

Compliance Journal

Volume 2, Number 8

January 1998

After many years of attempting to pass legislation related to the priority of future advances, it has finally happened. The "Special Focus" section this month reviews the new law of future advances and its effect. This winter/spring, WBA is offering many educational schools and workshops on lending issues so be sure to check out the Education Calendar on page five. ■

SPECIAL FOCUS

New Future Advance Statute

Notice No. 98-1

Wisconsin has a new law, 1997 Wis. Act 44, governing the priority of future advances secured by real estate, effective **January 3, 1998**. The Act creates sec. 706.11(1m)(a). Both the WBA 428 Real Estate Mortgage and WBA 238 Real Estate Security Agreement secure future advances. Priority issues for future advances under these documents arise when advances are made after an intervening lien has been recorded. The original lender contends that the future advance has the same priority as the original advance, dating to the recording date of the original mortgage. The intervening lender contends that the intervening lien takes priority over the future advance.

The new law clarifies some ambiguities in the prior law on future advances. The prior law distinguished between obligatory and optional advances. In general, if a lender was contractually obligated at the time of recording to make the future advance, the advance took priority from the date of the original mortgage and the priority of an intervening lien would be subordinate to those advances. In addition, cases in Wisconsin addressing optional future advances have held that optional future advances did not have priority over an intervening lien if the original lender had actual knowledge of the intervening lien. The rule is that actual knowledge means that the original lender must have actual notice of the intervening lien and is not charged with knowledge by virtue of the public recording of the intervening lien.

Under the new statute, a future advance (including accrued interest on the advance) will have the same priority as the original mortgage (assuming the document secures future advances) in the following circumstances:

1. No Actual Knowledge of Intervening Lien. If the advance is made before the original lender has actual knowledge of an intervening lien, the original lender has priority for the advance. The intervening lender's lien will have priority over optional future advances from the date the prior lender has actual knowledge of the lien. The statute does not further define actual knowledge. Under existing case law, actual knowledge means that the lender knows of the subordinate lien. The lender does not have actual knowledge of the subordinate lien by virtue of a mortgage recorded in the real estate records, unless the lender has been made aware of the recording. For example, if the lender has obtained a letter report or title commitment that identifies a subordinate lien, the lender has actual knowledge of that lien. Lenders may also obtain actual knowledge of a subordinate lien if notified of the existence of the subordinate lien by the subordinate lender. This provision is consistent with current case law governing optional future advances, discussed in WBA Notice February, 1990.
2. Lender Is Committed. If the advance is made under a commitment entered into before the lender has actual knowledge of an intervening lien, the original lender has priority for the advance. A commitment is an agreement by a lender to advance funds secured by a mortgage. An issue under the prior law was whether conditions in favor of the lender relieving the lender of its obligation under a commitment caused it to lose priority as to future

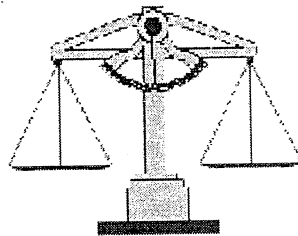
advances. Under the new law, as long as the lender "commits" to make advances before the lender knows of an intervening lien, it will not lose priority for future advances even if a default or other occurrence outside of the lender's control relieves the lender of the commitment or obligation to make the advance under the commitment. This provision provides protection for lenders making future advances under revolving credit lines, such as the WBA 448R Revolving Credit Agreement and the WBA 457 Home Equity Credit Agreement. When signed by the lender, these forms are commitments by the lender to advance funds.

3. Protective Advances. If the advance is a reasonable protective advance, including an advance for payment of real property taxes, property insurance or assessments or other maintenance charges under a condominium declaration or restrictive covenant the original lender has priority for the advance.

4. Construction Advances. If the advance is made under a mortgage securing an obligation incurred for constructing an improvement on land, including the acquisition cost of the land, and is made for the purpose of such construction, the original lender has priority for the advance. In order to qualify for construction advance priority, the mortgage must clearly state on the first page of the mortgage that it is a construction mortgage.

The current WBA 428 Real Estate Mortgage includes a check box for construction loans providing: " If checked here, this Mortgage is a construction mortgage under §409.313(1) Wis. Stats." However, the WBA Real Estate Mortgage has recently been revised. The phrase "under §409.313(1)" has been removed from the new form, which will be available from FIPCO by the end of February, 1998. Lender's using Financial Link or Mortgage Publisher will have the new form in software no later than the end of March, 1998. Until the new forms are distributed, if the mortgage is a construction mortgage, the WBA recommends that lenders check the existing box for a construction mortgage. If the lender is not using the WBA Real Estate Mortgage for a construction loan, the lender should add a provision indicating that the mortgage is a construction mortgage.

The priority protection under the new statute is effective for mortgages in favor of state and national banks, federal savings and loans, federal and state savings banks, federal and state credit unions and licensed lenders, WHEDA and mortgage bankers (and other miscellaneous lenders described in the statute). The law does not apply to mortgages in favor of state savings and loan associations, which continue to be subject to Wis. Stats. §215.21(4) for the priority of future advances. ■



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