

An investor purchased a tract of commercial land, financing a large part of the purchase price with a loan from a business partner that was secured by a mortgage. The investor made the installment payments on the mortgage regularly for several years. Then the investor persuaded a neighbor to buy the land, subject to the mortgage to his partner. They expressly agreed that the neighbor would not assume and agree to pay the investor's debt to the partner. The investor's mortgage to the partner contained a due-on-sale clause stating, "If Mortgagor transfers his or her interest without the written consent of Mortgagee first obtained, then at Mortgagee's option the entire principal balance of the debt secured by this Mortgage shall become immediately due and payable." However, without seeking his partner's consent, the investor conveyed the land to the neighbor, the deed stating that it was "subject to a mortgage to [the partner]" and giving details and recording data related to the mortgage. The neighbor took possession of the land and made several mortgage payments, which the partner accepted. Now, however, neither the neighbor nor the investor has made the last three mortgage payments. The partner has sued the neighbor for the amount of the delinquent payments.

In this action, for whom should the court render judgment?

- A. The neighbor, because she did not assume and agree to pay the investor's mortgage debt.
- B. The neighbor, because she is not in privity of estate with the partner.
- C. The partner, because the investor's deed to the neighbor violated the due-on-sale clause.
- D. The partner, because the neighbor is in privity of estate with the partner.

Explanation:

Transfer of mortgaged property

	Effect on buyer/transferee	Effect on seller
Subject to mortgage	Does not agree to pay loan & is not liable for debt	Remains solely liable for debt
Assumption of mortgage	Agrees to pay loan & is primarily liable for debt	Becomes secondarily liable as surety

A mortgagor (typically a landowner) is generally free to **transfer mortgaged property** to another (eg, a buyer). However, the mortgage will remain attached to the property and the **mortgagor** will remain **solely liable** for the debt **unless** the **buyer expressly agrees to assume** the mortgage. If that occurs, the buyer becomes primarily liable for the debt and the mortgagor becomes secondarily liable as a surety.

Here, the investor's mortgage to the partner contained a due-on-sale clause that was breached when the investor sold the mortgaged land to the neighbor without the partner's consent. But since the neighbor did *not* agree to assume the investor's mortgage, the neighbor is *not* liable for the investor's delinquent mortgage payments **(Choice C)**. Therefore, in the partner's action against the neighbor, the court should render judgment for the neighbor.

(Choices B & D) Privity of estate is a *shared* interest in property (eg, co-tenants or landlord/tenant). Here, the partner and the neighbor lack privity of estate because the neighbor's ownership interest is *distinct* from the partner's lien on the property. But the existence or lack of such privity has no bearing on the success of the partner's action.

Educational objective:

If a mortgagor transfers mortgaged property to another, the mortgage will remain attached to the property and the mortgagor will remain solely liable for the debt unless the buyer *expressly* agrees to assume the mortgage.

References

Restatement (Third) of Property: Mortgages § 5.2 (Am. Law Inst. 1997) (assumption of a mortgage).

Copyright © 2014 by the National Conference of Bar Examiners. All rights reserved.

Copyright © UWorld. All rights reserved.