

MD Automatic Subordination – Revisiting Lien Priorities

By Kevin D'Anna

On October 1, 2013, Section 7-112 of Maryland's Real Property Article went into effect, providing for the automatic subordination of certain junior liens upon the refinancing of a senior lien for a lower interest rate. Plenty has been written and can be found online about the statute and its technical aspects. Instead of just summarizing the statute's relatively straightforward requirements, let's look at some of its finer aspects, including why Section 7-112 was necessary in the first place.

Maryland is a "race-notice" jurisdiction for purposes of determining lien priority (see Section 3-203 at Section 7-112 link above). What does that mean? In short, the first to record a lien without notice of a prior lien takes priority. For example, if Lender A is granted a deed of trust on day 1, and Lender B is granted a deed of trust on day 2 without knowledge of Lender A's deed of trust, the first lender to record its deed of trust will take priority. So, let's assume Lender A is first to record its deed of trust. If Lender A's deed of trust is later refinanced, the refinancing lender would lose the first priority position established by Lender A. Why would that be? Upon refinancing, the first priority lien loses its place in the front of the line, with all the other existing liens moving up in priority.

Seems clear enough, right? Maybe not. Regardless of the priorities established pursuant to Section 3-203, lenders can agree among themselves to change their place in the line of priorities. In fact, refinancing lenders will typically work out a subordination agreement with any surviving junior lenders to preserve its first place in line. In some cases, however, junior lenders would refuse to execute a subordination agreement, which would derail the refinancing process. Now, however, under Section 7-112, subordination is automatic as long as all requirements set out therein are met. So, at the end of the day, no lender is worse off than it was prior to the refinancing.

Of course, as in any area of the law, there are exceptions to the general rule for establishing lien priority. One such exception is specifically noted in subsection (f) of Section 7-112. The doctrine of Equitable Subrogation generally provides that when Lender A refinances the mortgage of Lender B with the expectation of receiving the same priority as Lender B, Lender A should be allowed to take over the place of Lender B for priority purposes, regardless of any intervening liens. Equitable Subrogation is a judicial remedy, however, and should not be relied upon for establishing lien priority.

Kevin D'Anna, Esq., is a member of Paley Rothman's Real Estate Department.