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# When First Mortgages Become Second

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# WHEN FIRST MORTGAGES BECOME SECOND

by Joseph P. McKeehan*

Since a first mortgage "sticketh closer than a brother," how can it lose its position and be subordinated to liens entered at a later date?

The adherence of the mortgage to the land is illustrated when the owner sells and conveys the mortgaged land, regardless of provisions in his deed. The deed may make no reference to the mortgage, it may convey "under and subject" to the mortgage or the purchaser may "assume and agree to pay" the mortgage when due, but the rights and remedies of the mortgagee are unaffected, not only as against the land mortgaged but as against his original debtor. In fact he will acquire a new remedy against the purchaser, if the latter agrees in writing with his vendor to pay the mortgage debt. He is regarded as a third party beneficiary of such contract.[1]

So also, if the mortgagor dies, and the Orphans' Court orders the land sold to pay debts, the mortgage is not discharged, though this is a judicial sale.[2] The same is true of sheriff's sales and ordinary tax sales,[3] though the court may require the mortgagee to pay the taxes or submit to have his lien discharged.

Notwithstanding the fact that, when a mortgage is a first mortgage when entered, the debtor and his creditors can do nothing to impair its position without the consent of the mortgagee, other lien creditors of the mortgagor may acquire a priority because of transactions between the mortgagor and mortgagee which are not disclosed by anything appearing of record, and of which they do not have actual notice.

In *Weir* v. *Potter T. & M. G. Co.,* 323 Pa. 212, 185 A. 630, (1936) the question was as to the rights of the holder of a mechanic's lien after the debt secured by the mortgage was paid, though the mortgage was not satisfied of record. Justice Maxey held that when a debt is secured by a mortgage, the debt is everything and whatever affects the debt will produce a corresponding effect upon the mortgage, so that, if the debt be discharged, so is the mortgage. *Peirce* v. *Black,* 105 Pa. 342 (1884), was quoted and approved as holding: "It is undoubtedly true that as against subsequent lien creditors a mortgage or judgment once paid cannot be kept alive: *Anderson* v. *Neff,* 11 S. & R. 208; *Craft* v. *Webster,* 4 Rawle 241."

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1 Fair Oaks Bldg. and L. Assn. v. Kahler, 320 Pa. 245, 181 A. 779, 111 A. L. R. 1108 (1935) 17 Pa. Bar Asso. Quarterly 117.

2 Fiduciaries Act, sec. 16 (o), 20 P. S. 574; Act of June 7, 1917, P. L. 447 Mosely's Estate, 39 D. & C. 159. (Reese, Judge) (Pa. 1940).

3 Act of April 30, 1929, P.L. 874, 21 P.S. 651, City of Pittsburgh v. Fort Pitt Chemical Co., 345 Pa. 471, 29 A. 2d 41 (1942).

*Lovering, Hall & Co.* v. *Humboldt Safe Deposit and Trust Co.*, 113 Pa. 6, 4 A. 191 (1886), was quoted as follows:

> "When the mortgagors procured the payment of the first mortgage with what was admittedly their own money, it extinguished that mortgage at law and in equity as between it and the second mortgage, *and the latter took its place.*"

After stating that a friend could have bought the mortgage and it would have remained alive in his hands, it was said:

> "But when they procure it to be done with their own money, the assignment of the mortgage is of no validity as against the younger mortgage."

That a junior encumbrancer may take advantage of a total or part payment of a previous encumbrance was said to be the rule and one which could not be defeated by attempts to keep the senior encumbrance alive.

In the *Weir* case the debtors had to borrow the money used to pay the mortgages and they were assigned to the company that guaranteed the new loan to be secured by a "first mortgage". Though so appearing alive, it was held that the old mortgages were *"in fact paid off"*, as the proceeds of the new loan were used to pay for the assignment. As to the junior mechanic's lien holder, the assigned mortgages were held to be *"mere scraps of paper"*, and that it was immaterial whether they had been satisfied of record or not. *"It is the debt which gives the lien its life."*

*Marshall* v. *Klein*, 96 Pa. Super. Ct. 580 (1929), was approved in its holding:

> "When a mortgage has been paid by the mortgagor, the mortgage is extinguished: Kinley v. Hill, 4 W. & S. 426, and cannot be kept alive as against subsequent lien creditors: McCartney v. Kipp, 171 Pa. 644, 33 A. 233; 27 Cyc. 1396."

In conclusion Justice Maxey said:

> "By no device recognized in the law can the company *resurrect* those two mortgages to serve pro tanto as a security for the hazard it assumed."

The *Weir* case is the latest Supreme Court decision in point but the Superior Court decision in *Tesuro* v. *Calitri*, 153 Pa. Super. 156, 33 A. 2d 36 (1943), is later. The question was the amount the assignee of a first mortgage was entitled to collect from a terre-tenant who had purchased the property at a sheriff's sale on a junior lien. The assignee had supplied all the money used to make payments to the mortgagee. The mortgage debt was $1,500.00 and about half of this was paid before the mortgage was assigned. It was held that if the payments made prior to the assignment were intended to be payments of part of the price of the assignment, the assignee could collect the full $1,500.00 but, if the assignment was an afterthought, he could collect only what he paid when he took the assignment. A jury found that the first payments were made in reduction of the debt, so that recovery was limited to the final payment. The assignee was the son-in-law of the mortgage debtor and whether he gave or loaned the money to his wife's parents to enable

them to reduce the debt was immaterial. It becomes the debtors' money and the lien of the mortgage was extinguished by the amount of the payments.

Judge Stadfield quoted Chief Justice Frazer's statement in *Fair and Square B. & L. Assn.* v. *Pres. Bd. of Publication, etc.*, 302 Pa. 162, 153 A. 341 (1930), as follows:

> "After payment of a mortgage debt, although the mortgage security may be kept alive, as between mortgagor and mortgagee, (Pierce v. Black, 105 Pa. 342, 345, 346), as respects a subsequent mortgage or judgment creditor, it must be regarded as satisfied (Girard Trust Co. v. Baird, 212 Pa. 41, 44; 61 A. 507, 1 L.R.A.N.S. 405, 4 Anno. Cas. 314)."

*Pierce* v. *Black*, supra, was a case involving a change by agreement of the purpose for which a *judgment* was held as security. The original debt was paid but the debtor requested that no satisfaction be entered, so that he could use it as security for later loans. When a new loan was made on the security of the judgment, it was held that the new loan could be collected on an execution on the judgment. *"No one but a subsequent lien creditor can be heard to complain of this."* There were none and the debtor was held to be estopped from setting up the payment to defeat the judgment. A dictum in *Mitchell* v. *Combs*, 96 Pa. 430 (1880), was quoted with approval. This case, however, is one of the leading cases holding that, if a bank takes a mortgage to secure payment of a bond and the bond is paid, the bank cannot use the unsatisfied mortgage as security for later loans, and that, as to judgment creditors of the mortgagor, the mortgage must be deemed satisfied.

In *Penna Co. etc.* v. *Dovey*, 64 Pa. 260, at 268 (1870), Justice Sharswood said:

> "It is very plain that the first mortgage, being merely accessory and collateral, would have followed the fate of the principal obligation, and indeed could not by the agreement of the parties by parol have been converted into a mortgage or security for the second, and perhaps *even a written and recorded covenant to that effect could not have kept it alive as against intermediate purchases and mortgagees;* Bowers v. Oyster, 3 P. & W. 239; Metz v. Dieffenbach, 2 Pa. 233."

The former case holds that there is no such thing as a parol mortgage of real estate, (a Cumberland County case decided by Judge Reed, who was the founder of this school). The second case holds that there can be no such thing in Pennsylvania as an equitable mortgage by a deposit of a title-deed, as a security.

If a mortgage is a mere "scrap of paper" after payment of the debt it was given to secure, could a "recorded covenant" that it should secure new loans, not in contemplation when the mortgage was given and of course not referred to therein, be any more effective than a parol mortgage? Such a covenant would not have the requisites of a deed, which in form a mortgage is. This question raised by Justice Sharswood has never been satisfactorily answered.

If one knows that an unsatisfied mortgage has been paid, should he be deemed to have constructive notice of such a covenant recorded in the Miscellaneous Records?

It is, of course, true that when a contract for advances accompanies an actual mortgage, this contract is valid though not placed on record or referred to in the

mortgage. The obligation to make the advances supplies the consideration required to support the mortgage and the lien of advances, when later made, relates back to the date when the mortgage was recorded. *Land Title and Trust Co.* v. *Shoemaker,* 257 Pa. 213, 101 A. 335 (1917).

On the other hand, if the mortgagee did not bind himself to make the advances when the mortgage was taken, later voluntary advances relate in lien to the actual date of the advancements and are subject to all intervening encumbrances. *Moats* v. *Thompson,* 283 Pa. 313, 129 A. 105 (1925).

Suppose a search be made and no intervening encumbrances are found, can such a covenant be safely used in lieu of an actual new mortgage? The latter will be indexed as such and, of course, give constructive notice. Reference may be noted on the margin of the old unsatisfied mortgage to the place of record of the covenant but there is no statute authorizing this and, when an entry on the margin of a mortgage record is not one required by statute, it has no effect as constructive notice. The Act of April 6th, 1876, P.L. 18, 21 P.S. §624, requires such an entry giving the book and page where assignments of mortgages are recorded, with date of same but no other marginal notations are authorized. *Conn* v. *Hudson,* 350 Pa. 626, 39 A. 2d 826, 156 A.L.R. 1317 (1944), holds that such unauthorized entries do not give constructive notice.

*Girard Trust Co.* v. *Baird,* 212 Pa. 41 61 A. 507 (1905), holds that the parties to a mortgage may agree that as between themselves the lien of a mortgage shall continue after payment as security for future advances and that creditors with actual notice of the agreement are bound by it, as they would be if they had actual notice of an unrecorded mortgage. However, since cases in which creditors have such actual notice must be very rare, it is vital that some method of giving constructive notice must exist or a new mortgage must be recorded and properly indexed to insure such notice. In the light of the decision in *Conn* v. *Hudson, supra,* it is submitted that this is the only safe procedure.

Perhaps the fullest review of the earlier cases is contained in the opinion of the late Judge Keller in *F. & S. B. & L. Assn.* v. *Pres. B. of P.,* 98 Super. 409 (1930)[4] in which he says:

> "There is no perceivable difference between the revival of a satisfied mortgage and the creation of a new mortgage."
>
> *Kinley* v. *Hill,* 4 W. & S. 426, 433, (Pa. 1842).

There can be no question as to the effectiveness of a new mortgage duly certified by counsel that it is a first lien, whereas the attempt to revive an old mortgage may well turn out to be futile.

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[4] While the Supreme Court, in 302 Pa. 162, 153 A. 341 (1931), reversed the Superior Court in this case, it was on the ground that a bona fide assignee of the mortgage, who had required a declaration of no set-off, takes the encumbrance free and clear of latent equities in favor of third persons, as in this case a terre-tenant. The mortgagee had agreed to assign the mortgage and it was distinctly understood that money paid the mortgagee was part of the purchase price of the mortgage and not a payment on the debt.

The close affinity between the mortgage and the debt it was given to secure is the explanation of the long-settled rule in Pennsylvania that a sale of the mortgaged premises under a judgment for any part of the mortgage debt discharges the lien of the mortgage, though the sale produces only a fraction of the debt. Thus, in *Donley* v. Hays, 17 S. & R. 400 (Pa. 1828), a sale on one of several mortgage bonds, in pursuance of a judgment recovered before a portion of the debt was payable, had this effect. Thus, if a mortgage is given to secure several bonds maturing at different dates and held by different parties, and default occurs on the first due, the holder of this bond may get judgment and buy in the mortgaged land and, regardless of the price bid at the sheriff's sale, he will get a title clear of the lien of the mortgage. The early cases are reviewed in the opinion of Chief Justice Lewis in *Mendenhall* v. *The West Chester and Phila., R.R. Co.*, reported in a note in 36 Pa. 141, at 145, and the later cases are collected in 122 A.L.R. at page 486.

It is apparent that it is the height of folly to acquire any portion of a debt less than the whole, when the debt is secured by a mortgage, for the holder of another portion of the debt may get judgment, issue execution, buy in the mortgaged land for only enough to pay taxes and costs and so acquire a clear title to land worth several times the portion of the debt which he may have owned. This has frequently happened before the deluded holder of other bonds knew of the sheriff's sale and while he cherished the notion that his interest in the first mortgage could not be lost without his knowledge and consent.

It is obvious that when a mortgage is given to secure a number of bonds, which are to be sold to different holders, the mortgage should be given to a trustee and the remedy of the bondholders should be limited by the terms of the bonds to their right to share pro rata in money collected by the trustee. The duties and liability of such a trustee are discussed in 49 *Dickinson Law Review* 1 (1944). Though the mortgage is held by a trustee, who does nothing, if the holder of one bond can get a judgment thereon, he can, as shown above, divest the lien of the mortgage and other bondholders might have great difficulty in convicting the trustee of negligence in not promptly foreclosing the mortgage for the benefit of all the bondholders.

In Vol. 1 *Glenn on Mortgages,* at page 328 (1943) it is said:

> "In order to save expense in the way of recording fees and mortgage tax, parties may be tempted to use an old mortgage, still alive as far as the record goes, but actually discharged by payment or release of the debt by other methods. *Now, that simply cannot be done.* If the erstwhile lender wishes to make a fresh loan on the same security, a new mortgage must be executed; but no substitute in the shape of a "revival" or "reissue" agreement will protect the land from judgments obtained by the mortgagor's creditors, mechanics' liens or other encumbrance of later date. If a fresh loan is to be secured, there must be a new mortgage, for the old security, once dead, cannot be revived even as between the original parties."

In Vol. 2 of Dunlap's *Book of Forms*, page 2237, 9th Ed., there is a form entitled; "Endorsement to extend a mortgage, so as to secure the payment of money due on a second bond".

The endorsement is to be made on the mortgage, which presumably was recorded when given, so that the later endorsement will not appear of record. The form recites the loan of an additional sum subsequent to the original loan for which the bond and mortgage were given and that another bond has been given to cover the new loan. It then provides that "for the better securing and more sure payment" of the amount of the new loan, the borrower agrees that the mortgaged real-estate shall be security for the amount of the new loan as well as the amount of the original loan and that no part of the mortgaged premises shall be redeemable until not only the amount of the original loan but also the amount of the new loan has been paid.

This agreement would doubtless be enforced in any proceeding looking to the compulsory satisfaction of the mortgage, but, since it does not appear to be contemplated that the new agreement be itself recorded, it certainly could not operate to make the new loan a lien on the mortgaged real estate as against any other lien creditors, whether prior or subsequent to the time of the making of the new loan.

Certain lending organizations have adopted the following form[5] and are using it when a borrower, who has made payments on a debt secured by a mortgage, needs a new loan, not in excess of the amount of the payments made. The form is recorded in the miscellaneous docket and a notation made of the place of record on the margin of the record of the mortgage. Whether this is an effective substitute for a new mortgage, even when there are no intervening liens, is the question about which opinions differ and about which there appears to be no reported decision in Pennsylvania.

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"EXTENSION OF MORTGAGE LIEN

[5] ..... and ..... of ..... being obligated to ..... under an existing bond and mortgage in the principal amount of $....., which mortgage is dated the .....day of ....., 19...., and is recorded in the office of the Recorder of Deeds of Cumberland County, Pennsylvania, in Mortgage Book No. ....., page ....., on which bond and mortgage the principal sum of $..... is still unpaid, do hereby agree with ....., that in consideration of the lending of the further sum of $..... to the above mentioned Mortgagors by ..... ....., that all of the obligations of the above recited bond and mortgage and *the lien thereof shall be* and are hereby *extended to cover said additional sum* of $....., receipt of which is hereby acknowledged.

In witness whereof, the said mortgagor.... ha.... hereunto set ..... hand.. and seals.. this ..... day of ....., 194....

Witnesses:

..... .....(SEAL)

..... .....(SEAL)

State of Pennsylvania

SS:

County of .....

On the ..... day of .....,194...., before me the undersigned officer, personally appeared ..... and ..... known to me to be the person.... whose name ..... subscribed to this instrument, and acknowledged that ..... executed the same for the purposes therein contained.

In Witness wherof I have hereunto set my hand and official seal."