assignment of the note and mortgage to the asset management company and delivered to it the note, the mortgage, and the assignment. The asset management company paid value for the assignment without actual knowledge of the prior assignment to the investor and promptly and properly recorded the assignment. The principal of the note was not then due, and there had been no default in payment of either interest or principal.

If the issue of ownership of the land developer's note and mortgage is subsequently raised in an appropriate action by the investor to foreclose, for whom should the court hold?

- A. The asset management company as to both the note and the mortgage.
- B. The investor as to both the note and the mortgage.
- C. The asset management company as to the note and the investor as to the mortgage.
- D. The investor as to the note and the asset management company as to the mortgage.

Explanation:

Transfer of promissory note & mortgage

Transfer of both documents	<i>Both</i> 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 <i>or</i> increases mortgagor's duties, burdens, risks Transfer is void

*Jurisdictions are split as to effect of transfer.

A mortgage is a document that gives the mortgagee (eg, bank) an interest in real property as security for an obligation owed by the mortgagor (ie, borrower). The obligation is typically memorialized in a promissory note. The **mortgagee** is generally **free to transfer** the **promissory note and/or the mortgage** securing that note unless:

the mortgage or note expressly states otherwise

the transfer is forbidden by statute or public policy *or*

the transfer will increase the duties, burdens, or risks on the mortgagor.

The **recipient** of the transferred note/mortgage (ie, transferee) then **acquires the right of foreclosure**. However, the transferee **can lose** this right **to a bona fide purchaser**—ie, one who pays value for the property interest *without* **notice** of another's prior interest in the property.

Here, the investor acquired the right of foreclosure when it purchased the note and mortgage from the bank. The investor promptly and properly recorded the assignment (ie, transfer), providing record notice to any subsequent purchasers of that note and mortgage—including the asset management company. Since the asset management company was *not* a bona fide purchaser, it did not acquire the investor's right of foreclosure. Therefore, the court should hold for the investor as to both the note and the mortgage **(Choices A, C & D)**.

Educational objective:

The recipient of a promissory note and mortgage securing that note acquires the right of foreclosure. However, the recipient can lose this right if the note and mortgage are subsequently conveyed to a bona fide purchaser—ie, one who pays value *without* notice of another's prior interest.

References

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

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