

## Equitable subrogation beats a HELOC in Maryland.

Maryland's law of equitable subrogation is fairly settled. Where a lender has advanced money for the purpose of discharging a prior lien, and the disbursement is in reliance upon the lender receiving a security equivalent to the discharged lien (payoff of a first lien to obtain first lien position), without actual knowledge of the junior lien then the new lender is deemed subrogated to the prior lien. Decisions by our appellate courts now add nuance to this rule based on a limitless supply of neglectful or honestly mistaken loan transactions.

On October 9, 2014 Maryland's Court of Special Appeals decided *National Institutes of Health Federal Credit Union v. BAC Home Loans Servicing, LP* (Sept. Term, 2011, No. 2103). This unreported decision addressed the relative lien priority of a Home Equity Loan (known as a "HELOC") when compared to a later recorded refinance deed of trust. For Maryland lenders and title folks, the decision applies well known equitable subrogation law to a slightly re-ordered timeline of events. For those not familiar with equitable subrogation it is an excellent primer.

A HELOC loan is most commonly an open ended line of credit secured to real property. The recorded lien instrument will describe a maximum amount, and will also commonly include a statement that the credit line must remain open unless and until the borrower signs a formal request to close the account. The lien is released only after the credit line is closed. And so, in a Maryland real estate settlement involving payoff of an HELOC, the payoff must be accompanied by the borrower's request to close out the account. And if the settlement officer fails to obtain authorization to close the account, the borrower is free to run the HELOC back to its maximum limit even after the refinance. The risk to the refinance is obvious-- the new HELOC balance will prime the refinance deed of trust.

In our title insurance practice, we have experienced home sellers who drew on their unreleased HELOC to gamble in Atlantic City or invested in failing business



"I'd like to close out everybody's account."

## **HELOC lenders are also bound by notice and recording rules.**

concerns, leaving the new owners, their title insurers and lenders to sort through the wreckage.

In this case, the borrower took a \$1 Million Dollar loan from BAC to refinance a prior \$800,000 purchase money loan, and a HELOC. But in a twist not seen in prior cases, the refinance deed of trust was immediately recorded. The HELOC, however, had been funded one year earlier but was not recorded in the land records until one month AFTER the refinance deed of trust. Predictably, after the refinance the borrower ran the HELOC right back to its limit to bolster his failing business interests. And just as predictably, the borrower defaulted on all his loans and drifted into bankruptcy. The court case grew from the refinance lender's attempt to foreclose, and the HELOC lender's attempt to establish priority. The HELOC lender lost at trial before the Circuit Court.

It was very important to the intermediate appellate court that the HELOC lien instrument was not yet recorded at the time of the refinance loan. The refinance lender received the borrower's application, which disclosed the existence of a line of credit, but a title search confirmed there was no recording in the land records---the search showed what is commonly called "clear title."

It was also very important to the appellate court that the HELOC lender used a standard payoff statement that made reference to a "release fee" to be submitted with the payoff. And since the title report showed no recorded lien, the refinance lender did not include a lien release fee with the payoff disbursement for the full amount listed in the payoff statement.

The evidence was that the HELOC lender did not communicate a single thing to the refinance lender to suggest a secured lien. After the refinance lender's best efforts, it could only reasonably conclude that the payoff was going toward an unsecured debt. And it was on this basis that the trial court was affirmed.

The HELOC lender thus took nothing from the foreclosure sale, and was effectively wiped out by a sale price that covered only the first secured lien of the refinance lender. The failure to record timely cost this HELOC lender over \$250,000.

## Equitable subrogation can save your lien priority.

Equitable subrogation is a powerful tool, as demonstrated in this decision, but we have seen instances where trial courts dig deep into a refinance lender's files to impute "actual knowledge" of the unrecorded or late recorded interest of another lender. For example, in one recent trial, the court looked to a prior loan file for the same borrower that contained a credit report making reference to the other lender's "mortgage loan." Even though the refinance loan described in the file did not close, and it was one year before the refinance loan at issue, the court ruled that possession of this information in the refinance lenders business records was enough to impute "actual knowledge" to the entire corporation. The case settled quickly, so we do not know what the court of special appeals would have done on that set of facts.

So, get yourself some equitable subrogation--it's better than a gun.



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