A businessman owned a hotel, subject to a mortgage securing a debt he owed to a bank. The businessman later acquired a nearby parking garage, financing part of the purchase price with a loan from a financing company, secured by a mortgage on the parking garage. Two years thereafter, the businessman defaulted on the loan owed to the bank, which caused the full amount of that loan to become immediately due and payable. The bank decided not to foreclose the mortgage on the hotel at that time, but instead properly sued for the full amount of the defaulted loan. The bank obtained and properly filed a judgment for that amount.

A statute of the jurisdiction provides: "Any judgment properly filed shall, for 10 years from filing, be a lien on the real property then owned or subsequently acquired by any person against whom the judgment is rendered." There is no other applicable statute, except the statute providing for judicial foreclosure of mortgages, which places no restrictions on deficiency judgments.

Shortly thereafter, the bank brought an appropriate action for judicial foreclosure of its mortgage on the hotel and of its judgment lien on the parking garage. The financing company was joined as a party defendant and appropriately sued for foreclosure of its mortgage on the parking garage, which was also in default. All procedures were properly followed, and the confirmed foreclosure sales resulted in the following: The net proceeds of the sale of the hotel to a third party were $200,000 less than the bank's mortgage balance. The net proceeds of the sale of the parking garage to a fourth party were $200,000 more than the financing company's mortgage balance.

How should the $200,000 surplus arising from the sale of the parking garage be distributed?

A. It should be paid to the bank.

B. It should be paid to the businessman.

C. It should be paid to the financing company.

D. It should be split equally between the bank and the financing company.

Explanation:

Proceeds from a **foreclosure sale** are typically **distributed** in the following **order of priority**:

Expenses from the sale (eg, attorneys' fees, court costs)

Mortgage being foreclosed

Junior liens, in order of lien priority

Debtor, if any surplus remains

Here, the financing company had the senior lien on the garage since its mortgage was placed on the property first. The bank later acquired a judgment lien on all the businessman's property—including a junior lien on the garage—when the businessman defaulted on the bank's loan. And since the foreclosure sale of the garage satisfied the financing company's entire mortgage and resulted in a $200,000 surplus, the bank (as the junior lienholder) should receive the surplus to cover the balance still owed for its mortgage on the hotel **(Choices B, C & D)**.

Educational objective:

The proceeds from a foreclosure sale are distributed in the following order of priority: (1) the expenses from the foreclosure sale, (2) the mortgage being foreclosed, (3) junior liens in order of priority, and (4) the debtor.

References

55 Am. Jur. 2d Mortgages § 705 (2019) (distribution of foreclosure sale proceeds).

Restatement (Third) of Property: Mortgages § 7.4 (Am. Law Inst. 1997) (effect of priority on distribution of foreclosure surplus).

Distribution of foreclosure sale proceeds