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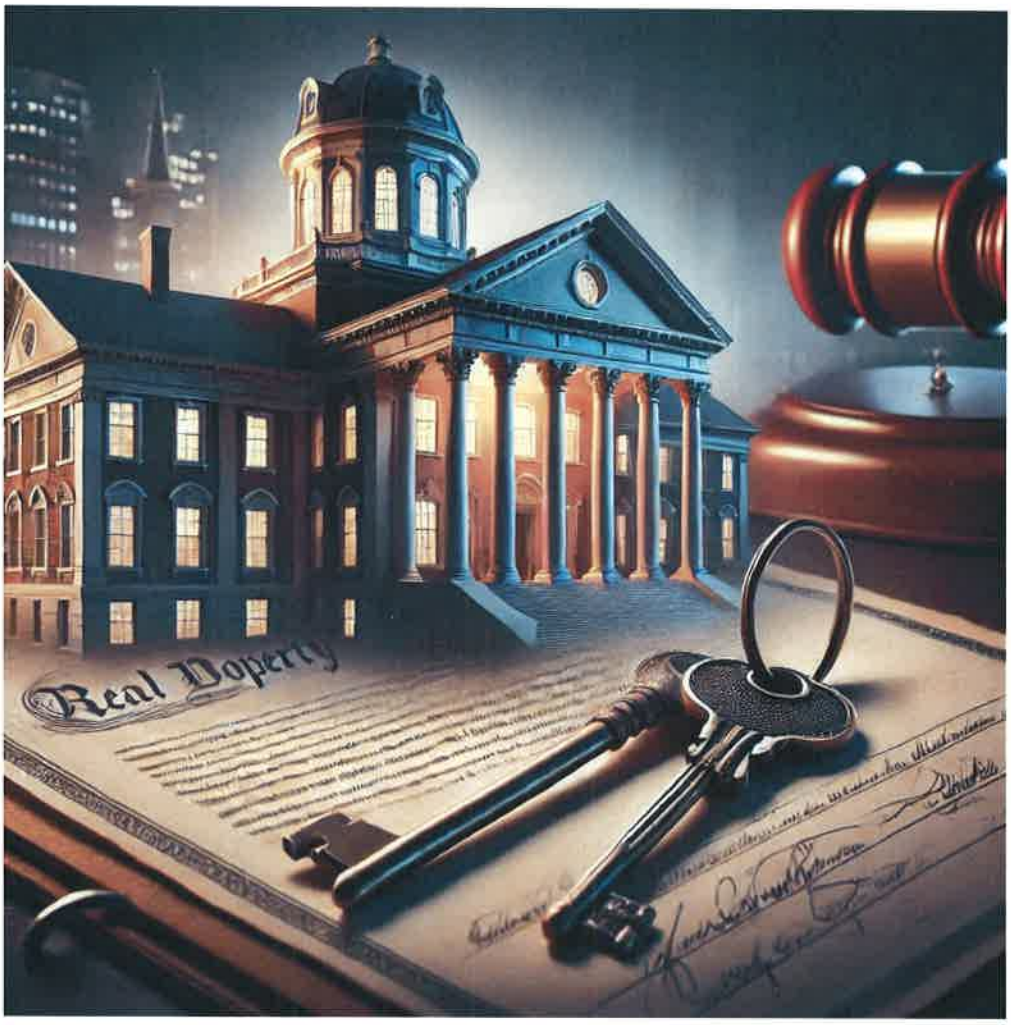

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# NEW EMINENT DOMAIN JURY INSTRUCTIONS ADOPTED

**By Paul B. Terpak**

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The Virginia Model Jury Instruction Committee, chaired by Justice Stephen R. McCullough, has adopted new Eminent Domain Jury Instructions, as proposed by a special Subcommittee of the Virginia State Bar Real Estate Section Eminent Domain Committee. The Subcommittee was composed of a group of attorneys representing both condemnors and landowner's counsel including Charles Lollar, Elizabeth Chupik, Michael Coughlin, Adam Cherry, Sandy Cherry, Nancy Auth and Paul Terpak, Chair. This is the first wholesale rewrite of Eminent Domain Jury Instructions in decades. Revisions include not only substantial changes to reflect new law on highest and best use, lost profits, enhancement, and mitigation costs, but also extensive revision to Scope Notes, Governing Statutes, Case Authority, and Practice Commentary.

There are several completely new instructions:

**46.080 Lost Access**

"Lost access" means a change of vehicular or pedestrian access to property that is caused by a public use project for which the power of eminent domain has been exercised against the property and which results in a reduction in the value of the property. Any liability for lost access shall be made a part of any award for damage to the residue. You must ensure that any compensation awarded for lost access shall not be duplicated in the compensation otherwise awarded to the owner of the property.

**46.085 Lost Profits**

You shall determine and specify the amount of lost profits owed to the [business; farm] owner if you find that the [business; farm] owner proved with reasonable certainty the amount of the loss and that the loss was directly and proximately caused by the taking or damaging of the property where the [business; farm] is or was located.

"Lost profits" means a loss of profits or expected profits suffered by a [business; farm] operation as a result of a taking or damaging of the property on which the [business; farm] operation is operated for a period not to exceed three years from the later of (i) the date of valuation or (ii) the date the state agency or its contractor prevents the owner from using the land or any of the owner's other property rights are taken. The [business; farm] operation claiming lost profits is entitled to compensation whether part of the property or the entire parcel of property is taken or damaged.

To award lost profits, the following conditions must be met:

1. the loss cannot be reasonably prevented by a relocation of the [business; farm] operation, or by taking steps and adopting procedures that a reasonably prudent person would take and adopt;

2. the loss will not be included in relocation assistance provided by the condemning agency;

3. compensation for the loss will not be duplicated in the compensation otherwise awarded to the owner of the property taken or damages; and

4. the loss shall be determined in accordance with generally accepted accounting principles applied on a consistent basis.

**46.200 Just Compensation-Common Area**

The common area owned by a property owner's association that is taken shall be valued on the basis of the common area's highest and best use as though it were free from restriction to sole use as a common area.

**46.210 Just Compensation-Reasonable Probability of Rezoning**

You may consider the following factors, among others, to determine whether there is, as of the date of valuation, a reasonable probability of rezoning of the subject property in the near future:

the rezoning of nearby property, growth patterns, change of use patterns and character of neighborhood, demand within the area for certain types of land use, sales of related or similar properties at prices reflecting anticipated rezoning, physical characteristics of the subject and of nearby properties, and the age of the zoning ordinance.

You must not evaluate the property as though the rezoning is already an accomplished fact. You must evaluate the property under the restrictions of the existing zoning and give consideration to the impact upon market value of the likelihood of a change in zoning.

The burden of proving a reasonable probability of rezoning in the near future rests on the property owner.

A full set of the new instructions with commentary and authority is a mandatory tool for any eminent domain practitioner. Copies are available online and in hard copy.

Please note that the full annotated version of these model jury instructions is available for purchase from Matthew Bender® by way of the following link:

https://store.lexisnexis.com/categories/area-of-practice/civil-procedure-154/virginia-model-jury-instructions-civil-skuusSku7357

# EQUITABLE SUBROGATION IN VIRGINIA: THE SEQUEL

**By James L. Windsor, Esq.**

*James L. Windsor is a member with Kaufman & Canoles, P.C. and is based in the firm's Virginia Beach office. He is the Chairman of the firm's Real Estate Claims & Title Insurance Solutions Group. Jim is rated an AV Preeminent lawyer with over 39 years of experience and expertise in counseling, mediation, and litigation involving construction, mechanic's liens, real property, title insurance, mortgage lending, and creditors' rights. Jim has co-authored a published text book, Modern Real Estate Practice; written a law review article regarding mechanic's liens and many other articles; authored the "Mechanic's Liens" chapter in Enforcement of Liens and Judgments in Virginia for 22 years and in other Virginia CLE publications; and has given over 120 seminars on topics involving construction and real estate law.*

*Jim has received many recognitions and honors including being listed in Best Lawyers in America, Real Estate, 2018¬2024; Best Lawyers in America, Litigation-Construction, 2022-2024; Virginia Business Magazine; CoVaBiz magazine; Virginia Super Lawyers.*

*In 2016, Jim received the Distinguished Service Award from the Virginia Land Title Association and, in 2024, received the Traver Scholar Award presented by the Real Property Section of the Virginia State Bar.*

In 2001, I wrote an article for the Virginia Land Title Association (VLTA) *Examiner* simply entitled *Equitable Subrogation in Virginia*. The article appeared in Volume 7, Number 1, of the VLTA *Examiner*. Twenty-three years later, this is the sequel.

Occasionally, lenders who believe they are secured by a "first" deed of trust are surprised to learn that they do not have the priority lien position they intended to have. For example, a lender may refinance and pay off a loan secured by a prior first-lien deed of trust and, due to a missed intervening judgment, the refinance lender may find its refinance deed of trust subordinate to the intervening judgment. Courts in Virginia have liberally applied the doctrine of equitable subrogation to provide relief from such errors under certain circumstances. Accordingly, real property lawyers should be aware of the doctrine's applications and limitations. The following briefly summarizes the law on equitable subrogation in Virginia.

**A. Equitable Subrogation is Based Upon Principles of Equity and Justice, FactSpecific, and is the Substitution of Another Person in the Place of a Creditor Whose Debt the Person Paid Off.**

1. In Asset Management Holdings, LLC v. Wells Fargo Bank, N. A. (In re Wagner), Case No. 12-13285-BFK, 2013 Bankr. LEXIS 4899 (Bankr. E.D. VA. Nov. 18, 2013), Judge Brian F. Kenney, applying Virginia state law, noted the Supreme Court of Virginia had described the principle of equitable subrogation as follows:

2. 'Subrogation is the substitution of another person in place of the creditor to whose rights he succeeds in relation to the debt. This doctrine is not dependent upon contract, nor upon privity between the parties; it is the creature of equity, and is founded upon principles of natural justice.' 179 Va. at 401, 18 S.E.2d at 920. 'Subrogation not being a matter of strict right, but purely equitable in its nature, dependent upon the facts and circumstances of each particular case, no general rule can be laid down which will afford a test in all cases for its application.' Id. at 402, 18 S.E.2d at 920. Nevertheless, we have

expressly acknowledged that 'Virginia has long been committed to a *liberal application* of the principle of subrogation.' Id.

2013 Bankr. LEXIS 4899, at *18; (quoting Centreville Car Care, Inc. v. North Am. Mortg. Co., 263 Va. 339, 345 (2002) (quoting Federal Land Bank of Baltimore v. Joynes, 179 Va. 394, 401-02 (1942)). (emphasis added); Dickerson v. Dickerson, No. CL17767, 2023 Va. Cir. LEXIS 92, at *3 (Orange Cnty. 2023).

3. "'Subrogation' is, in its simplest terms, the substitution of one party in the place of another with reference to a lawful claim, demand, or right so that the party that is substituted succeeds to the rights of the other." Yellow Freight Syst., Inc. v. Courtaulds Performance Films, Inc., 266 Va. 57, 64 (citation omitted) (2003). Subrogation is not dependent on a contract or privity and is a solely equitable doctrine linked to the facts and circumstances of each particular case. Joynes, 179 Va. at 401-02.

   Equitable subrogation "'is subrogation that arises by operation of law, and is not based on contract or privity of parties, but is purely equitable in nature, dependent on the facts and circumstances of each particular case.'" Dollar Tree Stores, Inc. v. Crum & Forster Specialty Ins. Co., 91 Va. Cir. 433, 436 (Norfolk 2015) (citing XL Specialty Ins. Co. v. DOT, 269 Va. 362, 369 (2005) (quoting Centreville Car Care, Inc. v. N. Am. Mortg., 263 Va. 339, 345 (2002).

4. In *Wagner*, Judge Kenney further noted two principles that have been applied consistently by the Supreme Court in Virginia in the context of equitable subrogation:

   a) "First, subrogation is not appropriate where intervening equities are prejudiced." 2013 Bankr. LEXIS at *19.

   b) "Second, ordinary negligence of the party claiming equitable subrogation does not bar the application of subrogation, where the equities strongly favor the subrogee." *Id.*

5. In addition, all of the cases agree that the application of the principle of equitable subrogation is necessarily "fact-specific." Id.; Dickerson, 2023 Va. Cir. LEXIS 92, at *3; See also Bank of N.Y. Mellon Trust Co., N.A. v. Tysons Fin., LLC (In re Botero-Paramo), 483 F. App'x 779, 786 (4th Cir. 2012) (Noting that "the fact-intensive inquiry required in subrogation claims does not generally support bright line rules").

   Due largely to the "fact-specific" application of equitable subrogation, in Virginia, some cases are favorable[1] and some cases are unfavorable.[2]

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1 See In re Wagner, No. 12-13285-BFK, Adv. Proceeding No. 13-01159 2013 Bankr. LEXIS 4899 (Nov. 18, 2013); In re Valley Vue Joint Venture, 123 B.R. 199 (Bankr. E.D. Va. 1991); In re Reasonover, 236 B.R. 219 (Bankr. E.D. Va. 1999); In re Smith, Case No. 98-26931, Adv. Proceeding No. 9902076 (Bankr. E.D. VA., July 12, 1999); Bankers Loan & Inv. Co. v. Hornish, 94 Va. 608 (1897); Helm v. Lynchburg Tr. and Sav. Bank, 106 Va. 603 (1907); Moritz v. Redd, 151 Va. 644 (1928); Morgan v. Gollehon, 153 Va. 246 (1929); Fed. Land Bank of Baltimore v. Joynes, 179 Va. 394 (1942); Thompson v. Miller, 195 Va. 513 (1954); G.E. Capital Mortg. Serv. v. Monno, 53 Va. Cir. 154 (Fairfax Cnty. 2000); Deutsche Bank Nat'l Tr. Co. v. Iqbal, 86 Va. Cir. 11 (Fairfax Cnty. 2012); Mortg. Elec. Registration Sys. v. Garnett, 84 Va. Cir. 72 (Madison Cnty. 2011); Mahaley v. Metters, No. CL21-2581-00, 2021 Va. Cir. LEXIS 769 (Arlington Cnty. Oct. 19, 2021); Mahaley v. Metters, 2023 Va. Cir. LEXIS 80 (Arlington Cnty. May 25, 2023).

2 First Cmty. Bank v. E. M. Williams & Sons, Inc. (In re E. M. Williams & Sons, Inc.), Case No. 08-30054-KRH, 2009 Bankr. LEXIS 1224 (Bankr. E.D. Va. May 8, 2009) (Huennekens, J.), aff'd, No. 3:09cv533, 2010 U.S. Dist. LEXIS 30709 (E.D. Va. Mar. 30, 2010); So. Bank & Trust Co. v. Alexander (In re Alexander), No. 11-74515-565, 2014 Bankr. LEXIS 3048 (Bankr. E.D. Va. July 16, 2014) (St. John, J.); Wilson v. Moir (In re Wilson), 359 B.R. 123 (Bankr. E.D. Va. 2006); In re Botero-Paramo, 445 B.R. 530 (Bankr. E.D. Va. 2011), aff'd, 483 F. App'x 779 (4th Cir. 2012); Meridian Title Ins. Co. v. Lilly Homes, Inc., 735 F. Supp. 182 (E.D. Va. 1990), aff'd, 934 F.2d 319, 1991 U.S. App. LEXIS 11315 (4th Cir. 1991); Deutsche Bank Nat'l Trust Co. v. United States, No. 1:12-cv-1059, 2013 U. S. Dist. LEXIS 107423 (E.D. Va. July 31, 2013) (Hilton, J.); In re Perrow, 498 B.R. 560 (W.D. Va. 2013); Gregory v. United States Dep't of Treasury – IRS, No. 1:12cv00042,

**B. Selected Cases.**

1. An early Virginia case is Morgan v. Gollehon, 153 Va. 246 (1929).

   a) Facts: When the property in this case was originally conveyed to a man and his mother, the sellers reserved a lien for a portion of the purchase price. The mother had a 1/3 life interest in the property with the remainder to her son. The son died, leaving his widow with a dower interest. The mother and widow borrowed money from a third-party to pay off the sellers' lien. The sellers' lien was paid off, and the third-party took a new lien on the land. But the lien was only effective as to the mother's and widow's limited interests in the land, not the whole fee. When the third-party loaned the money, he expected to receive a lien on the whole fee estate, not on the mother's and widow's partial interest. Thus, the third-party lender asked to be subrogated to the position of the sellers' original lien.

   b) Holding and Reasoning: The Court noted three classes of parties eligible for equitable subrogation and noted the lender was in the class least entitled to subrogation. Id. at 249. But the Court stated that subrogation is "generally allowed where the loan was made by one who took a security from the borrower which turned out to be invalid." Id. at 250. The Court reasoned that the widow and mother were certainly entitled to be subrogated to the sellers' original lien since they had paid it off for the benefit of the fee. Thus, the Court concluded that the widow and mother should be viewed as having assigned their right to be subrogated to the third-party lender, who would then stand in the shoes of the seller.

2. The Virginia case discussing equitable subrogation in the most detail is Federal Land Bank of Baltimore v. Joynes, 179 Va. 394 (1942).

   a) Facts: The case arose out of a complicated fact pattern involving priority of liens. A mother had a lien on property that she had deeded to her sons so that the land would secure an annuity to her. The mother's lien was the first lien on the property. The sons obtained a mortgage on the property, and the mother agreed to subordinate her lien to the bank mortgagor's deed of trust. Then the sons obtained a second mortgage from another bank, which was used to pay off the first mortgage. The mother did not agree to subordinate her lien to the second mortgage (the mortgage bank apparently forgot to have her sign the paperwork), so technically her lien was first in priority over the second mortgage.

   b) Holding and Reasoning: The Court allowed subrogation of the second mortgagor to the rights of the first mortgagor and kept the mother's lien in a junior position. The Court stated that "where the lender of money lent it with the intention and understanding that he be substituted to the position of the creditor whose debt he paid, but without taking an assignment, where there are no intervening equities to be prejudiced, the matter will be treated as if an assignment has been executed." 179 Va. at 402.

3. In U.S. Bank National Association, as Trustee v. Stiles, Case No. CL13001399-00 (Stafford Cnty. *Cir. Ct.* Apr. 4, 2014), a credit line deed of trust that was in a second lien position was

2012 U.S. Dist. LEXIS 159307 (W.D. Va. Nov. 7, 2012); Deutsche Bank Nat'l Trust Co. v. IRS, 361 F. App'x 527 (4th Cir. 2010); Home Bldg. Ass'n v. Mackall, 205 Va. 73 (1964); Centreville Car Care, Inc. v. N. Am. Mortg. Co., 263 Va. 339 (2002); Nat'l Valley Bank v. United States Fid. & Guar. Co., 153 Va. 484 (1929); Mega Int'l Commerce Bank v. MCAP Capital, L.L.C., 74 Va. Cir. 132 (Norfolk 2007); Bristol Cnty. Ret. Sys. v. Senior Tour Players Fund I, L.P., No. 24302, 2006 Va. Cir. LEXIS 337 (Loudoun Cnty. Mar. 10, 2006).

not paid off and released in the closing of a loan refinancing the first deed of trust. The refinance lender filed a lawsuit seeking alternative forms of equitable relief, including equitable subrogation. The Court entered an order equitably subrogating the refinance deed of trust to the lien position of the first deed of trust that was paid off and released to extent of the pay-off amount. The Court ordered that "the Refinance Deed of Trust . . . shall be and hereby is equitably subrogated to the lien position of the Household Deed of Trust . . . to the extent of $548,318.92" and "that the Refinance Deed of Trust . . . shall be and hereby does have priority over the Credit Line Deed of Trust. . . ."

4. In Wells Fargo Bank v. Anheuser-Busch Employees' Federal Credit Union, Case No. CL14000190-00 (Isle of Wight Cnty. Cir. Ct. Feb. 24, 2014), a credit union scheduled a foreclosure sale based on a deed of trust that was in first lien position, according to the record title. Wells Fargo filed a complaint for injunctive relief, based on the theory that its later recorded refinance deed of trust was actually entitled to first lien position according to the doctrine of equitable subrogation, because its refinance loan had paid off a deed of trust that was recorded prior to the deed of trust held by the credit union. The Court entered an order enjoining the credit union's foreclosure sale for 60 days pending further hearings. The Court stated, "The cloud on the title to the Property and the uncertainty as to the priority and extent of the deed of trust liens on the Property would have a chilling effect on the Foreclosure Sale, if the Court allowed it to proceed. It is likely that Plaintiffs will ultimately prevail on the merits of their case as set forth in the Complaint . . ." The case subsequently settled.

5. *Very Instructive Case*: Chase Manhattan Mortg. Corp. v. Smith (In re Smith), Case No. 98-26931, Adv. Proceeding No. 99-02076 (Bankr. E.D. Va. July 1999), the Honorable Judge David A. Adams held that, based on Virginia state law, the doctrine of equitable subrogation, a refinance lender was entitled to equitably subrogate back to the lien position of and stand in the shoes of a prior purchase money deed of trust recorded *before* a later recorded judgment, thereby giving it priority over an intervening judgment.

   In In re Smith in 1985, DePaul Hospital obtained a judgment for $23,518 plus interest against William M. Smith and Jeanne Marie Smith in the Norfolk Circuit Court (the "DePaul Judgment"). In 1994, "William Smith, Sr." ("Smith, Sr.") "divorced and unremarried" acquired property by deed in the City of Norfolk recorded in the Norfolk Clerk's Office. A portion of the purchase price paid by Smith was secured by a purchase money deed of trust ("PMDT"). Two years later, in 1996, Smith, Sr. obtained a new refinance loan which was used, in part, to pay off the loan secured by the 1994 PMDT. The refinance loan was secured by a recorded deed of trust against the Property in 1996 and the deed of trust loan was later assigned to Chase. The prior PMDT was released by a certificate of satisfaction. In 1998, Smith, Sr. filed a Chapter 13 bankruptcy petition which was later converted to a Chapter 7 at which time a trustee was appointed.

   In April 1999, Chase filed an adversary proceeding asking this court to (a) declare the Chase Refinance Deed of Trust to be equitably subrogated back to the lien position of PMDT, and (b) declare the Chase Deed of Trust, *as subrogated to the PMDT*, had priority over the DePaul Judgment which was recorded *before* the Chase Deed of Trust. Once Chase was subrogated to the PMDT, the PMDT, under Virginia state law, took priority of the DePaul Judgment.

   Judge Adams first found the resolution of the priority issue was governed by Virginia state law. In re Smith, (Order, p. 5). Next, Judge Adams found (a) "[e]quitable subrogation is a con-

cept which is recognized in Virginia and which is "*liberally construed*" to give in fact reality to the intentions of the parties and (b) the "law of equitable subrogation was as set forth in Federal Land Bank of Baltimore v. Joynes, 179 Va. 394 (1942)." (emphasis added.) (Id., pp. 5-6.)

Based on the foregoing, Judge Adams then ruled, in relevant part, as follows:

> Where, as here, a new mortgage (Saul Deed of Trust) is used to pay off an existing first mortgage (Purchase Money Deed Trust), but there is an intervening lien (Judgment) unbeknownst to the new mortgagee (B.F. Saul). The doctrine of equitable subrogation provides that the new or refinancing mortgagee (B.F. Saul) who pays off the existing first mortgagee (Purchase Money Deed of Trust) is treated as having the same preferential position as a first mortgagee with priority over the intervening lien ("Judgment"). Based upon the facts of this case and as a matter of law, the Saul Deed of Trust is equitably subrogated to the position and all rights and remedies of the Purchase Money Deed of Trust including, but not limited to, priority over the Judgment. (Id., pp. 5-6.
>
> The opinion of Judge Adams stands for the proposition, among others, that (a) equitable subrogation is to be "liberally construed to give in fact reality to the intentions of the parties," (b) under equitable subrogation, where a refinance loan deed of trust paid off a prior loan, the refinance loan deed of trust will be subrogated back to the lien position of the deed of trust securing the paid off loan, and (c) the refinance loan deed of trust, as subrogated, will take priority over an intervening lien creditor. (Id., p. 5.)

6. In Bankers' Loan & Inv. Co. v. Hornish, 94 Va. 608 (1897), a loan company advanced money to pay off notes secured by a first deed of trust with the understanding that it would have a first lien, but did not due to intervening judgments. The Court held that the loan company was subrogated to the rights of the noteholders who had priority over the intervening judgment creditors.

7. In Moritz v. Redd, 151 Va. 644 (1928), a man paid off a loan secured by a prior lien with the understanding that he would be the second lien holder, but there were intervening judgments. The Court awarded equitable subrogation, leaving the judgment creditors behind in priority, and noting that the "judgment creditors in this instance have in no just sense been prejudiced by applying the doctrine." Id. at 653.

   In short, under the facts of Hornish, Redd, and Smith, an intervening judgment lien creditor does *not* take priority of a later recorded deed of trust.

8. In Deutsche Bank National Trust Company v. Iqbal, 86 Va. Cir. 11 (Fairfax Cnty. 2012), a refinance deed of trust lender claimed it was entitled to, among other remedies, a constructive trust and equitable subrogation in a missing spouse case. In Iqbal, a couple both signed two purchase money deeds of trust in favor of WMC Mortgage Corporation, but the wife did not sign a subsequent refinance deed of trust granted in favor of Aegis Wholesale Corporation ("Aegis"). Deutsche Bank succeeded Aegis with respect to the refinance deed of trust and filed suit asserting claims for declaratory judgment, reformation of the deed of trust, equitable subrogation, unjust enrichment, imposition of a resulting trust and/or constructive trust and an award of monetary damages. The Iqbals failed to respond to the suit and the court entered an order finding them in default.

At a later hearing, Deutsche Bank moved for entry of a final order, specifically requesting that the court impose a constructive trust on both Iqbals' interest in the property and, alternatively, requesting relief under a theory of equitable subrogation. The court questioned whether Deutsche Bank stated a cause of action against Ms. Iqbal and requested the lender brief the issue. After reviewing Deutsche Bank's brief, the court issued an opinion and order. The trial court first determined that Deutsche Bank was unable to establish a basis for a resulting trust because it did not pay any portion of the purchase price at the time of the original purchase and paid off the WMC deeds of trust not as its own, but as the owner's lender. However, the court found that Ms. Iqbal evidenced her intent to subject her interest in the property to WMC's liens, which were paid off with the refinance deed of trust. Therefore, the Iqbals would be unjustly enriched if Deutsche Bank could not foreclose and was left only with the husband's unsecured promise to repay the refinance loan. Accordingly, the court agreed that Deutsche Bank was entitled to have a constructive trust imposed against the property. The court also concluded that, although Aegis was negligent in not obtaining Ms. Iqbal's signature on the refinance deed of trust, failing to equitably subrogate the refinance deed of trust to the lien position of the purchase money deeds of trust would result in the Iqbals owning the property free and clear of any lien. Thus, the equities strongly weighed in favor of Deutsche Bank and it was entitled to equitable subrogation. In the order attached to the opinion, the court imposed a constructive trust, *nunc pro tunc* to the date the refinance deed of trust was recorded, under the same terms and conditions stated in the refinance deed of trust. The order does not address equitable subrogation and did not specifically reform the refinance deed of trust to add Ms. Iqbal as a grantor.

**C. Equitable Subrogation is also Invoked in Situations Where, for Some Reason Other than Intervening Liens, the Security of One Who Paid Off a Prior Indebtedness is Void or Ineffective to Protect his or her Interests.**

9. A Virginia case of this type is Helm v. Lynchburg Trust and Savings Bank, 106 Va. 603 (1907). Helm claimed that she did not sign a deed of trust and that another had forged her name to it. *The loan intended to be secured by the forged deed of trust was used to pay off prior encumbrances.* The Court recognized that if the deed of trust was invalidated as a forgery, the second bank that had paid off the prior lender with a first deed of trust was entitled to have a new lien placed upon the property in the lien position of the prior lender "upon the equitable principle of subrogation," id. at 613, because of the benefit that had been bestowed.

**D. In No Other Jurisdiction has Equitable Subrogation Been More Firmly Adhered to or More Liberally Applied, to Meet the Exigencies of Particular Cases, than in Virginia.**

10. "[T]he Virginia Supreme Court reiterated that 'Virginia has long been committed to a liberal application of the principle of subrogation.' [Centerville Car Care], 263 Va. at 345; see also Fed. Land Bank of Baltimore, 179 Va. at 402 ('In no other jurisdiction has the doctrine been more firmly adhered to or more liberally expounded and applied, to meet the exigencies of particular cases, than in Virginia') (quoting Sands' Adm'r v. Durham, 99 Va. 263, 38 S.E. 145 (1901));"

11. Asset Mgmt. Holdings, LLC v. Wells Fargo Bank, N.A. (In re Wagner) No. 12-13285-BFK, Adv. Proceeding No. 13-01159, 2013 Bankr. LEXIS 4899, at *20. (Bankr. E.D. Va. Nov. 18, 2013)

**E. Equitable Subrogation is Primarily About Restoring the Interests of the Parties to their Intended Position Relative to Others.**

In In re Smith, Judge David A. Adams emphasized that equitable subrogation is "liberally construed to give in fact reality to the intentions of the parties." In re Smith (Order, at p. 5).

Similarly, in Asset Management Holdings, Judge Kenney reasoned: "At its heart, the doctrine of equitable subrogation is concerned with restoring the interests of the parties to their intended position relative to others. In re Perrow, 2013 Bankr. LEXIS 3757, 2013 WL 4787956, at *14." 2013 Bankr. LEXIS 4899, at *24. Judge Kenney further noted that "true" intervening lienholders in other published cases involving intervening lien creditors, really had "no bargained-for lien position with respect to the properties at issue." Id., at *26; see also Deutsche Bank Nat'l Trust Co. v. U.S., No. 1:12-cv-1059, 2013 U.S. Dist. LEXIS 107423, at *1 (E.D. Va. July 31, 2013); Deutsche Nat'l Bank Trust Co. v. Batmanghelidj (In re Batmanghelidj), No. 1:07cv683, 2007 U.S. Dist. LEXIS 68499, at *1 (E.D. Va. Sept. 17, 2007).

**F. Another Factor Virginia Courts Consider is Balancing the Equities and Whether the Equities Favor the Claimant Seeking Equitable Subrogation.**

1. Under Virginia law, even if a mortgage lender negligently omitted to record a deed of trust, this would constitute only "ordinary negligence" which is *not* a bar to subrogation. Fed. Land Bank of Baltimore, 179 Va. at 404; Asset Mgmt. Holdings, 2013 Bankr. LEXIS 4899, at *37.[3] Meridian Title Ins. Co. v. Lilly Homes, Inc., 735 F. Supp. 182, 186 (E.D. Va. 1990).

2. Negligence of the party claiming equitable subrogation or that party's agent can be a defense. However, in Asset Management Holdings, the mortgage lender negligently did *not* conduct a prior title examination before recording the subject deed of trust and Judge Kenney still found in favor of the mortgage lender, under equitable subrogation. Asset Mgmt. Holdings, 2013 Bankr. LEXIS 4899, at *10.

3. In addition, if equitable subrogation is awarded, will there be prejudice to the intervening party because of the claimant's equitable subrogation rights? Remember that a claimant's equitable subrogation rights are *limited to the amount actually paid to the prior lienholder*[4] *(e.g., the prior lender to whom refinance proceeds were paid by the refinancing lender/claimant)*, to fully satisfy the prior loan and release the prior deed of trust. See In re Reasonover, 236 B.R. 219, 232 (Bankr. E.D. Va. 1999) (limiting subrogee's rights to the amount paid to the prior lienholder).

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3 See Fed. Land Bank, 179 Va. at 404 (Negligence was alleged because the second mortgagor failed to search title records. The Court said, however, that the "negligence of the subrogee must be more than ordinary negligence to bar the application of subrogation. Furthermore, the negligence should be chiefly of significance when there are subsequently intervening rights involved which would be prejudiced if subrogation were allowed." Thus, the Court excused the lender's failure to conduct a title search. Id.); Morgan, 153 Va. at 246 (Court held that a party's negligence in failing to conduct a title search did not block equitable subrogation.); See also Centreville Car Care, 263 Va. at 345. (Supreme Court reversed trial court granting equitable subrogation to first priority position for lender where lender and/or its agent failed to uncover in a title examination defendants second deed of trust when it lent money to new purchasers and extinguished a former first deed of trust.); See also Deutsche Nat'l Bank Trust Co. v. Batmanghelidj, 2007 U.S. Dist. LEXIS 68499 (holding that equitable subrogation was not appropriate where it would place other liens in a worse position than they would be otherwise, where the borrower received a windfall by virtue of a cash disbursement of loan proceeds and where the equities did not strongly favor the subrogee.); Home Bldg. Ass'n v. Mackall, 205 Va. 73 (1964) (Equitable subrogation will be denied if a party fails to establish the factual predicates entitling it to equitable subrogation. The plaintiff attempted to invoke equitable subrogation. The Court refused to apply the doctrine because the plaintiff introduced no evidence establishing that its funds had been used to pay off prior indebtedness.)

4 But see Thompson v. Miller, 195 Va. 513 (1954) (equitable subrogation rights are limited to the amount actually paid to the prior lienholder, *plus interest.*)

4. Accordingly, for example, a prior lienholder would *not be prejudiced at all* by equitable subrogation because the lien position of the refinance lender/claimant, as subrogated, would actually be equal to the loan balance secured by the prior deed of trust to which the intervening lender was subordinate by virtue of the prior recorded deed of trust loan which was paid off by the refinancing lender/claimant.

I hope you have found this to be useful. Please do not hesitate to contact me if I can answer any questions or be of assistance in any way.

# MECHANIC'S LIENS AND SUPER-PRIORITY

**By Sandra M. Liedl**

*Sandra is an associate attorney at the law firm Jones, Walker & Lake, P.C. where she focuses her practice in the areas of residential real estate and estate planning. She particularly enjoys assisting first-time homebuyers with navigating the purchase process and working with hard money lenders to protect their interest in real property. A native of Virginia Beach, Sandra attended Virginia Wesleyan University for her undergraduate degree and then earned her law degree from Regent University School of Law in 2021. She is licensed to practice law in Virginia and North Carolina and is an area representative for the Virginia State Bar Real Property Section, serving on the Residential Real Estate Committee.*

A common saying regarding the priority of perfected liens is "first in time, first in right," but to every rule there is an exception. According to Virginia Code § 43 - 21, mechanics' liens can be one of the exceptions. The statute reads that "No lien or encumbrance upon the land created before the work was commenced or materials furnished shall operate upon the building or structure erected thereon, or materials furnished for and used in the same, until the lien in favor of the person doing the work or furnishing the materials shall have been satisfied." Thus, a mechanic's lien filed for work or materials could be required to be paid before a secured deed of trust, even if the deed of trust was recorded first – in other words, a "super-priority" lien against the improvements that gave rise to the lien.

**New Build Homes**

Mortgages or deeds of trust can be recorded against vacant land, using that land as collateral to ensure repayment. If a contractor who assisted in the building or a company that provided materials is unpaid, they can record a mechanic's lien against the property. The mechanic's lien will have priority as to the value of the newly completed building, while the previously existing deed of trust will have priority as to the value of the land. *Federal Land Bank of Baltimore v. Clinchfield Lumber & Supply Co.*, 171 Va. 118 (1938). The mechanic's lien holder will be reimbursed first, but the maximum recoverable amount will be equal to the value of the building and if any funds remain, the deed of trust holder will then be paid.

**Existing Structure Repairs and Improvement**

Whether a mechanic's lien has priority over the deed of trust placed on improved property before the filing of a mechanic's lien depends on whether the work completed on the building constitutes "repairs and improvements" rather than "new construction." *Hanson Assoc., P.C. v. Gallery Plaza Partnership*, 32 Va. Cir. 356 (Va. Cir. 1994). Defining and differentiating what improvement vs. new construction is has proven difficult. "Improvement" is defined as "a valuable addition made to a property. . .amounting to more than mere repairs or replacement. . . and intended to enhance its value, beauty, or utility or to adapt it for new or further purposes." *Id.*

In *Hanson*, the plaintiff argued that the extensive interior changes, which included changing the building's purpose from prior use, were more than repair and improvements, so its mechanic's lien should have priority over the preexisting deed of trust. The Court held that, despite the interior alterations, the exterior of the building remained unchanged, and the mechanic's lien remained

subordinate to the deed of trust. Courts most often distinguish the repair or improvement of an existing structure from the construction of a new structure by focusing on the changes, or lack of changes, to the exterior of the building. This is because the outer walls are the strongest mark of the building's identity, and obvious exterior changes provide notice of possible liens to purchasers and additional lien holders. *Id.*

At the time of *Hanson*, Virginia courts had not been asked to contemplate repairs and improvements vs. new construction, so this court instead looked to opinions of other jurisdictions. In *Lynch v. McCann*, 478 P.2d 835 (Alaska 1970), the contractors had built an addition attached to the original building, but the court found that the new structure was much smaller than the original building and could not be removed without damaging the existing structure; therefore, the addition was not new construction. Additionally, in the case *De Wald V. Woog*, 158 Pa. 497, 27 A. 1088 (Pa. 1893), the interior of the building was completely removed and redesigned so that two neighboring buildings became one building. The arrangement and layout of the exterior front of the first floor of the building was changed while the remaining floors remained unchanged, and the exterior of the back of the building was altered extensively; however, the court held that the work did not constitute a new building. The court quoted the specific rule of *Miller v. Hershey*, 59 Pa. 64 (Pa. 1868), which states that a new build is an "entire change of external appearance which denotes a different building from that which gave place to it. . . it would appear that there must be such a change in the external appearance of the building that persons, seeing the improvement, would recognize that a new building was erected." Despite the extensive changes, the subject building in De Wald was not new, but rather an improvement of a new building. Finally, in *Warren v. Freeman*, 187 Pa. 455, 41 A. 290 (Pa. 1898), the court held that, despite extensive alterations in the interior and the extension of the front and side walls, the work completed did not meet the definition of a new build as the work did not give the appearance of a new building.

**Mechanic's Liens and Foreclosures**

Foreclosing on a deed of trust cancels out liens subordinate to the foreclosing lien holder so the next owner takes title free of those debts. The exception to this is super-priority mechanic's liens. This super-priority allows workers who have done more than "improve" property to ensure that their rights to payment are upheld, even in the wake of foreclosure proceedings where the lender's interest would otherwise seem all-consuming. Lenders should be aware of the type of work completed by the contractor or company who recorded the lien and whether it constitutes repairs and improvements, or a new-build. A mechanic's lien for a new-build home, or work on an exterior of the existing home extensive enough to be considered a new-build, will have super-priority over a previously recorded deed of trust. The super-priority of mechanics' liens can create challenges when buyers acquire foreclosed properties, as they may inadvertently inherit outstanding liensthat supercede the lender's rights to that property.

**Protect Your Clients**

Title underwriters approach each examination on a case-by-case basis when deciding whether the foreclosure has canceled out a mechanic's lien filed after the deed of trust or if the mechanic's lien has super-priority. In past experiences, underwriters may require[1] the following proof that the work done has not altered the exterior of the building in such a manner that it would now be considered a newly constructed building:

1. Underwriters vary in their requirements for insuring foreclosures with recorded mechanic's liens. Agents and attorneys should contact underwriting counsel in these situations. ***–Ed.***

1. Before and after photos of the work done, including all exterior work;

2. An affidavit from the foreclosing lender that, from an exterior view, the property appears essentially the same at the time of foreclosure as when the loan was funded;

3. An affidavit from the seller that, from an exterior view, the property appears essentially the same at the time of the current sale as when the priority deed of trust loan was funded;

4. A copy of the seller or foreclosing lender's loan policy and letter of intent to clearly show the reason that the priority deed of trust loan was funded; or

5. An affidavit signed by the contractor containing a detailed list of work completed on the property.

Attorneys who represent lenders should encourage them to require that contractors keep detailed records, including before and after photographs and a list of the work completed for each project. Lenders should also review a borrower's plan before funding a loan to ensure that the borrowers do not intend to make exterior changes that would give the impression that a new building has been erected. Foreclosure attorneys should also prepare lenders for the possibility of inheriting liens on the foreclosed property if those liens are for work or material that would equate to a new building.

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**Spring 2025 SUBMISSION DEADLINE: April 4, 2025**

## MEETINGS

Dates and Locations to be announced.

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# VIRGINIA STATE BAR – REAL PROPERTY SECTION'S "LIVING LIBRARY" VIDEO SERIES TO EDUCATE ON REAL ESTATE LAW CAREERS

**From the Virginia State Bar Membership Committee**

The Real Property Section of the Virginia State Bar has unveiled an innovative new video series titled the "Living Library" produced by the Section's Membership Committee. The project is intended to demystify the complexities of real estate law. Its goals include providing Section and Bar members at large with a glimpse of the opportunities and resources available to expand the scope of existing practices and to educate law students on the myriad opportunities available in the practice of real estate law. Launched in 2024, this passion project of the Real Property Section features seasoned real estate attorneys sharing their insights and expertise with the aim of making valuable legal knowledge more accessible to both newcomers and experienced professionals.

To date, five informative Living Library "Chapter" presentations have been produced that cover diverse topics including Environmental Law, Foreclosures, Easements, Title Insurance, and Real Estate Litigation. The Committee intends to produce additional presentations at the rate of five or six topics each year; under consideration are Land Use, Local Government, Waterfront Issues, In-House Counsel, Eminent Domain/Condemnation, and Domestic Relations.

In addition to a general introduction of each practice area, the speakers provide an understanding and appreciation for the intricacies of a law practice of the subject specialties. Each video is constructed to provide practical tips as well as insight into the daily challenges and rewards encountered by practitioners. The videos vary in length from short introductions to half-hour presentations and are constructed to address the respective viewer's level of interest. The speakers range from veteran lawyers, lawyers in the prime of their careers, and relative newcomers, practicing in jurisdictions throughout the Commonwealth. Presenters have been chosen from large firms, solo practices, and governmental positions.

The series is available for free online. Viewers can find the series by searching for "Living Library" on YouTube or by visiting the Real Property Section webpage at the Virginia State Bar: https://vsb.org/RP/groups/RP/home.aspx?hkey=e412cde6-3812-4551-9e38-afb42bd8af24. As the legal landscape continues to evolve, initiatives like the "Living Library" play a crucial role in equipping legal professionals with the tools and knowledge needed to thrive in the ever-changing world of real estate law.

If you have an idea for a suitable topic or presenter for future Chapters of the Living Library, or if you wish to become involved with this exciting project, please contact Larry McIlwain at lmcelwain@larrylawva.com.

*[NOTE: The videos are not intended to be a substitute for Continuing Legal Education (CLE) but rather informal resources designed for mass distribution. They do not provide CLE credits.]*

# SOME CREATIVE WAYS TO USE AND STRUCTURE CONDOMINIUMS (A PRACTICAL PLAIN LANGUAGE INTRODUCTION)

By Robert C. Goodman Jr.
Kaufman & Canoles

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**Virginia condominium law is not limited to our commonly held perception of an apartment or a duplex. This is why we can legally be creative. Relevant sections of the Virginia Condominium Act are included at the end of this article.**

**Here are some examples of creative solutions:**

1.1 **Problem:** Site was approximately 6 acres on a creek with a quarter-plus mile gravel road to connect to the city street and no sewer lines. Owner wanted to sell off 5 building sites and keep one, but cost to subdivide with "proffers" to pave the road and install a sewer line out to the main road was prohibitive.

**Solution:** Vacant land condominium for 6 residential lots. The unpaved street and sewer lines were common elements. The building sites, with setbacks as if each "lot" were in a subdivision, were the Units. The front and side yards which comprised the same setbacks, as if the project was a subdivision, were limited common elements. There were customary residential restrictions to preserve the character of the neighborhood comparable to those in a subdivision. To facilitate approval we met with the relevant city officials and explained the legal and design process to them in advance of submitted applications for permits.

The Units are individually owned and taxed separately, together with the limited common elements of which all rights are exclusive to the respective unit. (In the vernacular, they "belonged" to the unit.) The connecting road is a common element and in effect belongs jointly to all the owners who share the maintenance costs.[1]

1.2 **Problem:** Darden Business School recent grads wanted to purchase a marina for a reasonable multiple of its earnings, but they want to sell the slips and then operate the marina for the individual owners. They anticipate a significantly higher value through the retail sale of slips than from rentals. They need to keep control of all facilities to ensure quality.

**Solution:** A marina condominium. The Unit is a cubic space of water and air of specified dimensions and the piers, docks and other facilities are a combination of limited and general common elements which reflect which facilities were limited to one or more slips and which were for all users of the marina. Rules and regulations provided control over use of the slips and conduct on the property.[2]

1.3 **Problem:** Client wanted to sell the pier and dock on its waterfront industrial site. It still intended to continue to use the rest of the same site, but it was going to require the buyer to lease the rest of the site under a triple net lease with the rent set at 15% of the purchase price – a bad economic result. The property had shared usage of facilities but was compli-

1. Godfrey Lane a Condominium

2. York River Yacht Haven Marina a Condominium

cated in its layout. Subdivision would have required expensive roads, sewers and water to all parts of the site.

**Solution:** A vacant land industrial condominium. This particular project was a real team effort to understand how the site should work. The client and I walked the site multiple times to talk about access, shared facilities, flexibility for future uses, practical utility service and control over conduct on the site (speeding, pollution, noise, storage etc.). Most of the retained buildings ("Units") were gradually sold off separately as the need for them changed. The property has continued to function successfully with the shared common elements.[3]

1.4 **Problem:** Client owned a site with access to a public highway, a good location to develop saleable lots for a light manufacturing/distribution park--although there were wetlands issues with some parts of the site. As a condition of subdividing the property, the City wanted a proffer of a $750,000 pump station to serve the entire nearby neighborhood, which was cost prohibitive for the project.

**Solution:** A vacant land condominium with a right for a subdivision of the condominium units to permit setting the size of the saleable "lots" (units) after each buyer decided how much land it needed for its building. We met in advance with the relevant city officials and explained how the Condominium Act would permit the development of the project without a traditional subdivision and asked for their input on any concerns they had.

Using the Condominium Act, we retained the right to divide large units as buyers indicated what size parcel they desired. Note that a condominium unit subdivision is not the same as a normal zoning subdivision (avoided in this instance). The access road for the project is a combination of a general common element for the part of the road used by all the sites and a limited common element for the part used by fewer units. There is also the right to add additional adjacent land at a future time. The wetlands are part of some of the units, but their acreage is not included for purpose of computing the amount that a unit must pay for road maintenance and the like. In lieu of lot size, we used a par value allocation so that a larger lot with wetlands would not bear a different share of common expenses than a smaller lot with a similar sized building area.

Below are some relevant sections of the Declaration dealing with Limited Common Elements where there were potentially special issues with water, sewer and electrical power:

**4.2 Limited Common Elements.**

(a) Certain Limited Common Elements, including the utility and access easements that constitute Limited Common Elements, are shown on the Plat.

(b) There may, from time to time, be utility easements in favor of various public utility providers ("Public Utility Easements") for the provision of certain utilities to the Property and the occupants therein (the "Public Utility Facilities").

(c) Any sanitary sewer or water utility facilities or BMP facilities that may be constructed or exist on the Property and are not owned by a utility provider (together, the "Private Utility Facilities") and which serve one or more but less than all of the Units shall be deemed Limited Common Elements assigned to the Unit or Units served by such Private Utility Facilities, regardless of whether shown on the Plat. Each Unit to which Private Utility Fa-

3. Money Point a Condominium

cilities are appurtenant as a Limited Common Element shall have as an appurtenance to its Unit a perpetual nonexclusive easement for installing, constructing, improving, operating, repairing, maintaining and replacing Private Utility Facilities benefiting such Unit over, across, under and through the portions of each other Unit on which Private Utility Facilities, are currently located (together, the "Private Utility Easements"). The exercise of such Private Utility Easement rights shall be subject to the same conditions as are set forth in Section 5.1.2.3 with respect to the performance of work within Common Element easements. Such easements shall include the right to use for their intended purposes the currently existing Private Utility Facilities serving such benefited Unit. Collectively the Private Utility Facilities and the Public Utility Facilities are referred to as the "Utility Facilities".

(d) Notwithstanding the foregoing, since, Declarant at its expense obtained from the City for the Association the master meters for the water and sewer lines and paid the connection fees to the City on behalf of the Association, each Unit Owner shall as a condition of its "hook-up" to the water and sewer lines be required (A) to install a submeter to measure usage with respect to such Unit Owner's Unit and (B) to permit the Association (and/or its agent) to read the submeter on a monthly basis and to pay to the Association its share of the water and sewer fees based on usage and other pea-iodic charges and (C) to pay Declarant (or its assignee) for such Unit's share of the costs paid to the City by Declarant which amount shall be calculated based on the then current fees which the City would charge in a subdivision for a comparable hook-up.

5.1.2.3—The Common Elements that are access easements may also be used for the installation, operation, maintenance, repair, and replacement of Utility Facilities to serve the Units. No utilities may be installed in a manner that will conflict with or diminish the utility of any other Utility Facilities. Any party desiring to install, or perform any other work with respect to, any Utility Facilities within a Common Element easement shall give written notice of its intention to install utilities to each Unit Owner on whose Unit the Common Element easement is located at least thirty (30) days prior to commencement of the work, provided that only such notice as shall be reasonable in the circumstances need be given in the event of an emergency. The party which performs such work, and any Unit Owner on whose behalf such work is performed, shall indemnify, hold harmless and defend all other Unit Owners and occupants of the other Units from and against any loss, claim and liability incurred by each of them as the result of the performance of any such work. The party which performs such work, and any Unit Owner on whose behalf such work is performed, shall promptly: (a) be obligated to restore any excavated or otherwise damaged areas or improvements to their pre-existing condition; and (b) perform such work in a manner that minimizes, both in terms of the severity and duration, the interference (including interruption of access) with any business operations on the affected Unit.[4]

1.5 **Problem:** Client owned a larger warehouse connected to the smaller one. Client had a potential user for the office and smaller warehouse, but the user wanted to own, not rent. Owner analyzed the space and concluded that the remaining larger warehouse space could be rented or sold so it was willing to sell the office building with a smaller warehouse.

4. Enterprise South Commerce Park a Condominium

**Solution:** Plan the necessary physical changes; create a condominium to separate the ownership into two units and then use a Declaration of Easements, Covenants, Conditions and Restrictions ("ECR") to deal with storm water management, shared power lines and certain access and vehicular movement issues. Use a negotiated par value for the two units to allocate common area costs. By using an ECR a survey was not necessary for limited common elements containing water lines, electrical power lines and the like. (A survey to meet the requirements of the Virginia Condominium Act for these lines as limited common elements would have been cost prohibitive). An ECR also permitted a party wall between the two warehouses which provided in the ECR more flexibility than was potentially feasible in the condominium documents. Other related issues included working out a cooperative set of guidelines for access to loading docks since there would no longer be a single owner to determine which trucks could access which docks while potentially blocking access to another dock. Owner then sold the first condo unit in a 1031 exchange and later sold the second unit as well. [5]

1.6 **Problem:** A single site on a busy highway with a gas/service station, a car wash and rental storage units in the rear.Owner wanted to sell the gas/service station fronting on the highway.

**Solution:** Create a vacant land condominium with three units and then use a Declaration of Easements, Covenants, Conditions and Restrictions ("ECR") to deal with access, parking restrictions, maintenance, utilities, insurance and indemnification. [6]

1.7 **Problem:** Three free-standing one-story office buildings on a road with only one access point; a health care provider wanted to buy one building. It also wanted preferred parking rights for its patients.

**Solution:** Create a vacant land condominium with three units. The Buyer suggested making the parking spaces adjacent to each building a limited common element with towing enforcement in the event patrons parked in the spaces of another building. We pointed out that such a restriction could mean towing of Buyer's patients if there were not enough reserved spaces and they parked adjacent to another building.. The solution was to make all parking common elements appurtenant to all units but to permit signage adjacent to the Buyer's unit which says "Please use only for patients at the Clinic." A second point was to be sure the site retained a well-maintained exterior appearance in order that both the limited and general common elements outside the units were placed under common maintenance. [7]

1.8 **Problem:** Hotel owned a large parking lot across the street from the hotel. A developer offered to pay a substantial price to buy the parking lot (which it was then going to develop as a parking garage) and lease back parking spaces to the hotel. Hotel owner's attorney strongly advised against giving up ownership of the parking lot because it potentially could adversely affect any future sale of the hotel.

**Solution:** Round One: Sale (1031 exchange) to the developer of air rights over 16 feet above paved surface level with, of course, a right for the developer to construct an access ramp from a side street not adjacent to the hotel. The reasoning for the 16 feet was to permit future development on the ground level in addition to the parking. The developer's plans for the space

5. 5465 Greenwich Road Condominium (Declaration and ECR)

6. 4101 Plantation Road (Declaration and ECR)

7. 152,154,156 Burnett's Way ( Declaration and ECR), dated February 29, 2024 and recorded in the Clerk's Office of the Circuit Court of the City of Suffolk, as Instrument No. 240002330

above were reviewed by seller's attorney and required to be changed to prevent water from flowing down into the new ground floor retail, storage and parking areas.[8]

Round Two: After adding retail shops, a storage area, and completing the limited access ground level parking with lighting, all went well. Then the hotel owner decided to sell the hotel. According to zoning law, only about two-thirds of the parking spaces were needed for the hotel. A ground level condominium was created for the parking spaces and the storage room. The Hotel owner conveyed the condominium unit (1031 exchange) with two-thirds of the spaces and retained the other unit with the rest of the spaces as well as the unit with the storage room. These units provided rental income until they were also sold.[9]

**Key statuary provisions of Chapter 19. Virginia Condominium Act for purpose of this article:**

**§ 55.1-1900** Condominium" means real property, and any incidents thereto or interests therein, lawfully submitted to this chapter by the recordation of condominium instruments pursuant to the provisions of this chapter. No project shall be deemed a condominium within the meaning of this chapter unless the undivided interests in the common elements are vested in the unit owners.

**§ 55.1-1905**. Local ordinances; nonconforming conversion condominiums; applicability of Uniform Statewide Building Code; other regulations.

**A. No zoning or other land use ordinance shall prohibit condominiums solely on the basis of the form of ownership, nor shall any condominium be treated differently by any zoning or other land use ordinance that would permit a physically identical project or development under a different form of ownership. Except as provided in subsection E, no local government may require further review or approval to record condominium instruments when a property has previously complied with subdivision, site plan, zoning, or other applicable land use regulations.**

**B. Subdivision and site plan ordinances in any locality shall apply to any condominium in the same manner as such ordinances would apply to a physically identical project or development under a different form of ownership; however, the declarant need not apply for or obtain subdivision approval to record condominium instruments if site plan approval for the land being submitted to the condominium has first been obtained.**

[emphasis added]

C. During development of a condominium containing additional land or withdrawable land, phase lines created by the condominium instruments shall not be considered property lines for purposes of subdivision. If the condominium can no longer be expanded by the addition of additional land, then the owner of the land not part of the condominium shall subdivide such land prior to its conveyance, unless such land is subject to an approved site plan as provided in subsection B, or prior to modification of such approved site plan. In the event of any conveyance of land within phase lines of the condominium, the condominium and any lot created by such conveyance shall be deemed to comply with the local subdivision ordinance, provided that such land is subject to an approved site plan.

D. During the period of declarant control and as long as the declarant has the right to create additional units or to complete the common elements, the declarant has the authority to

8. Deed of Air Rights, Easements and Reservation of Easements, dated August 29, 1996, and recorded in the Clerk's Office of the Circuit Court of the City of Virginia Beach, in Deed Book 3654, at page 1855

9. 8th Street Ground Level Parking, a Condominium;

execute, file, and process any subdivision, site plan, zoning, or other land use applications or disclosures, including related conditional zoning proffers and agreements that do not create an affirmative obligation on the unit owners' association without its consent, with respect to the common elements or applications affecting more than one unit, notwithstanding that the declarant is not the owner of the land.

In accordance with subsection B of § 55.1-1956, once the declarant no longer has such authority, the executive board of the unit owners' association, if any, and if not, then a representative duly appointed by the unit owners' association, shall have the authority to execute, file, and process any subdivision, site plan, zoning, or other land use applications or disclosures, including related conditional zoning proffers and agreements that do not create an affirmative obligation on the declarant without its consent, with respect to the common elements or applications affecting more than one unit, notwithstanding that the unit owners' association is not the owner of the land. Such applications shall not adversely affect the rights of the declarant to develop additional land. For purposes of obtaining building and occupancy permits, the unit owner, including the declarant if the declarant is the unit owner, shall apply for permits for the unit, and the unit owners' association shall apply for permits for the common elements, except that the declarant shall apply for permits for convertible land.

E. Localities may provide by ordinance that the declarant of a proposed conversion condominium that does not conform to the zoning, land use, and site plan regulations of the respective locality in which the property is located shall secure a special use permit, a special exception, or a variance, as the case may be, prior to such property's becoming a conversion condominium. The local authority shall grant a request for such a special use permit, special exception, or variance filed on or after July 1, 1982, if the applicant can demonstrate to the reasonable satisfaction of the local authority that the nonconformities are not likely to be adversely affected by the proposed conversion. The local authority shall not unreasonably delay action on any such request. In the event of an approved conversion to condominium ownership, a locality, sanitary district, or other political subdivision may impose such charges and fees as are lawfully imposed by such locality, sanitary district, or political subdivision as a result of construction of new structures to the extent that such charges and fees, or portions of such charges and fees, imposed upon property subject to such conversions may be reasonably related to greater or additional services provided by the locality, sanitary district, or political subdivision as a result of the conversion.

F. Nothing in this section shall be construed to permit application of any provision of the Uniform Statewide Building Code (§ 36-97 et seq.) or any local ordinances regulating design and construction of roads, sewer and water lines, stormwater management facilities, and other public infrastructure to a condominium in a manner different from the manner in which such provision is applied to other buildings of similar physical form and nature of occupancy.

**§ 55.1-1933. Subdivision of units.**

A. **If the condominium instruments expressly permit the subdivision of any units, then such units may be subdivided in accordance with (i) the provisions of this section and (ii) any restrictions and limitations not otherwise unlawful that the condominium instruments may specify.** [emphasis added] No unit shall be subdivided unless the condominium instruments expressly permit it.

B. If the unit owner of any unit that may be subdivided desires to subdivide such unit, then the principal officer of the unit owners' association, or such other officer as the condominium instruments may specify, shall, upon written application of the subdivider, as such unit owner shall hereinafter be referred to in this section, forthwith prepare and execute appropriate instruments pursuant to subsections C, D, and E.

C. An amendment to the declaration shall assign new identifying numbers to the new units created by the subdivision of a unit and shall allocate to those units, on a reasonable basis acceptable to the subdivider, all of the undivided interest in the common elements appertaining to the subdivided unit. The new units shall jointly share all rights, and shall be equally liable jointly and severally for all obligations, with regard to any limited common elements assigned to the subdivided unit except to the extent that the subdivider may have specified in his written application that all or any portions of any limited common element assigned to the subdivided unit exclusively should be assigned to one or more, but less than all of the new units, in which case the amendment to the declaration shall reflect the desires of the subdivider as expressed in such written application.

D. An amendment to the bylaws shall allocate to the new units, on a reasonable basis acceptable to the subdivider, the votes in the unit owners' association allocated to the subdivided unit and shall reflect a proportionate allocation to the new units of the liability for common expenses formerly appertaining to the subdivided unit.

E. Such plats and plans as may be necessary to show the boundaries separating the new units together with their other boundaries shall be prepared, and the new units depicted on such plats and plans shall bear their new identifying numbers. Such plats and plans shall indicate the dimensions of the new units, and the horizontal boundaries of such units, if any, shall be identified on such plats and plans with reference to established datum. Such plats and plans shall be certified as to their accuracy and compliance with the provisions of this subsection (i) by a licensed land surveyor in the case of any plat and (ii) by a licensed architect, licensed engineer, or licensed land surveyor in the case of any plan.

F. When appropriate instruments in accordance with this section have been prepared, executed, and acknowledged, they shall be recorded by an officer of the unit owners' association following payment by the subdivider of all reasonable costs for the preparation, acknowledgment, and recordation of such instruments. Such instruments are effective when executed by the subdivider and recorded, and the recordation of such instruments is conclusive evidence that the subdivision so effectuated did not violate any restrictions or limitations specified by the condominium instruments and that any reallocations made pursuant to subsections C and D were reasonable.

G. Notwithstanding the definition of "unit" found in § 55.1-1900 and the provisions of subsection D of § 55.1-1925, this section shall have no application to convertible spaces, and no such space shall be deemed a unit for the purposes of this section. However, this section shall apply to any units formed by the conversion of all or any portion of any such convertible space, and any such unit shall be deemed a unit for the purposes of this section.

# SELLER FINANCING OF RESIDENTIAL REAL ESTATE SALES

by Dale A. Whitman[1]

Most sellers of residential real estate expect the buyer to pay cash or to arrange institutional financing in the form of a mortgage loan. Sometimes neither of these options is attractive and the seller is willing to provide the financing. There are several reasons this may be so. The buyer may have poor credit and cannot qualify for attractive financing from a commercial lender; the seller may be flush with cash and have no need for a cash settlement at closing;. interest rates at conventional lenders may be unattractively high – so high that the buyer refuses to accept them; or the seller and buyer may have a personal or family relationship that induces one to provide financing for the other. For whatever reason, let us assume that the seller has decided to finance the buyer's purchase.

**Two ways of documenting the sale**. Financing of a real estate sale by the seller can be documented in two basically different ways. One is by a purchase-money deed of trust; in this transaction, the seller delivers a deed of the property to the buyer, transferring legal title. The buyer then executes a promissory note and a deed of trust back to the seller. The note and trust deed are similar to those that might be executed to a third-party lender and might even be written on the standard Fannie Mae-Freddie Mac forms. If the buyer defaults, the seller can sue on the note or (much more likely) foreclose the deed of trust, usually in Virginia by a nonjudicial foreclosure.

The other method of documenting a seller-financed sale involves use of a single document, a real estate installment contract, often called a "contract for deed." The contract gives the buyer immediate possession, but not legal title. The buyer promises to make payments of principal and interest, much like would be called for in a promissory note. The seller promises to deliver a deed conveying legal title, but only when the final payment is made and the price has been paid in full. Meanwhile the buyer has only an "equitable title."[2]

The contract may provide the seller with several remedies in the event of the buyer's default: a suit for the full remaining price (specific performance) or a suit for damages. However, the remedy most often spelled out and most widely employed is a right to terminate the contract, evict the buyer, and retain all payments made to date as liquidated damages. This remedy, often referred to as "forfeiture," is a powerful one. It is similar to the old common law remedy of "strict foreclosure," except that there is no court intervention or buyer's right of redemption. Aside from a brief grace period, during which the contract may (or may not) allow the buyer to make up the missed payment, the buyer who defaults simply loses whatever equity she or he has built up in the property.[3]

### Risks of Seller Financing under State Law

No matter which of these methods of documenting the sale is used – deed of trust or installment contract – seller financing may have disadvantages to the buyer in a residential sale. Most arise because there is no third-party lender and often no attorney or professional title officer involved. Here are a few of the problems:

1. Professor of Law Emeritus, University of Missouri.

2. Sale v. Swann, 138 Va. 198, 208, 120 S.E. 870, 873 (1924). On this reasoning, the Virginia Supreme Court held that a transfer by installment contract was sufficient to trigger a due-on-sale clause in a prior deed of trust; see Lipps v. First Am. Serv. Corp., 223 Va. 131, 286 S.E.2d 215 (1982).

3. Contracts for deed are often used in predatory or abusive transactions in which the seller expects the buyer to default. See Consumer Financial Protection Bureau (CFPB), Report on Contract for Deed Lending (Aug. 2024).

1. **Property condition**. In a seller-financed sale, there will usually be no third party to advise or insist on a professional inspection of the property. Unless the buyer is sophisticated enough to demand an inspection, the house may have structural problems or other unrevealed repair needs. Later, when these issues manifest themselves, the buyer may lack the financial means to cope with them.

2. **Lack of sound loan underwriting**. Professional lenders "underwrite" their loans by examining the credit scores of their borrowers, verifying their income and employment, demanding an appraisal of the property, and using other well-established methods. Property sellers, on the other hand, are often inexperienced as lenders; they are only vaguely familiar with these techniques and fail to employ them in assessing the buyer's credit worthiness. Hence they may merely guess, or may take at face value the buyer's statements concerning the buyer's ability to make the required payments. This frequently leads to buyer defaults.

3. **Nonstandard documents**. When an institutional lender and a real estate agent are involved in a sale, the sales contract, note, and deed of trust will nearly always be written on standardized forms that contain many clauses designed to protect consumers. On the other hand, a seller-financed sale may be written on documents from any source; they may be highly anti-consumer, amateurish, or missing important information. This is particularly a problem with installment contracts, since there are few good models for the parties to follow. Most buyers are ill-equipped to evaluate or negotiate document clauses, and most are unrepresented by counsel.

4. **Lack of clear title**. Seller-financed sales are often conducted without any form of title assurance to the buyer. Unsophisticated buyers may not realize that they should insist on a title examination or a title commitment and title insurance. Consequently, they may acquire property subject to prior tax liens, judgments, mortgages, or other encumbrances, or in the worst case, no title at all. Even if the seller holds title, if the seller fails to maintain the payments on prior encumbrances and becomes insolvent, the buyer's title can easily be destroyed.

5. **Lack of proper record-keeping.** The parties to seller-financed sales often do not clarify which of them will keep records of the payments and principal balance of the debt. Sometimes no one does. There is no loan servicer with a contractual duty to track the payments and balance. When the balance must be determined because the buyer wishes to sell or prepay, it can be a miserable experience to try to reconstruct the payments from old, cancelled checks or bank statements; sometimes it is impossible to reach a solid conclusion.

6. **Balloon payments.** Seller-financed sales often provide for the remaining purchase price to be paid in full after only a few years – a feature of the deal that the buyer may not fully understand or may not be ready or able to perform. The result is often a default that the buyer cannot cure. Indeed, this is sometimes exactly what the seller intends and anticipates will occur.

The foregoing list is applicable whether the sale is documented with a deed and purchase money deed of trust or with an installment contract. However, installment contracts present several additional serious risks to the buyer:

1. **Lack of recording.** In an installment contract sale, the contract is often left unrecorded.[4] The seller may even make recording difficult or impossible by refusing to have his or her signature acknowledged by a notary. Lack of recordation may facilitate the seller's retaking of possession if the buyer defaults; it also opens the buyer to the risk that the seller will further encumber the property, using it to secure unrelated indebtedness during the term of the contract. If the seller defaults on that unrelated debt or enters bankruptcy, the recording acts will usually give the later encumbrance priority over the contract, potentially wiping out the buyer's equity.

2. **Failure of the seller to pay taxes and insurance premiums**. In an installment contract, it is common to provide that the buyer will pay the required property taxes and insurance premiums to the seller, who in turn will pay them to the taxing jurisdictions and insurance carrier. However, the buyer typically has no simple way of knowing whether the seller actually makes these payments,[5] and if they are not made, whether the seller has absconded with the funds the buyer has paid. This is rarely a problem if a deed of trust is used as the financing instrument, since deed of trust forms nearly always provide for the buyer-beneficiary to pay the taxes and insurance premiums directly to the taxing authorities and insurer.

3. **Forfeiture.** As mentioned above, if the courts are willing to enforce the installment contract as written, a default in payment by the buyer can result in the seller's terminating the contract and dispossessing the buyer, thus wiping out any equity the buyer's payments have built up in the property.

**Is forfeiture enforceable?** Perhaps it is in a few states. But forfeiture looks a great deal like a strict foreclosure with no right of redemption, and hence like a clog on the equity of redemption – something that the Common Law courts were alert to prevent.[6] Most American courts have viewed forfeiture with skepticism and have tried to find ways to ameliorate its harshness to purchasers. How has this worked out in practice? Here are some of the typical results.

1. **Treatment as a mortgage**. Perhaps the most common interpretation of the installment contract is simply to treat it as a mortgage. Nearly a dozen states have taken this position by judicial construction or by statute,[7] and the Restatement agrees.[8] Of course, in a state that follows this view, one might ask why bother using the contract at all rather than a standard mortgage or deed of trust.

2. **Denial of the remedy of forfeiture on equitable grounds**. A court might simply hold that forfeiture is not an available remedy, leaving the vendor with such other remedies as actual damages or specific performance.[9] This approach would be analogous to the courts

4. Recording can be costly in Virginia. State taxes can total 0.35% of the sale price, with local taxes being added. Va. Code Tit. 58.1 Ch. 8 lists the various state transfer and recording taxes.

5. Verification of Ad Valorem taxes is usually available to the public through the taxing authority. –Ed.

6. See Nelson, Whitman, Burkhart & Freyermuth, Real Estate Finance Law §3.1 (2014).

7. See, e.g., Ricard v. Equitable Life Assur. Soc. of U.S., 462 So. 2d 592 (Fla. 5th DCA 1985); Skendzel v. Marshall, 261 Ind. 226, 301 N.E.2d 641 (1973); Sebastian v. Floyd, 585 S.W.2d 381 (Ky. 1979); Prue v. Royer, 193 Vt. 267, 2013 VT 12, 67 A.3d 895 (2013). A few states have taken this position by statute; see, e.g., Okla. Stat. Ann. tit. 16, § 11A; Md. Real Prop. Code §10-105(a) (buyer may convert installment contract to mortgage when 40% of original price has been paid).

8. Restatement Third, Property: Mortgages §3.4.

9. See Freyfogle, Vagueness and the Rule of Law: Reconsidering Installment Land Contract Forfeiture, 1988 Duke L.J. 609 (1988); Nelson, The Contract for Deed as a Mortgage: The Case for the Restatement Approach, 1998 BYU L. Rev. 1111.

which, in short-term earnest money contracts, hold that forfeiture of earnest money as liquidated damages by a vendor is inequitable because it unfairly overcompensates the vendor.[10]

3. **Granting of a right of redemption**. In states that do not go quite as far as the first category, the courts may still give the buyer a right of redemption before allowing a forfeiture by the seller.[11] In effect this is a right of the purchaser who is in default to have an extended grace period to make up the missed payments, either on an accelerated or an unaccelerated basis. The court may allow a period such as 60, 90, or 180 days in the court's discretion. Such a cure may be allowed by a court even if the contract itself allows no cure period at all or only a very short period.

4. **Granting of restitution of the buyer's equity.** If a court believes that the buyer has paid enough on the contract that it would be inequitable for the seller to retain all of the buyer's payments, the court may order the seller to return the excess to the buyer.[12] The result is roughly similar to a foreclosed party's right to surplus from a foreclosure sale. The court may calculate the amount of restitution by examining the fair market value of the property or its fair rental value for the period the buyer was in possession; the case law is mixed and often unpredictable.[13]

5. **Statutory adoption of forfeiture.** A number of states, particularly in the Midwest, have regularized the forfeiture process by statute.[14] These statutes often contain a number of pro-buyer provisions, including mandatory recording of the contract, adequate notice to the buyer, lengthy cure periods, and limitation of the forfeiture remedy to situations in which only a relatively small portion of the purchase price has been paid. Virginia has no similar statute.

The attraction of the first four of these remedial approaches to a particular court may be influenced by other factors, such as whether the purchaser's default was willful or intentional,[15] how much of the total purchase price the purchaser had paid at the time of the default, and whether the seller had a history of waiving prior defaults.[16]

It is impossible to develop hard and fast rules from this morass of cases. Which (if any) of these paths the Virginia appellate courts might take is hard to guess, and there are no clues in the reported cases. Perhaps this uncertainty is the best of all reasons for Virginia practitioners, whether representing sellers or purchasers, to avoid use of real estate installment contracts.

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10. See, e.g., Stonebraker v. Zinn, 169 W.Va. 259, 286 S.E.2d 911 (1982). The court considered denial of forfeiture but concluded that it would not be inequitable to enforce forfeiture because the monthly contract payments were approximately the equivalent of fair rental value and the initial down payment was fair compensation for the vendor's expenses in recovering the property.

11. In re Kingsmore, 295 B.R. 812 (Bankr. D. S.C. 2002); Jenkins v. Wise, 58 Haw. 592, 574 P.2d 1337 (1978); Nigh v. Hickman, 538 S.W.2d 936 (Mo. Ct. App. 1976); Lamberth v. McDaniel, 131 N.C. App. 319, 506 S.E.2d 295 (1998). This result may be termed "specific performance" for the purchaser.

12. Chace v. Johnson, 98 Fla. 118, 123 So. 519 (1929); Weyher v. Peterson, 16 Utah 2d 278, 399 P.2d 438 (1965).

13. See, e.g., Honey v. Henry's Franchise Leasing Corp. of America, 64 Cal. 2d 801, 52 Cal. Rptr. 18, 415 P.2d 833 (1966).

14. See, e.g., 735 ILCS 5/15-1206; 735 ILCS 5/9-102; Iowa Code Ann. §§ 656.1 to 656.6; LSA-R.S. §§ 9:2941 et seq.; Md. Code Ann., Real Prop. §§ 10-101 to 10-108; Mich. Comp. Laws Ann. § 606.5726; Minn. Stat. Ann. § 559.21; N.D. Cent. Code §§ 32-18-01 to 32-18-06; S.D. Codified Laws §§ 21-50-01 to 21-50-07; Ohio Rev. Code Ann.§§ 5313.05, 5313.06 and 5313.08; Or. Rev. Stat. Ann. §§ 93.905 to 93.940; Tex. Prop. Code Ann. §§ 5.061 to 5.085.

15. See Peterson v. Hartell, 40 Cal.3d 102, 707 P.2d 232 (1985), concluding that, contrary to prior California cases, the willfulness of the default was not a factor in determining the enforceability of a forfeiture clause in California.

16. See Nelson, Whitman, Burkhart & Freyermuth, Real Estate Finance Law §3.29 (2014).

Moreover, the great advantage of use of a deed of trust as a security instrument in Virginia, from the seller's viewpoint, is its certainty and relative speed. If a purchaser receives a deed and gives back to the seller a purchase-money deed of trust, a foreclosure of the deed of trust can theoretically be accomplished in as little as 65 to 70 days or so.[17] This is admittedly longer than is required for the forfeiture of a real estate installment contract, the duration of which in Virginia is simply whatever cure period may be allowed by the contract itself. But this is so only if the contract purchaser "rolls over" and seeks no judicial intervention. If the purchaser goes to court, the seller takes an indefinite voyage into uncharted waters. For these reasons, a seller who chooses to use an installment contract rather than a purchase-money deed of trust seems, in the opinion of the author, to be making an inherently unwise choice.

### Seller-financed sales and Federal Law

Most people in the real estate business are generally aware of the Truth in Lending Act (TILA) and of the Home Ownership and Equity Protection Act (HOEPA),[18] but probably assume that they are only the concern of institutional lenders. Few would likely suspect that these statutes and their accompanying regulations could apply to seller-financed real estate sales. As we will see, however, they can readily do so, and their consequences can be surprising and potentially quite devastating to sellers. Note that there is no meaningful distinction between seller-financed sales using purchase-money deeds of trust and those using real estate installment contracts; from the standpoint of federal law, these are simply different ways of documenting the same basic transaction.[19] There is no plausible argument against the proposition that in a real estate installment contract, the seller is a creditor and thus potentially subject to HOEPA and TILA.[20]

**High cost mortgage definition**. We begin with HOEPA's definition of a "high cost mortgage." This may seem a peculiar starting point, but the substance of both the HOEPA and Truth in Lending rules hinge on it. High cost mortgages have actually been quite rare in institutional lending,[21] but they are probably much more common in seller-financed transactions, and their definition is critical. Again, do not be misled by the term "mortgage;" it is quite plain that a real estate installment contract can be a "high cost mortgage" if it meets one of the tests outlined below.[22]

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17. Assuming the property is considered owner-occupied residential, a deed of trust foreclosure will require a few days for the foreclosure trustee to obtain a title report and prepare notices of sale to be sent to the owner and junior lien holders. The trustee will also need to prepare an advertisement of the property. Once these preliminaries are completed, the notices must be mailed at least 60 days prior to the date of the foreclosure sale; VA Code § 55.1-321(A). An advertisement of the sale must also be published once a week for 4 successive weeks, but this can easily fit within the 60-day notice time frame; the sale must be at least 8 days after the first advertisement. See VA Code § 55.1-322(A)(2).

18. HOEPA was enacted in 1994 (Pub.L.103-325, 108 Stat. 2160) as an amendment to TILA, and hence is part of TILA. Hence, any transaction that violates HOEPA is inherently a TILA violation. However, since HOEPA deals only with "high cost mortgages," while TILA generally is not so limited, a transaction may violate other aspects of TILA without violating HOEPA. For that reason, this article treats HOEPA rules and non-HOEPA TILA rules separately.

19. See, e.g., Lipps v. First American Service Corp., 223 Va. 131, 286 S.E.2d 215 (1982) (sale by installment contract was a transfer of equitable title and triggered due-on-sale clause in prior deed of trust). This is the view of the CFPB; see CFBP, Advisory Opinion, Consumer Protection for Home Sales Financed under Contracts for Deed 5-7 (Aug. 2024) (hereafter "CFPB Advisory Opinion"). The concept of equitable title in the contract purchaser is widely accepted; see In re Restivo Auto Body, Inc., 772 F.3d 168, 177 (4th Cir. 2014); In re Blanchard, 819 F.3d 981, 985 (7th Cir. 2016); Redevelopment Agency of City of Stockton v. BNSF Ry. Co., 643 F.3d 668, 678 (9th Cir. 2011).

20. TILA applies only to "creditors;" see 15 U.S.C. 1602(f), 12 C.F.R. §1026.2(a)(14). See the detailed argument for this proposition in CFPB Advisory Opinion, supra, at 11.

21. The CFPB estimated that less than half of one percent of all residential loans were "high-cost" in 2005, the peak year for such loans during the first decade of the 2000s; see Final Rule, High-Cost Mortgage and Homeownership Counseling Amendments to the Truth in Lending Act (Regulation Z) and Homeownership Counseling Amendments to the Real Estate Settlement Procedures Act (Regulation X), 78 Fed. Reg. 6856 (Jan. 31, 2013).

22. CFPB Advisory Opinion, supra note 18, at 8-10.

HOEPA applies only to loans secured by a consumer's principal dwelling;[23] a transaction financing a vacation home or second home is not covered. We will limit our discussion here to real property (and disregard recreational vehicles, mobile homes, and manufactured housing, although they, too, are covered by HOEPA). We will also disregard home equity lines of credit (HELOCs) and reverse mortgages, since our topic is the financing of residential sales.

There are three criteria, any one of which would make the transaction a high-cost mortgage.

1. The Annual Percentage Rate (APR) for the transaction is 6.5% or more above the Average Prime Offer Rate (APOR) on the date the rate is set or locked.[24] The spread between the loan APR and the APOR can be obtained for any date from the following web site: https://ffiec.cfpb.gov/tools/rate-spread.[25]

2. Points and fees exceed 5% of the loan amount.[26]

3. Prepayment fees can exceed 2% of the amount prepaid or can be charged more than 36 months after the loan is made.[27]

**HOEPA's rules for high cost mortgages**. If a seller-financed sale is a "high cost mortgage," HOEPA itself and the corresponding CFPB regulations impose a number of restrictions on the transaction's terms and the creditor's conduct. To summarize the most important of them that are applicable to a seller-financed house sale:

- A written disclosure must be given to the buyer 3 days before closing that discloses the loan terms (amount borrowed, APR, and monthly payment), explains the consequences of default, and if the rate is variable, states the maximum monthly payment.[28]

- Balloon payments are prohibited in most circumstances.[29]

- Prepayment penalties are prohibited.[30]

- Due-on-demand (acceleration) clauses are prohibited except for acceleration for default, fraud, or borrower actions that impair the creditor's security.[31]

- The creditor may not charge a fee to modify or amend a high cost mortgage.[32]

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23. 12 C.F.R. §1026.32(a)(1).

24. 12 C.F.R. §1026.32(a)(1)(i). 6.5% is the applicable spread for a first lien mortgage; for a junior lien, the spread is 8.5%. Id.

25. For example, the calculator on the web site shows that a loan made on the date of this writing, Oct. 12, 2024, with a maturity of 20 years and an APR of 12.5%, would have a spread of 6.66%. If that loan were a secured by a first lien, it would, by a slight margin, be a "high cost mortgage."

26. 12 C.F.R. §1026.32(a)(1)(ii)(A). This assumes that the loan amount is equal to or greater than $26,092, as virtually all house sales will be. $26,092 is the figure applicable to 2024 and is adjusted annually for inflation; see 88 Fed. Reg. 65113 (Sept. 21, 2023). Calculating points and fees can be complex. For guidance, see CFPB, 2013 Home Ownership and Equity Protection Act (HOEPA) Act, Small Entity Compliance Guide 15-18 (2013).

27. 12 C.F.R. §1026.32(a)(1)(iii).

28. 12 C.F.R. §1026.32(c).

29. 12 C.F.R. §1026.32(d)(1)(i).

30. 12 C.F.R. §1026.32(d)(6).

31. 12 C.F.R. §1026.32(d)(8).

32. 12 C.F.R. §1026.34(a)(7).

- Late fees may not exceed 4% and pyramiding of late fees is prohibited.[33]
- Generally, fees may not be charged for payoff statements.[34]
- Points and fees cannot be financed (rolled into the principal amount of the loan).[35]
- Negative amortization is not permitted.[36]
- Increasing interest upon default is not permitted.[37]
- The sale cannot be closed until the creditor has received certification that the borrower has received pre-loan counseling from an agency approved by HUD or a HUD-approved state housing agency.[38]

Finally, the creditor must satisfy the "ability-to-pay" rule; that is, it must make a reasonable and good faith determination that the consumer will have a reasonable ability to repay the loan, using verifiable third-party records.[39] If a creditor violates any of the HOEPA requirements, the borrower can seek actual damages, a refund of twice the finance charges and fees paid, statutory damages of $400 to $4,000, court costs, and attorney's fees.[40]

**The Truth in Lending Act's broader application to seller-financed sales.** The Truth in Lending Act (TILA) potentially governs seller-financed sales more broadly than the HOEPA rules discussed above. This broader aspect of TILA applies to any closed-end credit sale of real estate to a consumer, and unlike HOEPA is not limited to principal residences.[41] If a loan is a high cost mortgage, the entire scope of TILA applies even if the lender makes only one transaction in any given year.[42] However, if the "high cost" feature is absent, only transactions by sellers who made more than five home financing transactions in the previous year or the current year are covered by the full scope of TILA.[43] Typical multi-transaction users of installment sales contracts and purchase-money deeds of trust include developers of recreational subdivisions and "flippers" who buy homes for immediate resale with little or no renovation. Of course, even an amateur property owner may, in some cases, sell and finance more than five houses in a single year, triggering TILA's application.

Assuming that the full TILA is applicable to a seller-financed sale, what are its implications? The most important answer is that the seller must give the buyer, in a timely fashion, the Loan Estimate and Closing Disclosure (together, the "Integrated Mortgage Disclosures") required by TILA and Regulation Z.[44] The Loan Estimate must be given within three days after "loan application" and no

33. 12 C.F.R. §1026.34(a)(8).

34. 12 C.F.R. §1026.34(a)(9).

35. 12 C.F.R. §1026.34(a)(10).

36. 12 C.F.R. §1026.32(d)(2).

37. 12 C.F.R. §1026.32(d)(4).

38. 12 C.F.R. §1026.34(a)(5).

39. 12 C.F.R. §1026.43(c). The details of this rule are covered in CFPB, Ability-to-Repay and Qualified Mortgage Rule, Small Entity Compliance Guide (2013).

40. 15 U.S.C. §1640. Liability can be excused for unintentional errors made in good faith; id.

41. 15 U.S.C. §1602(dd)(5).

42. 12 C.F.R. §1026.2(a)(17)(v).

43. Id.

44. 12 C.F.R. §1026.19(e)(1)(i). The "Integrated Disclosure" assumes that both RESPA and TILA apply to the transaction in question, but the coverage of these two acts is not identical. RESPA applies only to "federally related mortgage loans;" see 12 C.F.R.

later than seven days before closing.[45] Many house sellers financing their own sales may not think of requiring their buyers to complete a loan application, but they will need the information in such an application in order to comply with the HOEPA "ability to pay" rule discussed above.[46]

The information in the Loan Estimate required by TILA includes full details of the sale and the financing aspects of the transaction.[47] For an amateur seller, perhaps the most unfamiliar item is the Annual Percentage Rate (APR), a computation that takes into account both the stated interest rate and the points, fees, and certain costs associated with the transaction. On-line calculators can help, but one must get the mathematics right.[48]

TILA imposes several other substantive limitations on the transactions to which it applies. Those relevant to seller-financed sales, these include the following:

- Mandatory arbitration clauses are prohibited.[49]
- Waivers of causes of action under federal law are not permitted.[50]
- Credit insurance may not be financed as part of the principal of the loan.[51]
- Even if the HOEPA counseling requirement for high-cost loans mentioned above does not apply,[52] first-time home borrowers who obtain loans that could result in negative amortization must receive counseling.[53]

The civil liability mentioned earlier in connection with violation of the HOEPA rules[54] applies to the additional TILA duties of creditors just described as well. However, there is a bit of good news for house sellers amid all of this complexity. Readers may be familiar with TILA's three-day right of rescission. But that rescission right does *not* apply to a purchase-money loan to buy a residence;[55] sellers who finance their own house sales need not be concerned with it.

**Conclusion**

We have seen that seller financing contains traps for both parties. From the buyer's viewpoint, the transaction comes with few of the guardrails that are largely included in an institutional loan. The situation is worse for the buyer if the transaction is an installment contract, mainly because of the

§1024.5(a). For our purposes, that definition applies generally to loans secured by residential real estate, but is limited to loans made by a "lender" (an institution regulated or insured by the federal government), a "creditor" (an entity that makes or invests in residential real estate loans totaling more than $1 million per year), or loans intended to be sold to FNMA, GNMA, or FHLMC. See 12 C.F.R. §1024.2(b). Thus, while seller-financed sale transactions may in some instances be covered by RESPA, many such sales are not. Since the Integrated Disclosure is driven in part by compliance with TILA and in part by RESPA, an interesting question arises as to whether a house seller who is not covered by RESPA could legitimately fill out only the portions of the Integrated Disclosure that are required by TILA and not those required by RESPA. There seems to be no regulatory answer to this question.

45. 12 C.F.R. §1026.19(e)(1)(iii).

46. See text at note 38 supra.

47. 12 C.F.R. §1026.37.

48. 12 C.F.R. §226.14.

49. 12 C.F.R. §1026.36(h)(1).

50. 12 C.F.R. §1026.36(h)(2).

51. 12 C.F.R. §1026.36(h)(3).

52. See text at note 37 supra.

53. 12 C.F.R. §1026.36(k)(1).

54. See text at note 39 supra.

55. 12 C.F.R. §1026.23(f)(1).

risk that a court will enforce the forfeiture clause as written, giving the buyer little or no opportunity to cure a default before losing his or her equity in the property.

From the seller's standpoint, documenting the sale with an installment contract seems shrewd, giving the seller the benefit of any Draconian forfeiture clause. The problem with this reasoning is that in a state like Virginia, which has virtually no statutory or case law on installment contracts, there is no assurance that a forfeiture clause will be enforced. It appears, then, to be little more than an invitation to litigate. It would seem to be wiser, from the viewpoint of both parties, to use a purchase-money deed of trust, which can be foreclosed quickly and with virtually total certitude. Buyers still need and should seek the advice of counsel to help them avoid the common mistakes that are inherent in seller-financed purchases.

The potential for coverage by HOEPA and TILA will come to most house sellers who finance their own sales as a surprise, to put it mildly. That coverage can come into play no matter whether a deed of trust or an installment contract is the operative security instrument. It hinges on either using loan terms that make the transaction a "high cost mortgage" or engaging in more than 5 residential financing transactions per year. It is quite easy to fall into the "high cost mortgage" category unknowingly.

If HOEPA and/or TILA apply, their restrictions on the content of the documents and the seller's conduct are comprehensive. Thus, sellers can easily become subject to civil liability growing out of violations of these federal statutes. On the other hand, buyers can applaud the many protections the rules give them.

The description above of the demands of HOEPA and TILA is merely an outline and omits many subtleties and interpretations. It is intended only to convey a sense of the broad scope of federal control of seller-financed sale transactions, and the risks sellers take if this control is ignored. At least where the seller has counsel is involved, a careful analysis should be done to determine whether TILA and HOEPA apply to a seller-financed house sale. If they do, the extra effort to comply with them is surely worthwhile.

# ETHICS: PROTECT YOUR ELECTRONIC CONTACT LIST FROM PRYING EYES

by Sharon D. Nelson, Esq., John W. Simek and Michael C. Maschke
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## Introduction to an Ethical Problem Most Attorneys Don't Know About

In April of 2022, a headline caught our attention. It referenced a new legal ethics opinion issued by the New York State Bar Association's Committee on Professional Ethics. Opinion 1240 has this digest statement: "If 'contacts' on a lawyer's smartphone include any client whose identity or other information is confidential under Rule 1.6, then the lawyer may not consent to share contacts with a smartphone app unless the lawyer concludes that no human being will view that confidential information, and that the information will not be sold or transferred to additional third parties, without the client's consent."

So . . . what client information do you have in your Contacts – and how many apps have you granted the power to access your Contacts? If you are clueless about whether you have granted this access to various apps, you are part of a very large club.

## What Do You Actually Store in Your Contacts?

All lawyers likely have the client's name, office and cell number, email and physical address and job title. But many keep other information in the Notes field of Outlook, including such things as nicknames, anniversaries, birthdays, spouse's name, names of children, pet names. etc. If you click on "Details" in the ribbon, you have a specific form for entering certain details, but most lawyers, in our experience, simply dump the information into the Notes field when they create a new contact.

Because we do digital forensics, we can tell you that there is often a lot of information in the Notes field, including passwords, social security numbers, building access codes and a lot of other private information which the attorney wants readily at hand.

Many lawyers have no clue that apps can potentially see all that information if you grant them access. A quick search on Google shows that Venmo, Facebook, Zoom, Snap, Slack, Tinder, Signal, Pinterest, Telegram, Chase Bank, Wayfair and even Samsung's smart washer will ask you for access to your Contacts. The list of apps seeking access to your Contacts is undoubtedly huge.

Sometimes, apps will restrict access. In iOS, third-party apps with permission can access any contact field, except for the Notes section, which requires additional approval from Apple. The company added that restriction in 2019, but it declines to say how many or which apps are cleared to access Notes.

Some will access just the basics – name, phone numbers and email address. Others will take anything they can get. Disabling the app's privileges doesn't necessarily result in the app deleting information it already has. An app may – or may not- give you instructions on how to delete previously obtained information.

## Apps Have a History of Misconduct

It has often been said that data is "black gold." So, if companies can get your data, they will. They will use it to advertise themselves, to sell their products, and for countless other purposes. They can also sell your data to others.

Several companies over the years have settled with the FTC over how they collected or used data without user consent.

All the way back in 2013, documents provided by Edward Snowden proved that the National Security Agency was collecting millions of contact lists, often from email and instant messaging accounts, to find hidden connections and relationships between targets.

Perhaps more significantly to lawyers, contacts have been leaked in data breaches. Once those Contacts are out there, there is no way to call them back. They almost certainly will be misused. Wire fraud and business email compromises are frequently the objectives.

**Back to Ethics . . .**

Like New York, most states have a rule that similar to this one:

> Rule 1.6(c) of the New York Rules of Professional Conduct (the "Rules") requires a lawyer to "make reasonable efforts to prevent the inadvertent or unauthorized disclosure or use of, or unauthorized access to" the confidential information of current, former and prospective clients. Rule 1.6(a), in turn, provides that confidential information "consists of information gained during or relating to the representation of a client, whatever its source, that is (a) protected by the attorney client privilege, (b) likely to be embarrassing or detrimental to the client if disclosed, or (c) information that the client has requested be kept confidential."

The opinion points out that the client is more likely to find that disclosure of the fact of a current or prior representation by a lawyer is embarrassing or detrimental where the representation involves or involved criminal law, bankruptcy, debt collection or family law. It strikes us that many high level executives, politicians, celebrities, etc. would consider their contact information highly confidential and would not be happy to have it (however inadvertently) disclosed by their lawyers.

**Final Words**

As we previously noted, our digital forensics work has exposed us to many contact lists of clients, including those of attorneys. Contacts are frequently used, especially in the Notes section, to record in brief very sensitive personal data that attorneys want to be able to reference quickly. But besides being alluring to advertisers and the like, such information, in the hands of cybercriminals, can be used to compromise clients in a host of ways. We applaud the New York opinion which shines a bright light on the sensitivity of Contact data and the duty of lawyers to protect all data which may be confidential.

Our advice? Whenever an app wants you to consent to sharing Contact data, **JUST SAY NO!**

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Real Property Section of the Virginia State Bar
Annual Meeting of the Board of Governors and Area Representatives

Hilton Oceanfront Hotel, Albemarle Hall
Virginia Beach, Virginia
May 31, 2024 – 11:45 am

Welcome and meeting called to order by Robert E. Hawthorne, Jr., Section Vice Chair, at 11:45 am.

1. WELCOME AND ATTENDANCE. Please see the attached list. Please contact the Section Secretary at the time of the meetings, Rick Chess, at the following email address with any corrections, additions, or amendments to the attendance record: rick@chesslawfirm.com.

   Robert E. Hawthorne, Jr., received a gavel for his role as upcoming Section Chair. He then reviewed the ground rules for participating live or via remote access. In person attendees, then those attending on Teams, introduced themselves.

2. MINUTES ADOPTION. The board adopted the minutes, from the meeting on March1, 2024, without amendment.

3. FINANCIAL REPORT. Report presented by Rick Chess. Robert E. Hawthorne, Jr. made note that membership of the Section has not been negatively impacted because of raised Section dues.

4. STANDING COMMITTEES

   a. Membership – Rick Chess – No written report. Chess gave an update on the Area Representative list update, now showing 79 active section members. The committee will continue their

work on this project through year end 2034. Nana Yeboah of the "living library" team gave an update on their progress. The board will consider at the September meeting making the focus of the "Living Library" part of a separate committee of the Section.

b. Fee Simple – Steve Gregory & Hayden Anne Breedlove - Steve noted production issues (staff support), which delayed publication, have been resolved. Steve solicited new members for his committee. There was a suggestion made to include in FEE SIMPLE a write up on each committee of the Section, with contact information on the Co-Chairs of each.

c. Programs – Heather Steele & Jim Windsor – Jim Windsor announce over 80 attorneys are anticipated for the Advanced Real Estate seminar which follows today's board meeting. The Annual Real Estate program, to be held in both Fairfax and Richmond, will include (among other topics) a 90-minute legislative update and a 90-minute case law update. The board authorized the acquisition of sufficient copies of the TITLE EXAMINERS MANUAL ($125/book) to supply this committee gifts for presenters. Jim Windsor abstained from this vote. Dolly was to be approached by the committee chair to determine how much funds remains in the current budget, to determine the number of books (not to exceed 25) to acquire.

5. SUBSTANTIVE COMMITTEES

a. Commercial Real Estate – John Hawthorne – The committee submitted a written report which was distributed in advance of this meeting. Next meeting of the committee is projected to be in August 2024 by Teams. John solicited a co-chair for this committee.

b. Common Interest Community – William Sleeth, III – No activity; maybe a candidate to drop committee.

c. Creditor's Rights and Bankruptcy – Lewis Biggs – No written or oral report.

d. Eminent Domain – Christina Lollar – No written or oral report.

e. Ethics Co-Chairs – Ed Waugaman & Blake Hegeman – No written or oral report. New leadership of this committee will be considered by the next Section Chair.

f. Land Use and Environmental Co-Chairs – Karen Cohen & Lori Schweller – The committee submitted a written report which was distributed in advance of this meeting.

g. Residential Real Estate – Ben Winn & Rachel Hinson – The committee submitted a written report which was distributed in advance of this meeting.

h. Title Insurance – Cynthia Nahorney – The committee submitted a written report which was distributed in advance of this meeting.

6. VBA UPDATE – Kay Creasman (who will be the VBA liaison to the RPS starting later this year) gave an update on VBA activities. Input was requested regarding "quirks" in how clerks vary significantly in how they interpret "uniform fees" (e.g., for recordation of a deed of trust).

7. NEW BUSINESS

a. Janna E. Wolff and Laura M. Murray were unanimously elected an Area Representative.

b. The Technology Committee, which was originally created to focus on the Virginia State Bar website, became dormant when the committee chair, Mattson Coxe, relocated to Florida. There was a discussion considering a merger of the Technology Commitee with the "Living Library" project, as a combined free-standing committee of the Section.

c. There was a discussion, but no decision, on the sunsetting of the following committees (until need arises) – Commercial, Creditor's Rights, Ethics.

d. The Nominating Committee, chaired by Susan Pesner, recommended the following for the positions noted, and they were unanimously elected.

| | |
|---|---|
| 1) Robert E. Hawthorne, Jr. | Chair |
| 2) Rick Chess | Vice Chair |
| 3) Cynthia Nahorney | Secretary – Treasurer |
| 4) Karen Cohen | Area Rep (as was past Chair) |
| 5) Aubrey Cross | Board of Governors |
| 6) Nana Yeboah | Board of Governors |
| 7) Heather Steele | Board of Governors (2nd Term) |

8. Announcements

a. Steinhilber's reception and dinner May 31st at 6:30 PM is only for members of the Section who attended this annual meeting.

b. Wayne Glass, a long-time active Area Representative, passed away May 1st.

c. NEXT MEETING – Fall Meeting – 11:00 am September 20, 2024 – Virginia CLE HQ, Charlottesville, VA.

d. ADJOURNMENT – Meeting was adjourned at noon.

Submitted by Richard B. Chess, Section Secretary

# BOARD OF GOVERNORS
# REAL PROPERTY SECTION
# VIRGINIA STATE BAR
# (2023-2024)

| Full Name | Position | Address of Record | Term Start | Term End |
|---|---|---|---|---|
| Robert Hawthorne, Jr. | Chair | Hawthorne & Hawthorne, P.C.<br>1805 Main Street, PO Box 931<br>Victoria, VA 23974 | 7/1/2024 | 6/30/2025 |
| Richard B. Chess | Vice Chair | Chess Law Firm, PLC<br>3821 Darby Drive<br>Midlothian, VA 23113 | 7/1/2024 | 6/30/2025 |
| Cynthia A. Nahorney | Secretary | Fidelity National Title Insurance Co.<br>4525 Main Street, Ste 810<br>Virginia Beach, VA 23464 | 7/1/2024 | 6/30/2025 |
| Sarah Louppe Petcher | Immediate Past Chair | S&T Law Group<br>6641 Locust St<br>Falls Church, VA 22046 | 7/1/2024 | 6/30/2025 |
| Shane M. Murphy | Ex-Officio | Miles & Stockbridge, P.C.<br>1751 Pinnacle Drive, Ste 1500<br>Tysons, VA 22102 | 1/23/2023 | 6/30/2024 |
| Vanessa S. Carter | Board of Governors | 716 Dissdale Lane<br>Chesapeake, VA 23320 | 7/1/2023 | 6/30/2026 |
| George Hawkins | Board of Governors | Dunlap Bennett & Ludwig, PLLC<br>8300 Boone Boulevard, #550<br>Vienna, VA 22182 | 7/1/2022 | 6/30/2025 |
| Blake Hegeman | Board of Governors | 12101 Robson Street<br>Henrico, VA 23233-1735 | 7/1/2021 | 6/30/2024 |
| Kevin Pogoda | Board of Governors | Old Republic National Title Insurance Co<br>7960 Donegan Drive, Ste 247<br>Manassas, VA 20109 | 7/1/2022 | 6/30/2025 |
| John E. Rinaldi | Board of Governors | Walsh, Colucci, Lubeley & Walsh, P.C.<br>Glen Park I, Suite 300<br>4310 Prince William Parkway<br>Prince William, VA 22192 | 7/1/2022 | 6/30/2025 |
| Heather Steele | Board of Governors | Pesner Altmiller Melnick DeMers & Steele<br>8000 Westpark Drive, Ste 600<br>Tysons, VA 22102 | 7/1/2021 | 6/30/2024 |
| Benjamin C. Winn Jr. | Board of Governors | Benjamin c. Winn Jr., Esquire, PLC<br>42485 Cochran Mill Road<br>Leesburg, VA 20175 | 7/1/2023 | 6/30/2026 |
| Dolly C. Shaffner | Liaison | Virginia State Bar<br>1111 E Main St Ste 700<br>Richmond, VA 23219-0026 | 7/1/2023 | 6/30/2024 |
| Kim Villio | Liaison | 105 Whitewood Drive<br>Charlottesville, VA 22901-1613 | 7/1/2023 | 6/30/2024 |

This list and additional information about the Board of Governors can be found at:
**https://vsb.org/RP/groups/RP/rp-board.aspx**

# REAL PROPERTY SECTION
# VIRGINIA STATE BAR
# AREA REPRESENTATIVES
# (2023-2024)

*[Note: as used herein, a Nathan[1] (*) denotes a past Chair of the Section, and a dagger (†) denotes a past recipient of the Courtland Traver Scholar Award]*

## AREA REPRESENTATIVES

Area Representatives are categorized by six (6) regions: Northern (covering generally Loudoun County in the west to Prince William County in the east); Tidewater (covering generally the coastal jurisdictions from Northumberland County to Chesapeake); Central (covering generally the area east of the Blue Ridge Mountains, south of the Northern region, west of the Tidewater region and north of the Southside region); Southside (covering generally the jurisdictions west of the Tidewater region and south of the Central region which are not a part of the Western region); Valley (covering generally the jurisdictions south of the Northern region, west of the Central region and north of Botetourt County); and Western (covering generally the jurisdictions south of Rockbridge County and west of the Blue Ridge Mountains).

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1. Named after Nathan Hale, who said "I only regret that I have but one asterisk for my country." -Ed.

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I $35.00 enclosed

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