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## LEGAL UPDATE

Legal Services Division



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### IOWA SUPREME COURT DECISION — PRIORITY OF ADVANCES UNDER MORTGAGES

**Purpose.** *Legal updates are prepared by the nonpartisan Legal Services Division of the Legislative Services Agency. A legal update is intended to provide legislators, legislative staff, and other persons interested in legislative matters with summaries of recent meetings, court decisions, Attorney General Opinions, regulatory actions, federal actions, and other occurrences of a legal nature that may be pertinent to the General Assembly's consideration of a topic. Although an update may identify issues for consideration by the General Assembly, it should not be interpreted as advocating any particular course of action.*

#### **Blue Grass Savings Bank v. Community Bank & Trust Company**

**Filed March 27, 2020**

**No. 19-0657**

[www.iowacourts.gov/courtcases/9116/embed/SupremeCourtOpinion](http://www.iowacourts.gov/courtcases/9116/embed/SupremeCourtOpinion)

**Facts and Procedural Background.** Between April 2011 and March 2017, Blue Grass Savings Bank (Blue Grass) loaned money to Joseph Stecher. On May 23, 2014, Blue Grass loaned Stecher \$148,000 pursuant to a promissory note. To secure the promissory note, Stecher entered into a mortgage with Blue Grass as the mortgagee (Blue Grass Mortgage).

The Blue Grass Mortgage covered Lot 1 of Stecher Farms Subdivision in Muscatine County (Stecher Farms). The Blue Grass Mortgage contained a “dragnet clause” that purported to secure “[a]ll present and future debts from [Stecher] to [Blue Grass] . . . .” The Blue Grass Mortgage also contained the following provision:

NOTICE. THIS MORTGAGE SECURES CREDIT IN THE AMOUNT OF \$148,000.00. LOANS AND ADVANCES UP TO THIS AMOUNT, TOGETHER WITH INTEREST, ARE SENIOR TO INDEBTEDNESS TO OTHER CREDITORS UNDER SUBSEQUENTLY RECORDED OR FILED MORTGAGES AND LIENS. HOWEVER, THE PRIORITY OF A PRIOR RECORDED MORTGAGE UNDER THIS SECTION DOES NOT APPLY TO LOANS OR ADVANCES MADE AFTER RECEIPT OF NOTICE OF FORECLOSURE OR ACTION TO ENFORCE A SUBSEQUENTLY RECORDED MORTGAGE OR OTHER SUBSEQUENTLY RECORDED OR FILED LIEN.

By March 2017, Blue Grass had loaned Stecher approximately \$556,965. At that time, the principal balance on the promissory note secured by the Blue Grass Mortgage was approximately \$139,341.

On March 18, 2017, Community Bank & Trust Company (Community Bank) loaned Stecher \$589,502.59. To secure this loan, Stecher entered into a mortgage with Community Bank as the mortgagee. This mortgage also covered Stecher Farms.

On August 10, 2018, Blue Grass filed a petition to foreclose on Stecher Farms. Blue Grass alleged the Blue Grass Mortgage secured the \$556,965 debt, plus interest. Blue Grass named Community Bank as a defendant because of Community Bank’s junior mortgage. Community Bank filed an answer alleging that the Blue Grass Mortgage was limited to \$148,000. Blue Grass moved for summary judgment. Community Bank resisted.

On April 8, 2019, the district court granted Blue Grass's summary judgment motion. The district court found that Blue Grass's priority over Community Bank was not limited to the \$148,000 amount in the Blue Grass Mortgage. Instead, the district court found that Blue Grass's priority over Community Bank extended to all debt secured by the Blue Grass Mortgage to the extent Blue Grass advanced the funds to Stecher before Community Bank recorded its mortgage.

Community Bank appealed to the Iowa Supreme Court (Court).

**Issue.** Whether the Blue Grass Mortgage has priority over Community Bank's mortgage for all amounts due to Blue Grass from Stecher or only up to \$148,000, plus interest.

**Holding.** The Court held that, although the Blue Grass Mortgage *secures* all amounts due to Blue Grass from Stecher, the Blue Grass Mortgage only has *priority* over Community Bank's mortgage up to \$148,000, plus interest.

**Analysis.** Pursuant to Iowa Code section 654.12A (priority of advances under mortgages):

[I]f a prior recorded mortgage contains the notice prescribed in this section and identifies the maximum credit available to the borrower, then loans and advances made under the mortgage, up to the maximum amount of credit together with interest thereon, are senior to indebtedness to other creditors under subsequently recorded mortgages and other subsequently recorded or filed liens even though the holder of the prior recorded mortgage has actual notice of indebtedness under a subsequently recorded mortgage or other subsequently recorded or filed lien.

The Blue Grass Mortgage contained such a notice. The Blue Grass Mortgage identified \$148,000 as the maximum amount of credit available.

The Court first analyzed Blue Grass's argument that Iowa Code section 654.12A should be interpreted against the backdrop of common law. Blue Grass alleged that common law supported the idea that the Blue Grass Mortgage had priority for all amounts due to Blue Grass from Stecher. The Court acknowledged Iowa Code section 4.6 allows it to consider common law when a statute is ambiguous. The Court analyzed prior Court cases in which it examined Iowa's common law with respect to the priority of mortgages. In *Van Dusseldorp v. State Bank of Bussey*, 395 N.W.2d 868, 870 (Iowa 1986), the Court found that first mortgages are presumed to have priority over junior mortgages, even with respect to subsequent advances. However, in *First State Bank v. Kalkwarf*, 495 N.W.2d 708, 713 (Iowa 1993), the Court commented that this presumption could be overcome with respect to subsequent advances in the event the holder of the first mortgage had actual knowledge of an intervening encumbrance. Next, the Court examined language in *National Bank of Waterloo v. Moeller*, 434 N.W.2d 887 (Iowa 1989), a case that was not governed by Iowa Code section 654.12A because its underlying transactions predated the enactment of Iowa Code section 654.12A. In *Moeller*, the Court stated:

[Iowa Code section 654.12A] clearly favors senior mortgagees. It provides, in pertinent part, that mortgage instruments containing prescribed language giving notice of a future advances provision, are senior to indebtedness to other creditors under subsequently recorded mortgages . . . or filed liens even though the holder of the prior recorded mortgage has actual notice of indebtedness under a subsequently recorded mortgage or other subsequently recorded or filed lien.

The Court stated that because the Court in *Moeller* did not apply Iowa Code section 654.12A, the Court's statements with respect to Iowa Code section 654.12A were dicta and thus not binding. The Court then reasoned that the dicta in *Moeller* may not have been correct or complete. The Court theorized that Iowa Code section 654.12A may actually have been intended to clarify the common law and make it more workable. This is because:

[S]ometimes [Iowa Code section 654.12A] would benefit the senior lienholder by priming the senior lienholder's advances up to the dollar limit in the notice regardless of the timing of those advances. Sometimes [Iowa Code section 654.12A] would benefit the junior lienholder by capping the priority of the senior lienholder's advances to the dollar limit in the notice regardless of timing.

The Court referenced the legislative history of Iowa Code section 654.12A to support this argument. Although its effect is not limited to home equity mortgages, Iowa Code section 654.12A was enacted as part of a bill related to home equity mortgages. Because home equity loans often involve frequent extensions of credit and fluctuating balances, the Court stated that the General Assembly may have believed Iowa Code section 654.12A would help support the home equity loan industry by providing more certainty to lenders. The Court concluded the common law backdrop did not support Blue Grass's argument that the Blue Grass Mortgage had priority for all amounts due to Blue Grass from Stecher.

The Court next examined two secondary sources that supported Community Bank's interpretation of Iowa Code section 654.12A. The secondary sources indicated that when a mortgage discloses a maximum principal amount, a subsequent mortgagee should be able to rely on such amount as a "rough gauge of the maximum total balance." The secondary sources also indicated at least 17 states declare that all future advances up to a maximum amount will have priority over intervening mortgages. In such a state, second mortgage lenders assume advances up to the maximum amount will be made, and only consider the property's value in excess of that amount as being available to secure the subsequent mortgage.

The Court then cited cases from New Mexico, Kansas, and Missouri that supported Community Bank's interpretation of Iowa Code section 654.12A that the Blue Grass Mortgage has priority over Community Bank's mortgage only up to \$148,000, plus interest.

The Court concluded that the Blue Grass Mortgage secures all amounts due to Blue Grass from Stecher, but that the Blue Grass Mortgage only has priority over Community Bank's mortgage up to \$148,000, plus interest. With respect to the amounts Blue Grass loaned to Stecher in excess of \$148,000, plus interest, Community Bank's mortgage has priority over the Blue Grass Mortgage.

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Doc ID 1139832