

The owner of a residence entered into a contract of sale with a couple. After a down payment, the remaining purchase price of the residence was \$500,000. The couple was only able to secure a mortgage loan from a bank for \$400,000, so the owner-seller agreed to advance the couple the difference in exchange for a mortgage on the residence. At closing, the couple paid the owner-seller \$400,000 from the proceeds of their bank loan. The couple also signed notes that obligated them to pay \$400,000 to the bank and \$100,000 to the owner-seller, and to give the bank and the owner-seller mortgages on the residence to secure those notes. The owner-seller, agreeing to the bank's demand, subordinated her mortgage to the bank's mortgage. The bank recorded its mortgage one day after the owner-seller recorded her mortgage.

Several years later, the couple stopped paying on both notes at a time when the principal balances of their obligations were \$350,000 to the bank and \$85,000 to the owner-seller. The owner-seller has filed a complaint for foreclosure on her mortgage.

The recording act of the applicable jurisdiction reads, "No conveyance or mortgage of real property shall be good against subsequent purchasers for value and without notice who shall first record."

Is the owner-seller required to make the bank a party to this action?

- A. No, because the owner-seller subordinated her mortgage to the bank's mortgage.
- B. No, because the remaining principal amount of the couple's obligation to the bank exceeds that of the owner-seller.
- C. Yes, because the owner-seller recorded her mortgage before the bank recorded its mortgage.
- D. Yes, because the owner-seller's purchase-money mortgage has priority over the bank's mortgage.

## Explanation:

The owner-seller has filed a complaint for foreclosure on her mortgage, thereby seeking a **foreclosure** conducted by a **judicially supervised sale**. Under this [method of foreclosure](#), the foreclosing mortgagee (ie, lender):

**must give notice** to the holders of any **junior interests** in the property so that they can participate or send a representative—otherwise, the junior-interest holder's interest will remain after the sale

**may**, but need not, **join others** who have an **interest in the property** (eg, senior-mortgage holder) or who are **liable on the debt** (eg, guarantor) as proper, but not necessary, parties\*

In foreclosure proceedings, [lien priority](#) is determined by the "first in time, first in right" rule unless the jurisdiction has a [recording act](#)—eg, a race-notice act (as seen here). Additionally, mortgages given to secure the purchase price of the mortgaged property (ie, purchase-money mortgages) have super priority over all other liens. However, a senior-mortgage holder can always agree to subordinate his/her interest to that of a junior-mortgage holder, in which case the junior mortgage receives priority.

Here, the owner-seller and the bank acquired purchase-money mortgages because their loan proceeds were used to purchase the residence. Although the facts do not indicate which mortgage was created first, a seller's purchase-money mortgage generally has priority over a lender's purchase-money mortgage—regardless of who recorded first. But since the owner-seller agreed to subordinate her mortgage, the bank has the senior mortgage **(Choices C & D)**. Therefore, the bank need not be made a party to this foreclosure action.

\*That is because a valid foreclosure only terminates interests in the foreclosed property that are junior to the interest being foreclosed. It has no effect on any other interests.

**(Choice B)** The size of the obligation secured by a mortgage does not determine its priority with regard to other mortgages on the same property.

## Educational objective:

For a judicially supervised foreclosure sale, the foreclosing mortgagee *must* give notice to the holders of any junior interests in the property. Any others who have an interest in the property (eg, senior-mortgage holder) or who are liable on the debt (eg, guarantor) *may* be joined as proper but unnecessary parties.

## References

55 Am. Jur. 2d Mortgages § 592 (2019) (discussing the requirement to notify junior lienholders of the foreclosure action).

## Notice of judicially supervised foreclosure sale

