

VALIDITY OF JUNIOR MORTGAGES

Anytime a lender is considering collateralizing a loan with a junior mortgage encumbering real estate, it is important that the lender review all senior mortgages or other senior encumbrances to ensure that they do not contain encumbrance consent provisions.

In *Bank Midwest, Minnesota, Iowa, N.A. v. Lipetzky*, 674 N.W.2d 176 (Minn. January 15, 2004), Jerome and Marion Lipetzky sold their family farm to James and Tamara Lipetzky via a Contract for Deed. The Contract for Deed contained a consent clause that stated that “[b]uyer agrees they cannot sell, transfer or assign this property without written permission or consent of seller.” Approximately four years later, James and Tamara granted a Mortgage on their vendees’ interest to Bank Midwest. James and Tamara subsequently defaulted on their loan with Bank Midwest, and Bank Midwest commenced foreclosure proceedings.

In *Bank Midwest*, the Court determined that the term “transfer,” as used in the consent clause, includes the grant of a Mortgage. Accordingly, the Court held that the grant of the Mortgage by James and Tamara, in favor of Bank Midwest, was in breach of the consent clause. However, the conclusion that the grant of the Mortgage was in breach of the consent clause did not necessarily mean that the Mortgage was invalid. The determining factor in the Court’s decision that the Mortgage was invalid was due to the fact that, because the Contract for Deed was a recorded document, Bank Midwest was held to have taken the Mortgage with constructive knowledge of the consent clause.

Although the consent clause in *Bank Midwest* was contained in a Contract for Deed, it is reasonable to conclude that the Court’s ruling would also apply in situations where a senior mortgage contains a similar consent clause.

The invalidity of a junior mortgage due to a junior mortgagee’s constructive knowledge of a consent clause in a senior mortgage should not be confused with anti-encumbrance provisions commonly found in encumbrance documents such as Mortgages and Contracts for Deed. Anti-encumbrance provisions typically state that any further encumbrance, transfer, or assignment of the property owner’s rights in the property shall constitute an event of default under that particular encumbrance. Such provisions do not necessarily lead to the same invalidity claim as consent clauses like the one in *Bank Midwest*.

In light of the Court’s decision in *Bank Midwest*, it is always important to review senior mortgages to ensure the validity of a junior mortgage.