Five years ago, an investor who owned a vacant lot in a residential area borrowed $25,000 from a friend and gave the friend a note for $25,000 due in five years, secured by a mortgage on the lot. The friend neglected to record the mortgage. The fair market value of the lot was then $25,000.

Three years ago, the investor discovered that the friend had not recorded his mortgage and in consideration of $50,000 conveyed the lot to a buyer. The fair market value of the lot was then $50,000. The buyer knew nothing of the friend's mortgage. One month thereafter, the friend discovered the sale to the buyer, recorded his $25,000 mortgage, and notified the buyer that he held a $25,000 mortgage on the lot.

Two years ago, the buyer needed funds. Although she told her bank about the mortgage claimed by the investor's friend, the bank loaned her $15,000, and she gave the bank a note for $15,000 due in two years secured by a mortgage on the lot. The bank promptly recorded the mortgage. At that time, the fair market value of the lot was $75,000.

The recording act of the jurisdiction provides: "No conveyance or mortgage of real property shall be good against subsequent purchasers for value and without notice unless the same be recorded according to law."

Both notes are now due, and both the investor and the buyer have refused to pay. The lot is now worth only $50,000.

What are the rights of the investor's friend and the bank in the lot?

A. Both mortgages are enforceable liens, and the friend's has priority because it was first recorded.

B. Both mortgages are enforceable liens, but the bank's has priority because the buyer was an innocent purchaser for value.

C. Only the bank's mortgage is an enforceable lien, because the buyer was an innocent purchaser for value.

D. Only the friend's mortgage is an enforceable lien, because the bank had actual and constructive notice of the investor's fraud.

Explanation:

Recording acts determine the priority of competing interests in the same property. Most recording acts protect **bona fide purchasers** (BFPs or innocent purchasers for value)—ie, persons or entities who:

pay value for an interest in property *and*

lack notice of a prior interest in the property.

In a jurisdiction with a **notice recording act** (as seen here), a **BFP's property interest** is always **superior** to an earlier competing property interest of which the BFP lacked notice. And under the **Shelter Rule**, a person who receives a property interest from a BFP is entitled to the **same protection** under the recording act as the BFP. This ultimately protects the BFP by ensuring that the BFP receives the full benefit of the purchase and is able to convey an interest in the property.

Here, the buyer was a BFP because she knew nothing of the friend's prior unrecorded mortgage when the investor sold her the vacant lot. The buyer therefore had priority under the jurisdiction's notice act and took the lot free of the friend's mortgage. The buyer then mortgaged the lot to the bank. And although the buyer told the bank about the friend's prior mortgage (ie, the bank was not a BFP), the Shelter Rule entitles the bank to the buyer's protection under the recording act. As a result, only the bank has an enforceable mortgage on the lot **(Choices A, B & D)**.

Educational objective:

Under the Shelter Rule, a person who receives a property interest from a bona fide purchaser (BFP) is entitled to the same protection under the jurisdiction's recording act as the BFP.

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