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BILL ANALYSIS

Senate Fiscal Agency

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Senate Bill 940 (Substitute S-1 as passed by the Senate)

Sponsor: Senator Dick Posthumus

Committee: Commerce and Technology

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Mich. State Law Library

Date Completed: 8-30-90

RATIONALE

Typically, when a person obtains a future advance mortgage such as a home equity loan to finance, for example, home improvements or a vacation, a line of credit is established with a specified maximum amount and the person draws against it as the need arises. For example, a homeowner who wishes to build a swimming pool for \$10,000 may sign all the documents necessary to obtain a \$10,000 loan but take an advance of only \$3,000 to make an initial down payment with a contractor or purchase supplies. When the \$10,000 loan is approved by the lender, he or she files a security interest in the borrower's home. Apparently, however, it is not clear under current law whether the original security interest document actually secures the entire loan or just the initial advance. If, therefore, a third party were to file a lien against the home before the borrower used the rest of the funds from the \$10,000 loan, there is some confusion as to whether the third party's lien would have priority over subsequent advances made under the future advance mortgage loan, or whether the lien would be secondary to the future advance mortgage loan, regardless of the fact that not all of the money from that loan had been dispersed. Reportedly, at least one court ruling has specified that unless the lender for the future advance mortgage loan is obligated by the terms of the loan contract to make all future advances to the borrower, the only part of the loan secured by the lender's original security interest filing is the initial advance. Each subsequent advance apparently has to be secured by a subsequent security interest document. Some have suggested, therefore, that it would help to minimize confusion and paperwork if it were made clear that the security interest that a

lender takes for a future advance mortgage secures the entire amount of the loan, not just the first advance.

CONTENT

The bill would create a new act to provide that a future advance mortgage that secured a future advance would have priority with respect to the future advance as if the future advance were made on the date the future advance mortgage was recorded. Further, if a recorded mortgage had been or would be amended to become a future advance mortgage, it would have priority with respect to a future advance secured by the mortgage as if the future advance were made on the date the amendment was recorded. The bill would not give a mortgage priority over another mortgage that was recorded prior to October 1, 1990, to the extent that the other mortgage would have had priority before that date.

"Future advance" would be defined as "an indebtedness or other obligation that is secured by a mortgage and arises or is incurred after the mortgage has been recorded, whether or not the future advance was obligatory or optional on the part of the mortgagee" (such as a home equity loan or a farm operating loan). "Future advance mortgage" would be defined as a mortgage that secured a future advance and was recorded either prior to or after the effective date of the bill. If a recorded mortgage were amended to secure a future advance arising after the amendment, the mortgage would become a future advance mortgage on the date the amendment was recorded.

The bill specifies that it would not apply to a

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mortgage governed by provisions in the Construction Lien Act that pertain to the priority of construction liens or in Public Act 122 of 1941 that pertain to taxes as liens.

The bill would take effect October 1, 1990.

FISCAL IMPACT

The bill would have no fiscal impact on State or local government.

ARGUMENTS

Supporting Argument

The bill would help eliminate confusion, time-consuming paperwork, and possible litigation by providing that all advances made under a future advance mortgage loan were secured by the original security interest document, regardless of whether the lender was obligated to make those advances.

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This analysis was prepared by nonpartisan Senate staff for use by the Senate in its deliberations and does not constitute an official statement of legislative intent.