



Harris Ominsky

Mortgage Priorities: Pennsylvania Rule May Impair Refinancing

A recent case on mortgage priorities confirms how the Pennsylvania rule on equitable subrogation differs from the rule in other states, and the *Restatement (Third) of Property*, in a way that could impair borrowers' ability to refinance their loans. Equitable subrogation allows a person who pays off an encumbrance to assume the same priority position as the holder of that encumbrance.

The Pennsylvania Superior Court followed an earlier precedent and rejected a refinancing lender's argument that it should be subrogated to the priority position of senior mortgages that it had paid off at the borrower's request. *Ontario, Inc. v. Carr*, 954 A.2d 1 (Pa. Super. Ct. 2008). Over a period of time, the borrower had placed three mortgages on his property with a mortgage to Ontario, Inc. in third lien position. The borrower then borrowed additional money from a mortgage company and the proceeds of that loan were used to pay off the first two mortgages that were then recorded as satisfied. The mortgage company then assigned its mortgage to U.S. Bank. After satisfaction of the two earlier

mortgages, only two mortgages were left on the property, the Ontario mortgage and the U.S. Bank mortgage. However, the U.S. Bank was unaware of the Ontario mortgage, due to an error in its title search.

Restatement Of Property

When the borrower later defaulted on the Ontario mortgage and Ontario started foreclosure, U.S. Bank contested the priority of that mortgage and asserted that U.S. Bank had a superior lien based on its right of "equitable subrogation." In this argument, U.S. Bank cited the rule of subrogation as set forth in *Restatement (Third) of Property: Mortgages* §7.6 that permits a lender to assume the priority of an earlier loan that is paid off.

That rule would apply in order to prevent "unjust enrichment," even though the proceeds are used to discharge the earlier mortgage. It applies when the lender "was promised repayment and reasonably expected to receive a security interest in the real estate with the priority of the mortgage being



Harris Ominsky, is a former president of the Pennsylvania Bar Institute and is the author of four books, including *Real Estate Lore: Modern Techniques and Everyday Tips for the Practitioner* (American Bar Association, 2006). He can be reached at rominsky@verizon.net.