

PURCHASE MONEY DEEDS OF TRUST- A NEW "INSTANTANEOUS SEISIN" CASE

**By: Ed Urban, Vice President and State Counsel
Attorneys Title, a division of United General Title Insurance Company**

1. General Comments.

The subject of purchase money deeds of trust and the "instantaneous seisin" rule or "purchase money" rule and its effect upon priority is discussed in detail in the following:

E. Urban, *Purchase Money Mortgages and Deeds of Trust- Can A Second Lien Deed of Trust Qualify for the "Instantaneous Seisin Rule"?* (February 2005 TCNC Newsletter at www.oldrepublictitle.com/nc); E. Urban and J. Miles, *Mechanics' Liens for the Improvement of Real Property: Recent Developments in Perfection, Enforcement, and Priority*, 12 Wake For. L. Rev. 283, at 329-330 (1976), reproduced and updated in P. Hetrick and J. McLaughlin, *Webster's Real Estate Law in North Carolina*, §20-20 (1999); E. Urban, *North Carolina Real Property Mechanics' Liens, Future Advances and Equity Lines-Including Title Insurance*, § 8-3 (Thomson West, 1998, Supp. 2006 (Hereafter, "Mechanics' Lien Book")); E. Urban and G. Whitney, *North Carolina Real Estate*, § 21-72 (Thomson West 1996, Supp. 2006); G. Osborne, *Mortgages*, § 213 and § 216 (1970); G. Nelson and D. Whitman, *Real Estate Finance Law*, § 9.1 and § 9.2 (3rd Ed. 1994); R. Kratovil and R. Werner, *Modern Mortgage Law and Practice*, Chapter 19 (2d. Ed. 1981).

Those sources should be reviewed and all of the discussion of the applicable rule set forth in those discussions will not be set forth in this new article. Instead, this article will focus on the new case set forth below.

2. The new case: ***West Durham Lumber Company v. Meadows***, _____ ***N.C. App.*** _____, _____ ***S.E. 2d*** _____ ***(N.C. Ct. of Appeals No. COA05-1181, filed 9-5-06)***.

In the case, the reported chronological facts (with the author's parenthetical remarks) are as follows: (1) prior to 2-03, Meadows arranged with "potential homeowners" to build a house on the property; (2) on 2/25/03, Meadows obtained a CCB commitment letter for a \$560,000 loan; (3) on 3-7-03 Sadler "conveyed" the property to Meadows (Author's comment: in view of facts below, perhaps the Court meant to say that the Sadler to Meadows deed was *dated* 3-7-03 and perhaps given in escrow to the closing attorney. It would seem at some point prior to 3-7-03, Sadler and Meadows probably had a contract for the sale and purchase of the property. But what's a few facts among friends?); (4) on 3-18-03, West Durham first furnished materials; (5) on 3-25-03, Meadows executed a deed of trust in favor of CCB; (6) on 3-26-03, the Sadler to Meadows deed and Meadows to CCB deed of trust were recorded and CCB "closed the loan" and made a \$112,000 advance to Meadows which Meadows used to purchase the property, with CCB's deed of trust securing the \$112,000, and CCB made "additional obligatory advancements" to Meadows of \$448,000 (the total of all being \$560,000); (7) on 7-11-03, West Durham last furnished materials; (8) total CCB advances were \$524,000 prior to foreclosure; (9) on 8-12-03 CCB commenced foreclosure, with the total due CCB at foreclosure being \$527,000; (10) on 10-2-03, CCB purchased at the foreclosure sale for \$425,000; (11) on 10-14-03, West Durham filed a valid claim of lien; (12) on 10-06-03 (the court must mean some date after 10-14-03) West Durham commenced its action of lien enforcement.

The first issue the court addressed was applicability of "instantaneous seisin" and *Dalton Moran Shook, Inc. v. Pitt Development Co.*, 113 N.C. App. 707, 440 S.E. 2d 585 (1994). West Durham, the lien claimant, did not "argue whether or not the execution, delivery and recordation of the deed and deed of trust were part of one transaction." And that was probably good that the lien claimant did not, because it would appear from the facts that all that was part of one transaction. The Court declined to accept the lien claimant's contention that instantaneous seisin was an affirmative defense under G.S. 1A-1, Rule 8(c) and should have been so plead.

In following *Dalton*, the Court held that (1) CCB's deed of trust had instantaneous seisin priority over West Durham's claim of lien to the extent of \$112,000 in purchase money; (2) West Durham's claim of lien for \$77,615.51 was second in priority; and (3) CCB's deed of trust was subordinate to West Durham's claim of lien to the extent of disbursements that were *not* used for purchase money.

When CCB foreclosed, the foreclosure sale wiped out West Durham's claim of lien since CCB had first lien priority to the extent of \$112,000.

The Court then discussed the "surplus proceeds" issue. The applicable statute is G.S. 45-21.31 (b). G.S. 45-21.31(a) requires the person making the sale to make payments in a specified order, including the obligation to the foreclosing lender. G.S. 45-21.31 (b) states that surplus funds existing after payments under G.S. 45-21.31 (a) shall be paid to the party or parties entitled thereto, if the person making the sale knows who is so entitled. Otherwise, the person making the sale shall pay the surplus proceeds to the Clerk of Superior Court if the person making the sale has any doubt or if an adverse claim to the funds is asserted. West Durham failed to file such a claim and so could not get surplus proceeds by perfecting (and enforcing) a claim to surplus proceeds and claim of lien rights against them.

The Court found that West Durham's claim of lien was itself valid (the priority determined as above) because, although the claimant initially set forth the wrong date of last furnishing, the claimant corrected the mistake in a timely manner by cancelling incorrect claims of lien and filing a new and correct claim of lien under G.S. 44A-12 (d). The claimant also named the correct owner in the claim of lien by listing Meadows, CCB and South Land Associates as owners, said the Court.

Not clearly addressed in the opinion was whether Meadows qualified as an "owner" under G.S.44A-7(3) for purposes of being entitled to a claim of lien under G.S. 44A-8, the two statutes together requiring a contract with the "owner" in order to support a contractor's lien. However, in a case that the Court cited for other reasons, *Carolina Builders Corporation v. Howard-Veasey Homes, Inc.*, 72 N.C. App. 224, 324 S.E. 2d 626, disc. rev. den., 313 N.C. 597, 330 S.E. 2d 606 (1985), the Court held that the interest of a contract vendee was an ownership interest under G.S. 44A-7(3) and G.S. 44A-8 which interest came into effect not on the date that the vendor and vendee orally agreed to the sale, but instead, due to the Statute of Frauds, the date the vendor executed deeds to the vendee. In *Carolina Builders*, the vendee acquired his interest as vendee by virtue of the vendor signing the deeds and then the contractor commenced his furnishing. See *Mechanics' Lien Book*, supra, Sec. 3-3 for a complete discussion. In *West Durham*, on 3-7-2003, Sandler "conveyed" to Meadows, on 3-18-03 the lien claimant first furnished and on 3-26-03 the deed was recorded. So, *Carolina Builders* was apparently complied with in this regard.

Not discussed was whether the lien claimant, in a partial subordinate position to CCB (see above), received adequate notice of CCB's foreclosure. See E. Urban, *Foreclosures Under Power of Sale- Notice to Subordinate Lienholders* (TCNC May 2003 newsletter at www.oldrepublictitle.com/nc). The crux of that discussion is that while North Carolina law does not require such notice unless the lien claimant files a request for notice, *Mennonite Board of Missions v. Adams*, 103 Sup. Ct. 2706 (1983), can require such notice. However, in *West Durham*, on 8-12-03, CCB commenced foreclosure and on 10-2-03, CCB purchased the land at a foreclosure sale. On 10-14-03, West Durham filed its claim of lien. Since CCB did not know of West Durham's claim of lien on time, CCB should not have fallen under the *Mennonite* rule. Arguably, things would have been different if West Durham filed its claim of lien *before* CCB commenced its foreclosure.

The instantaneous seisin rule should not be confused with the future advances priority rule. In order to take advantage of the former, loan proceeds must be used to finance purchase money. The conflicting lien (over which the purchase money lender seeks priority based on the instantaneous seisin rule) must come into existence before the lien claimant's obligor acquires title by deed. The future advances rule says, essentially, that if a deed of trust is recorded before a lien claimant first furnishes, advances thereafter made by the lender will have priority as of the deed of trust's recording. G.S. 45-70(a). That is why CCB's construction loan proceeds finished third in priority— the lien claimant first furnished before CCB recorded.

Finally, it is this author's opinion that the lien claimant must be contracting with the eventual recorded deed holder for instantaneous seisin to apply. It does not suffice for the lien claimant to contract with O-1 who then conveys to O-2 and O-2 places the purchase money deed of trust on the land.